

# **CORPORATION TAX ACT 2009**

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## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### **Part 5: Loan Relationships**

##### **Overview**

1027. This overview deals with Parts 5 and 6.
1028. This and the following Part contain provisions on loan relationships. The extent of the legislation merits two Parts.
1029. A company has a loan relationship when it stands in the position of a creditor or debtor in respect of a money debt which is a transaction for the lending of money. The rules dealing with loan relationships are found in this Part. This Part is based mainly on Chapter 2 of Part 4 of FA 1996, which brings into account for corporation tax purposes all gains and losses arising to a company from its loan relationships.
1030. Other arrangements which are treated as loan relationships such as debt which does not involve the lending of money, finance arrangements that do not involve the payment or receipt of interest, particular share issues, repurchase agreements etc are found in Part 6. The source legislation for this Part is sometimes found outside FA 1996.
1031. Although the rules for computing the credits and debits on loan relationships used for the purposes of a trade are within this Part, the credits are treated as receipts and the debits as expenses in computing the trading profits within Part 3 of the Act. Profits on loan relationships that are not used for the purposes of a trade are charged under this Part. The charge on such profits is separate from the charge on trading profits.
1032. Losses on non-trading loan relationships (where debits exceed credits) are relieved against company profits.
1033. Profits on derivative contracts which are not used for the purposes of a trade are charged as if they were gains on loan relationships, but the rules for computing such profits are to be found in the Part 7 (derivative contracts) of this Act. Losses on such derivatives are also dealt with as if they were losses on a loan relationship.
1034. Provisions on capital gains within the loan relationships provisions have not been rewritten in this Part or Part 6 but are inserted into TCGA by Schedule 1.

#### **Chapter 1: Introduction**

##### **Overview**

1035. This Chapter acts as an introduction to this Part. It sets out the structure of the Part and the way in which credits and debits on a loan relationship are brought into account in the case of both trading and non-trading loan relationships.

***Section 292: Overview of Part***

1036. This section provides an overview of the Part. It is new.
1037. *Subsection (1)* refers only to “profits” on a loan relationship and not “profits and gains” as does the source legislation. This has been followed throughout the Part on the ground that only one term is necessary. “Profits” has been adopted as being the usual taxation term and as making the link to case law on profits for corporation tax purposes clearer for the two Parts.
1038. The term “loan relationship” has been retained for its familiarity although the term is not as appropriate now as it was when the source legislation was enacted in 1996. The provisions now apply to a number of relationships which are not “loans”.

***Section 293: Construction of references to profits or losses from loan relationships***

1039. This section provides that profits and losses from loan relationships include profits and losses from related transactions. It is based on section 84(1) of FA 1996. The inclusion of related transactions avoids the repetition of the source legislation (“gains and losses on loan relationships and related transactions, etc”).

***Section 294: Matters treated as loan relationships***

1040. This section requires references to this Part of the Act to include references to Part 6 and arises from the decision to spread the loan relationships provisions over two Parts of the Act. It is new.

***Section 295: General rule: profits arising from loan relationships chargeable as income***

1041. This section provides the basic rule that all profits on loan relationships are charged as income. It is based on section 80(1) of FA 1996.

***Section 296: Profits and deficits to be calculated using credits and debits given by this Part***

1042. This section is based on section 82(1) of FA 1996.

***Section 297: Trading credits and debits to be brought into account under Part 3***

1043. This section explains how debits and credits are to be treated where a loan relationship is used for the purposes of a trade. It is based on sections 80(2) and 82(2) and (7) of FA 1996.

***Section 298: Meaning of trade and purposes of trade***

1044. This section explains what is meant by a company being a party to a creditor relationship for the purposes of a trade. It is based on section 103(2) and (3) of FA 1996.

***Section 299: Charge to tax on non-trading profits***

1045. This section brings the company into charge to corporation tax on its non-trading profits. It is based on sections 9(1) to (3), 18(1) to (3) and 582(2) of ICTA and section 80(1) and (3) of FA 1996. See *Change 59* in Annex 1 under section 413 in respect of the Schedule D Case VI charge in section 582(2) of ICTA.

***Section 300: Method of bringing non-trading deficits into account***

1046. This section explains how non-trading deficits on loan relationships are brought into account. It is based on section 80(4) of FA 1996.

***Section 301: Calculation of non-trading profits and deficits from loan relationships: non-trading credits and debits***

1047. This section explains the use of the terms “non-trading credits” and “non-trading debits” in respect of loan relationships which are not used for the purposes of a trade and provides the rules for set-offs between the two. It is based on section 82(1) and (3) to (6) of FA 1996.

***Chapter 2 Basic definitions***

**Overview**

1048. This Chapter provides definitions for this Part and Part 6.

***Section 302: “Loan relationship”, “creditor relationship”, “debtor relationship”***

1049. This section defines three important terms used in the two Parts. It is based on sections 81(1) and 103(1) of FA 1996.

***Section 303: “Money debt”***

1050. This section defines “money debt” for the purposes of the definition of a loan relationship in section 302 and elsewhere. It is based on section 81(2) to (4) of FA 1996.

1051. **Section 81(6)** which states that “money” includes money expressed in a currency other than sterling is unnecessary and has not been rewritten. “Money”, in its usual meaning, already includes currencies other than sterling.

***Section 304: “Related transaction”***

1052. This section explains what is meant by a “related transaction”. It is based on section 84(5) and (6) of FA 1996.

***Section 305: Payments, interest, rights and liabilities under a loan relationship***

1053. This section explains what is meant by these terms. It is based on section 81(5) of FA 1996.

***Chapter 3: The credits and debits to be brought into account: general***

**Overview**

1054. This Chapter provides the rules for bringing profits and deficits on loan relationships into account for corporation tax purposes. The provisions in this Chapter all represent rules that apply generally rather than to specific types of securities or specific types of companies. They have therefore been placed early on in the Part.

***Section 306: Overview of Chapter***

1055. This section provides an overview of the Chapter, explains the purpose of the sections within the Part and signposts other relevant Chapters. It is new.

***Section 307: General principles about the bringing into account of credits and debits***

1056. This section provides the rule that credits and debits are those recognised in determining the company’s profit and loss for a period and must fairly represent profits and losses from loan relationships and also gives further rules on allowable expenses. It is based on section 84(1) and (3) and 85A(1) of FA 1996.

1057. *Subsections (3)(c) and (4)* allow certain expenses on loans to be treated as debits for the purposes of this Part.
1058. The inclusion of profits of a capital nature in section 84(1)(a) of FA 1996 is rewritten in section 293(3).

***Section 308: Amounts recognised in determining a company's profit or loss***

1059. This section explains what is meant by amounts recognised in determining a company's profit or loss account for a period. It is based on section 85B(1) and (2) of FA 1996.
1060. This section updates the references in section 85B(1)(a) and (b) of FA 1996 to a company's statement of income and gains, etc in line with current accountancy practice.
1061. Accounting terms appearing more than once are included in section 476 (other definitions). "Profit and loss account" (*subsection (1)(a)*) and "prior period adjustment" (*subsection (2)*) appear here only and take their ordinary accountancy meaning.
1062. *Subsection (1)(b)* rewrites "statement of recognised gains and losses" as "statement of total recognised gains and losses" as being the usual accountancy term.
1063. "Generally accepted accounting principles" appears in the Schedule 4 to this Act.
1064. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals section 85B(6) of FA 1996 with effect from a date to be appointed.

***Section 309: Companies without GAAP-compliant accounts***

1065. This section gives the rule to be applied where accounts have not been prepared in accordance with generally accepted accounting practice. It is based on section 85A(2) to (4) of FA 1996 and paragraph 14(8) of Schedule 13 to FA 2007.
1066. "Correct accounts" in section 85A(2) has been rewritten as "GAAP-compliant accounts" in *subsection (1)* as being a more neutral term.

***Section 310: Power to make regulations about recognised amounts***

1067. This section gives powers to make regulations affecting section 308. It is based on section 85B(3) to (6) of FA 1996 and paragraph 52 of Schedule 4 to FA 2005.
1068. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals section 85(6) of FA 1996 with effect from a day to be appointed. *Subsection (5)*, which rewrites section 85B(6) of FA 1996, will therefore cease to have effect from an appointed day (see Part 8 (loan relationships) of Schedule 2 to this Act).

***Section 311: Amounts not fully recognised for accounting purposes: introduction***

1069. This section sets out the circumstances in which section 312 applies. It is based on section 85C(1) and (2) of FA 1996. This and the following section apply where, as a result of GAAP (generally accepted accounting practice), the full amount arising on transactions is not brought into account. This can arise in two circumstances: first where assets and liabilities are "matched" and GAAP permits the whole or part of the income arising on those assets to be "derecognised" and second where there is a capital contribution and the company is not treated as a party to a debtor relationship or as having a recognised accounting liability.

***Section 312: Determination of credits and debits where amounts not fully recognised***

1070. This section gives the rule to be applied where the circumstances in the preceding section are in point and requires credits and debits arising on transactions which are not

recognised in determining the company's profit or loss to be recognised. It is based on section 85C(3) to (8) of FA 1996.

***Section 313: Basis of accounting: "amortised cost basis", "fair value accounting" and "fair value"***

1071. This section deals with the accounting bases that may apply to loan relationships. It is based on section 85A(1) and section 103(1) of FA 1996.
1072. In general a company may make use of either an amortised cost basis or fair value in accounting for loan relationships (both these terms are defined in the section) but certain provisions specify that an amortised cost basis or fair value basis must be used. These are listed in *subsection (2)*.

***Section 314: Power to make regulations about changes from amortised cost basis***

1073. This section provides the powers for the Treasury to make regulations providing for the continued use of an amortised costs basis. It is based on section 90A(1) and (2) of FA 1996.

***Section 315: Introduction to sections 316 to 319***

1074. This section acts as an introduction to the following four sections which provide the rules to apply where there is a change in accounting policy from one period of account to the next. It is based on paragraph 19A(1) and (2) of Schedule 9 to FA 1996.
1075. Although this provision was enacted specifically to deal with companies changing from UK GAAP to international accounting standards or *vice versa* it will apply equally to other changes where both policies accord with the law and practice.

***Section 316: Change of accounting policy involving change of value***

1076. This section requires debits or credits to be brought into account representing the difference between the value of the asset or liability at the end of the last period of account under the old accounting policy and the beginning of the first period under the new accounting policy. It is based on paragraph 19A(3) and (5) of Schedule 9 to FA 1996.

***Section 317: Carrying value***

1077. This section gives the meaning of terms used in the previous section. It is based on paragraph 19A(4), (4A) and (4B) of Schedule 9 to FA 1996.

***Section 318: Change of accounting policy following cessation of loan relationship***

1078. This section provides for debits and credits representing differences in the value of assets and liabilities following a change of accounting policy to be brought into account where section 331 (company ceasing to be party to a loan relationship) also applies. It is based on paragraph 19A(4C) to (5) of Schedule 9 to FA 1996.
1079. Sub-paragraph (4C) of paragraph 19A provides for the difference between the two values to be brought into account *at the beginning* of the later period. This is not rewritten as it is unnecessary. This brings the section into line with paragraph 50A(3C) of Schedule 26 to FA 2002, the equivalent provision for derivative contracts.

***Section 319: General power to make regulations about changes in accounting policy***

1080. This section gives the Treasury powers to make regulations providing for debits and credits to be brought into account or not to be brought into account under this Part where a change of accounting policy affects the amounts brought into account for

accounting purposes. The section is based on paragraph 19B of Schedule 9 to FA 1996 and paragraph 52 of Schedule 4 to FA 2005.

***Section 320: Credits and debits treated as relating to capital expenditure***

1081. This is the first of several sections which require debits and credits to be brought into, or not brought into, account for the purposes of this Part where normal accounting treatment is not followed. It is based on paragraph 14 of Schedule 9 to FA 1996. This section provides that a credit or debit which has been capitalised but which is in respect of a loan relationship is, in certain circumstances, to be brought into account.
1082. The words “for the purposes of corporation tax” in paragraph 14(2) have been rewritten in *subsection (2)* more narrowly as “for the purposes of this Part”, the wider purpose being unnecessary in this context.
1083. In *subsection (6)* “the interest component of the asset” is the interest element capitalised with the relevant asset.

***Section 321: Credits and debits recognised in equity***

1084. This section provides that credits and debits on loan relationships taken directly to reserves should be brought into account as if they were taken to the profit and loss account. It is based on paragraph 14A of Schedule 9 to FA 1996.

***Section 322: Release of debts: cases where credits not required to be brought into account***

1085. This section provides that credits are not brought into account by a debtor company on the release of the debt when an amortised cost basis is used and certain conditions are met. It is based on paragraph 5(3), (4), (7) and (8) of Schedule 9 to FA 1996.
1086. Conditions 2 and 3 of paragraph 5 of Schedule 9 to FA 1996 apply only where the debtor and creditor companies are connected and are rewritten in sections 358 and 359 in Chapter 6 of this Part (connected companies relationships: impairment losses and releases of debts).
1087. *Subsection (6)* lists the insolvency conditions from paragraph 6A(1) of Schedule 9 to FA 1996 rather than cross-referring as does paragraph 5(7).

***Section 323: Meaning of expressions relating to insolvency etc***

1088. This section gives the meaning of various terms relevant to the preceding section. It is based on paragraphs 5(7) and 6A(3) to (5) of Schedule 9 to FA 1996.
1089. References to Northern Ireland legislation in this section have been updated to take into account amendments made by the [Insolvency \(Northern Ireland\) Order 2005 \(SI 2005/1455 \(NI10\)\)](#).

***Section 324: Restriction on debits resulting from revaluation***

1090. This section precludes debits from being brought into account on revaluation of assets representing creditor relationships for the purposes of this Part (other than impairment losses or debt releases on the revaluation of asset) unless under fair value accounting. It is based on paragraph 6D(1) and (3) to (5) of Schedule 9 to FA 1996.

***Section 325: Restriction on credits resulting from reversal of disallowed debits***

1091. This section provides that the reversal of debits disallowed under the previous section are not brought into account under this Part. It is based on paragraph 6D(2) and (5) of Schedule 9 to FA 1996.

***Section 326: Writing off government investments***

1092. This section provides that no credit need be brought into account where the government releases a liability on a government debt. It is based on paragraph 7 of Schedule 9 to FA 1996.

***Section 327: Disallowance of imported losses etc***

1093. This section ensures that no part of a loss on a loan relationship is brought into account if it arose at a time when the loan relationship was not subject to United Kingdom taxation. It is based on paragraph 10 of FA 1996.

***Section 328: Exchange gains and losses***

1094. This section includes exchange gains and losses within credits and debits on loan relationships. It is based on section 84A(1) to (3A) and (8) to (10) of FA 1996.

1095. This section updates the references in section 84A(3)(b) of FA 1996 in line with current accountancy practice.

1096. *Subsection (3)(b)* rewrites “statement of recognised gains and losses” as “statement of total recognised gains and losses” as being the usual accountancy term.

1097. Section 84A(8) of FA 1996 as it applies to chargeable gains (section 84A(9)(b)) is rewritten as an insertion into TCGA. See Schedule 1 to this Act.

1098. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals section 84A of FA 1996 with effect from a day to be appointed. This section, which rewrites that section, therefore ceases to have effect from an appointed day (see Schedule 2 to this Act).

1099. Section 84A(8) and (9)(b) of FA 1996 allows the Treasury to make regulations for the purposes of TCGA. This provision is rewritten in new section 151E of TCGA.

***Section 329: Pre-loan relationship and abortive expenses***

1100. This section allows abortive expenditure in connection with a loan relationship. It is based on section 84(4) of FA 1996.

***Section 330: Debits in respect of pre-trading expenditure***

1101. This section provides for an election to be made for non-trading debits incurred before the commencement of a trade to be treated as trading debits after that trade has commenced. It is based on section 401(1AB) and (1AC) of ICTA.

***Section 331: Company ceasing to be party to loan relationship***

1102. This section provides for debits and credits to be taken into account in respect of a loan relationship to which a company is no longer a party if those debits and credits have not already been fully taken into account. It is based on section 103(6) to (8) of FA 1996.

***Section 332: Repo, stock lending and other transactions***

1103. This section provides that where a company ceases to be party to a loan relationship in any period (whether as a result of a repo or otherwise) but continues in accordance with GAAP to recognise amounts in its accounts in respect of that relationship the company must bring those amounts into account. It is based on paragraph 15 of Schedule 9 to FA 1996.

***Section 333: Company ceasing to be UK resident***

1104. This section provides that a company ceasing to be resident in the United Kingdom is treated as disposing of assets and liabilities which represent loan relationships at

fair value unless they are held or owed by a permanent establishment in the United Kingdom. It is based on paragraph 10A(1) to (3) of Schedule 9 to FA 1996.

***Section 334: Non-UK resident company ceasing to hold loan relationship for UK permanent establishment***

1105. This section provides for a deemed disposal for fair value where an asset or liability representing a loan relationship of a non-UK resident company ceases to be held or owed by a permanent establishment in the United Kingdom other than as a result of a disposal etc. It is based on paragraph 10A(1), (1A) and (4) of Schedule 9 to FA 1996.

***Chapter 4: Continuity of treatment on transfers within groups or on reorganisations***

**Overview**

1106. This Chapter sets out what happens when a loan relationship is transferred between members of a group and on a reorganisation.

***Section 335: Introduction to Chapter***

1107. This section acts as an introduction by setting out the three cases under which the continuity of treatment provisions in the Chapter apply and explaining how the Chapter is organised. It is based on paragraphs 12(1) and (8) and 12G(1) and (4) of Schedule 9 to FA 1996.

***Section 336: Transfers of loans on group transactions***

1108. This section specifies the transfers within the first case in section 335(1) where the continuity rules of the Chapter apply – transfers between group members. It is based on paragraph 12(1) and (3) of Schedule 9 to FA 1996.

***Section 337: Transfers of loans on insurance business transfers***

1109. This section specifies the transfer within the second case in section 335(1) where the continuity rules of the Chapter apply. It is based on paragraph 12(1), (4) and (5) of Schedule 9 to FA 1996.

1110. In *subsection (6)(b)* “corresponding category” means the category of asset in section 440(4) of ICTA as modified by regulation 11(3) of The [Overseas Life Insurance Companies Regulations 2006 \(SI 2006/3271\)](#).

***Section 338: Meaning of company replacing another as party to loan relationship***

1111. This section explains what is meant by one party replacing the other as a party to a loan relationship for the purposes of section 335. It is based on paragraph 12(6) to (7A) of Schedule 9 to FA 1996.

1112. *Subsections (3) and (4)* deal with the position where a company replaces another company as a creditor and *subsections (5) and (6)* where it replaces the other company as a debtor. The debtor rules will apply where a company has borrowed money but substitutes another group company as the debtor by novating the debt.

***Section 339: Issues of new securities on certain cross-border reorganisations***

1113. This section sets out the third case in section 335(1) where the continuity rules of the Chapter apply. This case is where section 135(3) of TCGA (exchange of securities for those in another company) applies (or would do but for section 116(5) of that Act) and certain conditions are met. It is based on paragraphs 12G(1), (3) and (6) and 12J(2) of Schedule 9 to FA 1996.

***Section 340: Group transfers and transfers of insurance business: transfer at notional carrying value***

1114. Under this section any gain or loss is disregarded where, as a result of a transaction or series of transactions referred to in section 335(1)(a) and (b) 335, one company replaces another as a party to a loan relationship. It is based on paragraph 12(1), (2ZA), (2), (2C) and (9) of Schedule 9 to FA 1996. The section provides that the transaction or series of transactions take place at book value (“carrying value”).
1115. The rules in this section regarding the bringing into account of debits and credits apply only where the company being replaced as party to the loan relationship accounts for the relationship under the amortised cost basis. Section 341 provides rules for where the company being replaced as a party to the loan relationship uses fair value accounting.

***Section 341: Transferor using fair value accounting***

1116. This section applies where the company making the transfer under section 340 uses fair value accounting as respects the loan relationship or the debits and credits to be brought into account rather than the amortised cost basis. It is based on 12(2A) to (2C) of Schedule 9 to FA 1996.
1117. The company which is being replaced as a party to the loan relationship brings in the asset or liability at fair value. The company becoming a party to the loan relationship is treated as acquiring the asset or liability for the same value it has in the accounts of the company being replaced.

***Section 342: Issues of new securities on reorganisations: disposal at notional carrying value***

1118. This section provides that where section 339 applies (the third case in section 335(1)), debits and credits are to be brought into account as if there were a disposal of the loan relationship at its carrying value in the accounts. It is based on section 12G(1) and (3) to (5) of Schedule 9 to FA 1996.

***Section 343: Receiving company using fair value accounting***

1119. This section provides the rule to apply in place of the rule in section 342 where fair value accounting is used by the company to which the issue of shares or debentures is made. It is based on paragraph 12G(5) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

***Section 344: Introduction***

1120. This section introduces the two following sections and provides that they apply where a company leaves a group within six years and an asset or liability was transferred to that company in circumstances where section 340 applies. It is based on paragraph 12A(1), (5), (5A) and (8) of Schedule 9 to FA 1996.

***Section 345: Transferee leaving group otherwise than because of exempt distribution***

1121. This section provides the first of the degrouping rules: where a company ceases to be a member of a group otherwise than as a result of an exempt distribution under section 213(2) of ICTA. It is based on paragraph 12A(1) to (5) and (9) of Schedule 9 to FA 1996. Because section 213 of ICTA is designed to facilitate demergers, there is no degrouping charge where that section applies to exempt a distribution of the company’s shares. This section deems there to have been a disposal and reacquisition at market value just before the company leaves the group and any resulting credit must be brought into account.

1122. *Subsection (4)* is designed to ensure parity of treatment between a loan relationship and a derivative contract that is being used to hedge it. The effect is to allow a debit on the loan relationship on deemed disposal if a credit is brought into account on the derivative contract.

***Section 346: Transferee leaving group because of exempt distribution***

1123. This section applies to bring in a charge, in certain circumstances, where one group member replaces another group member as a party to a loan relationship and ceases to be a group member as a result of an exempt distribution under section 213(2) of ICTA. It is based on paragraph 12A(3) to (9) of Schedule 9 to FA 1996.
1124. Where a company exploits a demerger for avoidance purposes by transferring within a five year period funds or assets to its members, a chargeable payment arises under section 214(2) of ICTA. Where such chargeable payments are made this section treats the company as disposing of, and immediately reacquiring, the loan relationship at fair value when the chargeable payment is made.

***Section 347: Disapplication of Chapter where transferor party to avoidance***

1125. This section applies where an asset or liability is likely to be transferred by the transferee company and the continuity provisions applying for sections 336 and 337 would otherwise apply. It is based on paragraph 12(2D) to (2F) of Schedule 9 to FA 1996. Where the transfer is under arrangements to which the transferor company is a party and the intention is to avoid tax, the continuity provisions of this Chapter which would otherwise apply do not.

***Chapter 5: Connected companies relationships: introduction and general***

**Overview**

1126. Connected companies loan relationships are subject to special rules under this Part. The Chapter explains what is meant by such a relationship, the accounting rules to apply to that relationship and what happens when a company begins or ceases to be a connected company.

***Section 348: Introduction: meaning of “connected companies relationship”***

1127. This section provides the meaning of “connected companies relationship”. It is based on section 87(1), (3) and (5) of FA 1996.
1128. “Person” in section 87(1), (3) and (5) of FA 1996 has been rewritten as “company”. See *Change 56* in Annex 1.
1129. **Section 87(5)** deals with intermediaries between two connected companies through which a loan is “dog-legged”. Such intermediaries may be individuals. This has been rewritten in this section by treating debtor and creditor relationships separately. Paragraph (b) of *subsections (2) and (4)* is necessary because loans between individuals do not fall into the definition of a loan relationship in section 81(1) of FA 1996.
1130. *Subsection (6)* brings out more clearly than in the source legislation (section 87(3) of FA 1996) that where there is a connection at any time in an accounting period there is a connected companies relationship for the whole of the period.

***Section 349: Application of amortised cost basis to connected companies relationships***

1131. This section provides that where a loan relationship is a “connected companies relationship” (the parties to a loan relationship are connected) both parties must use the same basis of accounting – the amortised cost basis rather than the fair value basis. It is based on section 87(1) and (2) of FA 1996. The same basis of accounting ensures

both that the value of the loan cannot be artificially depressed and that debits in the one company are matched by credits in the other.

1132. In *subsection (2)* “for the period” has been added for clarification. The words do not appear in section 87(2) which this subsection rewrites.
1133. *Subsection (3)* makes the requirement for amortised cost basis subject to section 454 (reset bonds) which requires fair value accounting to apply. See *Change 57* in Annex 1.

### ***Section 350: Companies beginning to be connected***

1134. This section provides the rule to be applied when companies begin to be connected under section 348 and this involves a change in accounting basis from fair value accounting to the amortised cost basis. It is based on section 87(2A) and (2B) of FA 1996.

### ***Section 351: Companies ceasing to be connected***

1135. This section provides the rule to be applied when companies cease to be connected under section 348 and this involves a change in accounting basis from the amortised cost basis to fair value accounting. It is based on section 87(2A) and (2C) of FA 1996.

### ***Section 352: Disregard of related transactions***

1136. This section provides that credits and debits in respect of related transactions are only brought into account where they do not create greater deductions or smaller credits than would have been the case if the transactions had not taken place. The section is based on paragraph 6(1), (2) and (6) to (8) of Schedule 9 to FA 1996.

## ***Chapter 6: Connected companies relationships: impairment losses and releases of debts***

### **Overview**

1137. This Chapter provides rules for impairment losses and release of debt where there is a connection between the debtor and creditor companies.
1138. Paragraph 5ZA of Schedule 9 to FA 1996 requires paragraphs 6, 6A and 6C of that Schedule to apply in relation to a debit in respect of the release of a liability as they apply in relation to an impairment loss. In rewriting these paragraphs references to a debt on the release of a liability (referred to here as a “release debit”) have been inserted into the relevant sections.

### ***Section 353: Introduction to Chapter***

1139. This section explains the subject and layout of the Chapter and provides some definitions. It is based on section 87(3) of, and paragraphs 4A(8), 5ZA and 6C(1) of Schedule 9 to, FA 1996.

### ***Section 354: Exclusion of debts for impaired or released connected companies debts***

1140. This section provides the basic rule that neither impairment losses nor debts arising as a result of the release of liability under a creditor relationship (“release debts”) are brought into account if the debtor and creditor company are connected. It is based on paragraph 6(1) to (3) and (8) of Schedule 9 to FA 1996.

### ***Section 355: Cessation of connection***

1141. This section provides that debits for impairment losses or release debts which are not brought into account under the preceding section are not to be brought into account in

subsequent accounting periods after connection ceases. It is based on paragraph 6C(1) and (3) of Schedule 9 to FA 1996.

1142. Paragraph 6C(3) of Schedule 9 refers to a “debit .... in respect of an amount” although there is now no preceding reference in the paragraph to an amount. This reference was not repealed following an amendment by FA 2002. Sub-paragraph (1) previously read:

- (1) Where, in the case of a creditor relationship of a company,-
  - (a) a departure that would otherwise have been allowed under paragraph 5(1) above in respect of an amount is or was, by virtue of paragraph 6 above, not allowed in the case of an accounting period; and
  - (b) there is a subsequent accounting period for which there is, within the meaning of section 87 of this Act, no connection between the company and any person standing in the position of a debtor as respects the debt,sub-paragraphs (2) and (3) below shall apply.

1143. The paragraph has been rewritten to reflect the fact that “the amount” refers to the impairment loss (or release debit by virtue of paragraph 5ZA of Schedule 9).

***Section 356: Exception to section 354: swapping debt for equity***

1144. This section provides the first of two exceptions to the basic rule in section 354. It is based on paragraph 6(4) and (5) of Schedule 9 to FA 1996. The exception in this section applies when the liability is released in consideration for shares in the debtor company which give rise to the connection.

***Section 357: Exception to section 354: insolvent creditors***

1145. This section provides the second exception to the basic rule in section 354. It is based on paragraph 6A(1) and (2) of Schedule 9 to FA 1996. The exception in this section applies where the creditor is in insolvent liquidation, etc and the impairment loss or release debit accrues during the winding up, etc.

***Section 358: Exclusion of credits on release of connected companies debts: general***

1146. This section precludes a debtor company from bringing a credit into account under this Part on the release of a debt where the debtor and creditor companies are connected. It is based on paragraph 5(3) and (5) of Schedule 9 to FA 1996. This section excludes the credits on the release since the debits have been disallowed (see section 354).

1147. *Subsection (1)(b)* brings out the fact that the section applies in respect of the accounting period in which the release occurs.

***Section 359: Exclusion of credits on release of connected companies debts during creditor's insolvency***

1148. This section precludes a debtor company from bringing a credit into account on the release of a debt where the creditor company meets the insolvency, etc conditions in section 357 if the insolvency, etc breaks the connected company relationship. It is based on paragraph 5(3) and (6) of Schedule 9 to FA 1996.

1149. *Subsection (1)(d)* and *(e)* reflect the rule in section 12(7) and (7ZA) of ICTA that an accounting period ends with insolvency or administration.

***Section 360: Exclusion of credits on reversal of impairments of connected companies debts***

1150. This section provides that the credit on a reversed impairment loss is not brought into account under this Part where that loss is not brought into account under section 354. It is based on paragraph 6(3A) and (8) of Schedule 9 to FA 1996.

***Section 361: Acquisition of creditor rights by connected company at undervalue***

1151. This section applies where a company acquires a debt from a third party as a result of which it becomes connected to the debtor. The section is based on paragraph 4A of Schedule 9 to FA 1996. If the pre-acquisition value of the debt exceeds the consideration, the difference is treated as a release by the acquiring company and hence a charge on the debtor company.

1152. Under paragraph 4A(2)(d) the provisions of that paragraph do not apply where the new creditor acquires the debt from a connected person. "Person" has been rewritten in *subsection (1)(d)* to apply to a company only. See *Change 56* in Annex 1.

***Section 362: Parties becoming connected where creditor's rights subject to impairment adjustment***

1153. Under this section where a debtor company and a creditor company become connected, any reduction in the value of the debt as a result of an impairment loss which was not yet reflected in the book value of the debt at the time of acquisition is treated as a release by the creditor. It is based on paragraph 4A(1), (4), (5), (7) and (10) of Schedule 9 to FA 1996.

***Section 363: Companies connected for sections 361 and 362***

1154. This section explains what is meant by connected companies for the purposes of the two preceding sections. It is based on paragraph 4A(8) and (9) of Schedule 9 to FA 1996.

1155. This definition differs from the definition for connectedness in section 466 by its application to periods of account rather than accounting periods.

***Chapter 7: Group relief claims involving impaired or released consortium debts***

**Overview**

1156. This Chapter provides rules to prevent both a claim to group relief surrendered by a consortium company and debits for impairment losses on loans made to the consortium company. The purpose of these rather complex provisions is to prevent a claim to "double relief", ie in respect of both an impairment loss for the consortium member and a group relief claim surrendered by the consortium company. This situation would not arise in the case of companies within a group as a result of the rule in section 354 which disallows impairment losses if the debtor and creditor companies are connected.

1157. Paragraph 5ZA of Schedule 9 to FA 1996 applies paragraph 5A, on which this Chapter is based, in relation to a debit in respect of the release of a liability as it applies in relation to an impairment loss. In rewriting these paragraphs in this Chapter references to a debit on the release of a liability (referred to here as a "release debit") have been inserted into the relevant sections.

***Section 364: Introduction to Chapter***

1158. This section sets out the general circumstances when the provisions of the Chapter will apply, what the Chapter does and, in *subsection (2)*, provides an important definition. It is based on paragraphs 5ZA and 5A(1) to (4) and (16) of Schedule 9 to FA 1996.

***Section 365: Reduction of impairment loss debits where group relief claimed***

1159. This section provides the basic rule: where group relief is surrendered to a consortium member (or a member's group company) by the consortium company and there is an excess of impairment losses over credits arising on loans to the consortium company, those impairment losses are reduced by the group relief claimed. It is based on paragraphs 5ZA and 5A(5) to (7) and (19) of Schedule 9 to FA 1996.

***Section 366: Effect where credit for release brought into account on amortised cost basis***

1160. This section provides that where a consortium company brings in a credit on an amortised cost basis on the release of a liability by a consortium member and that member debits an equal amount, the debit is not taken into account under this Chapter. It is based in paragraph 5A(15) of Schedule 9 to FA 1996.

***Section 367: Reduction of credits exceeding impairment losses***

1161. This section provides that where credits on loan relationships between the consortium member (or group company) and the consortium company exceed debits on those loans, the credits are reduced by debits previously reduced under section 365. It is based on paragraph 5A(8) to (10) of Schedule 9 to FA 1996. The reduction compensates for the restrictions in an earlier period which would not have arisen had there not, in that period, been an excess of debits over credits.

1162. Paragraph 5A(8)(a) of Schedule 9 refers to related debt recovery credits brought into account "under paragraph 5 above". This is an incorrect reference and was overlooked in the consequential amendments to FA 2004 which removed paragraph 5(1) to (2A) of Schedule 9. This has been rewritten as if referring to the amounts brought into account in computing the "relevant net debits" (see paragraph 5A(5)(b)), which is the obvious meaning.

***Section 368: Reduction of claims where there are earlier net consortium debits***

1163. This section provides that claims for group relief surrendered by the consortium company to a consortium member (or group company) are reduced by the excess of debits over credits on loans to the consortium company in preceding years. It is based on paragraph 5A(11) to (13) of Schedule 9 to FA 1996.

***Section 369: Carry forward of claims where there are no net consortium debits***

1164. This section applies where there is a claim for group relief by a consortium company (or group member) but no net debit in respect of debts with the consortium company. It is based on paragraph 5A(14) of Schedule 9 to FA 1996. In these circumstances the group relief claim is carried forward and treated as increasing a group relief claim for the subsequent accounting period for the purposes of section 365.

***Section 370: Group accounting periods***

1165. This section gives the meaning of "group accounting period" for the purposes of this Chapter. It is based on paragraph 5A(17) and (18) of Schedule 9 to FA 1996.

***Section 371: Interpretation***

1166. This section defines various terms used in this Chapter. It is based on paragraph 5A(2) to (5) and (19) to (21).

## ***Chapter 8: Connected parties relationships: late interest***

### **Overview**

1167. This Chapter gives the rules for bringing into account debits for interest which is either not paid or paid late where the two parties to the loan are connected in some way.

### ***Section 372: Introduction to Chapter***

1168. This section explains the purpose of the Chapter and provides an overview. It is based on paragraph 2 of Schedule 9 to FA 1996.

### ***Section 373: Late interest treated as not accruing until paid in some cases***

1169. This section sets out the basic rule: where interest is not paid within 12 months after the end of the accounting period and corresponding credits are not brought into account the interest is allowed on a paid rather than an accruals basis where one of the circumstances set out in the following sections applies. It is based on paragraph (1), (2) and (6) of Schedule 9 to FA 1996.

### ***Section 374: Connection between debtor and person standing in position of creditor***

1170. This section gives the first circumstance when section 373 applies and this is where the debtor and creditor companies are connected under section 466. It is based on paragraph 2(1A) of Schedule 9 to FA 1996.

### ***Section 375: Loans to close companies by participators etc***

1171. This section gives the second circumstance when section 373 applies: where the company making the loan is a close company (other than a CIS-based close company or CIS limited partnership) and the creditor is a participator or similar. (CIS is an abbreviation of “collective investment scheme”.) It is based on paragraph 2(1B) and (1E) to (1G) of Schedule 9 to FA 1996.

### ***Section 376: Interpretation of section 375***

1172. This section gives the meaning of various terms used in section 375. It is based on paragraph 2(5) to (6) of Schedule 9 to FA 1996.

### ***Section 377: Party to loan relationship having major interest in other party***

1173. This section gives the third condition when section 373 applies: where either the debtor or creditor has a major interest (defined in section 473) in the other. It is based on paragraph 2(1C) of Schedule 9 to FA 1996.

### ***Section 378: Loans by trustees of occupational pension schemes***

1174. This section gives the fourth and final condition when section 373 applies: where the loan is made by a trustee of an occupational pension scheme and there is a specified relationship between the debtor company and the employees benefiting from the scheme or their employing company. It is based on paragraph 2(1D) of Schedule 9 to FA 1996.

### ***Section 379: Persons indirectly standing in the position of creditor***

1175. This section provides that the preceding sections on late interest which refer to the creditor company include companies which stand indirectly in that position as a result of a series of loan relationships or money debts. It is based on paragraph 2(3) and (4) of Schedule 9 to FA 1996.

## ***Chapter 9: Partnerships involving companies***

### **Overview**

1176. This Chapter provides special rules for determining debits and credits on loan relationships where a money debt is owed by or to a partnership in which one or more of the members is a company.

### ***Section 380: Partnerships involving companies***

1177. This section gives the basic rule for computing the debits and credits where a money debt is owed by or to a partnership in which one or more of the members is a company. It is based on paragraph 19(1) and (2) of Schedule 9 to FA 1996.

1178. “Profession” in paragraph 19(1)(a) has not been rewritten on the grounds that a company cannot carry on a profession for corporation tax purposes either as a partner or otherwise.

### ***Section 381: Determinations of credits and debits by company partners: general***

1179. This section expands on the basic rule given in subsection (3) of the previous section. It is based on paragraph 19(3) to (6) of Schedule 9 to FA 1996. Each company partner is treated as owing or being owed the debt and the credits and debits in relation to those debts are treated as those of the company partner in its profit-sharing ratio.

1180. “Gross” in paragraph 19(5) and (6) of Schedule 9 means that the total credits and debits are calculated notwithstanding that the debt is treated as owed to or by each company partner and this is brought out in *subsection (5)*.

### ***Section 382: Company partners using fair value accounting***

1181. This section provides that company partners using fair value accounting must bring debits and credits into account on the same basis. It is based on paragraph 19(11) of Schedule 9 to FA 1996. Without this provision it might be assumed that the deeming required by this Chapter did not require a company to adopt its normal accounting method.

### ***Section 383: Lending between partners and the partnership***

1182. This section provides the rules for determining whether a company partner controls a partnership in circumstances where a money debt exists between the partnership and a company partner. It is based on paragraph 19(7) to (9) and (14) of Schedule 9 to FA 1996. If there is such a money debt the rule in section 349 applies under which debits and credits on a loan relationship are determined under the amortised cost basis.

### ***Section 384: Treatment of exchange gains and losses***

1183. This section disapplies, in certain circumstances, the rule on exchange gains and losses in section 328 which disallows a credit or debit on an exchange gain or loss which is taken directly to a company’s reserves. It is based on paragraph 19(12) of Schedule 9 to FA 1996. Only where the exchange gain or loss by-passes the partnership’s profit and loss account will that section apply.

1184. The words “subsection (3) of section 84A of this Act does not apply ... except to the extent that ..... exchange gains and losses are recognised” in paragraph 19(12) of Schedule 9 to FA 1996 are rewritten to clarify the meaning that the section rewriting section 84A(3) applies *so far* as the exchange gains and losses ‘are recognised rather than the possible meaning that the section applies only *if* they are recognised.

1185. *Subsection (2)* updates the references in paragraph 19(12) of Schedule 9 to FA 1996 to a company’s statement of income and gains, etc in line with current accountancy practice.

1186. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals paragraph 19(12) of Schedule 9 to FA 1996 with effect from a day to be appointed. This section, which rewrites that subparagraph, will therefore cease to have effect from an appointed day (see Part 8 (loan relationships) of Schedule 2 to this Act).

***Section 385: Company partners' shares where firm owns deeply discounted securities***

1187. This section treats deeply discounted securities held by a partnership as if they were held by each company partner in its profit-sharing ratio. It is based on paragraph 19(13) of Schedule 9 to FA 1996.
1188. *Subsection (3)(b)* adopts the language (“in accordance with the firm’s profit-sharing arrangements”) of section 1262 in Part 17 (partnerships) which rewrites section 114(2) of ICTA.

***Chapter 10: Insurance companies***

**Overview**

1189. This Chapter rewrites the provisions on insurance companies from Schedule 11 to FA 1996. These mainly deal with the treatment of deficits.

***Section 386: Overview of Chapter***

1190. This section sets out what is in the Chapter and gives signposts to other provisions specific to insurance companies. It is new.

***Section 387: Treatment of deficit on basic life assurance and general annuity business: introduction***

1191. This is the first of five sections providing special rules for the treatment of deficits on loan relationships of insurance companies which arise on basic life assurance and general annuity business. It is based on paragraph 4(1) of Schedule 11 to FA 1996.

***Section 388: Basic rule: deficit set off against income and gains of deficit period***

1192. This section gives the basic rule on set-off. It is based on paragraph 4(2) of Schedule 11 to FA 1996.
1193. *Subsection (1)* requires the deficit to be offset first against any income and gains relating to basic life assurance and general annuity business of the deficit period. This avoids the necessity of a claim. See *Change 58* in Annex 1.
1194. Paragraph 4(2)(a) of Schedule 11 requires the deficit to be set off to be against any income or gains of the deficit period referable to basic life assurance and general annuity business and arising or accruing otherwise than in respect of loan relationships. The words “arising or accruing otherwise than in respect of loan relationships” have not been rewritten. If a company has such income and gains they must be other than in respect of loan relationships since, by definition, the company has a loan relationship deficit and no non-trading income and gains on its loan relationships.

***Section 389: Claim to carry back deficit***

1195. This section provides for a claim to be made to carry back the excess if a deficit exceeds the income and gains of the deficit period. It is based on paragraph 4(3), (5) and (15) of Schedule 11 to FA 1996. The deficit must be set off against the company’s “available profits”, defined in the following section.
1196. *Subsection (5)* replaces “the Board” in paragraph 4(15) with “an officer of Revenue and Customs”. See *Change 1* in Annex 1.

***Section 390: Meaning of “available profits”***

1197. This section explains what is meant by “available profits” in the preceding section. It is based on paragraph 4(7) to (11) of Schedule 11 to FA 1996.

***Section 391: Carry forward of surplus deficit to next accounting period***

1198. This section provides that the deficit should be carried forward to the next accounting period so far as it is neither set off against the deficit period nor carried back to a period before the deficit period. It is based on paragraph 4(4) of Schedule 11 to FA 1996.

***Section 392: Exclusion of loan relationships of members of Lloyd’s***

1199. This section prevents this Part from applying to loan relationships of corporate members of Lloyds which are assets or liabilities of a premium trust fund. It is based on paragraph 7 of Schedule 11 to FA 1996.

***Section 393: General rules for some debtor relationships***

1200. This section provides rules for determining the credits and debits of a debtor loan relationship of an insurance company which is referable to any category of an insurance company’s long-term insurance fund. It is based on paragraph 3A of Schedule 11 to FA 1996.

***Section 394: Special rules for some debtor relationships***

1201. This section provides special rules for referring credits and debits in respect of those debtor relationships which are liabilities of a long-term insurance fund to particular categories of the company’s long-term business. It is based on paragraph 3A of Schedule 11 to FA 1996.

1202. *Subsections (4), (5) and (6)* deal with deposit back arrangements. Deposit back arrangements arise where reinsurers of pension annuities deposit back all or a substantial proportion of the premium paid with the original insurer. The original insurer may then pay interest to the reinsurer on that deposit back. “Deposit back arrangements” are defined in section 431(2) of ICTA.

***Chapter 11: Other special kinds of company***

**Overview**

1203. This Chapter provides rules for determining the profits and losses on the loan relationships of particular types of companies: investment trusts, venture capital trusts and credit unions.

***Section 395: Investment trusts: profits or losses of a capital nature***

1204. This section excludes profits and losses of a capital nature on loan relationships from being taken into account by an investment trust. It is based on paragraph 1A of Schedule 10 to FA 1996 and the [Investment Trusts and Venture Capital Trusts \(Definition of Capital Profits, Gains or Losses\) Order 2006 \(SI 2006/1182\)](#). Before FA 1996 investment trusts were treated as exempt from profits arising on the disposal of investments and that position was preserved by the loan relationships regime.

1205. *Subsections (2) and (3)* rewrite article 3 of [SI 2006/1182](#) rather than referring to the appropriate SI as does paragraph 1A(3).

1206. *Subsection (5)* allows orders to be made for “such incidental, supplemental, consequential and transitional provision and savings”. This is the standard formulation in this Act for the additional amendments that can be introduced under an order and regulation-making power. It is not considered a change in the law.

***Section 396: Venture capital trusts: profits or losses of a capital nature***

1207. This section excludes profits and losses of a capital nature on loan relationships from being taken into account by a venture capital trust. It is based on paragraphs 1B and 9(1) of Schedule 10 to FA 1996 and the [Investment Trusts and Venture Capital Trusts \(Definition of Capital Profits, Gains or Losses\) Order 2006 \(SI 2006/1182\)](#). Before FA 1996 venture capital trusts were treated as exempt from tax on profits arising from the disposal of investments and that position was preserved in the loan relationships regime.
1208. *Subsections (2) and (3)* rewrite article 3 of [SI 2006/1182](#) rather than referring to the SI as does paragraph 1B(3).
1209. *Subsection (5)* allows orders to be made for “such incidental, supplemental, consequential and transitional provision and savings”. This is the standard formulation in this Act for the additional amendments that can be introduced under an order and regulation-making power. It is not considered a change in the law.

***Section 397: Credit unions***

1210. This section provides that credits and debits on loan relationships of credit unions with union members are not brought into account under this Part. It is based on section 487(1), (2) and (3A) of ICTA.

***Chapter 12: Special rules for particular kinds of securities***

**Overview**

1211. This Chapter brings together a number of loan relationship rules from within and outside Chapter 2 of Part 4 of FA 1996 on particular types of securities.
1212. Section 96 of FA 1996, which one might expect to be rewritten here, is not. That section prevents any rise in capital value of certain gilts from being brought into charge as credits on a loan relationship. The two gilts identified in the section are expressly protected from a capital gains charge and it was considered improper that a charge should arise on changes in capital value under the loan relationships legislation. Therefore the interest component only in any credit is taxed.
1213. 3½% Funding Stock 1999-2004 was redeemed in June 2003. Section 96 of FA 1996 is rewritten in Schedule 2 to this Act.

***Section 398: Overview of Chapter***

1214. This section explains how the Chapter is organised. It is new.

***Section 399: Index-linked gilt-edged securities: basic rules***

1215. This and the following section provide special rules for dealing with index-linked securities. It is based on section 94(1), (2) and (7) of FA 1996. The section contains the main rule that fair value accounting must be used and requires adjustments under the following section. It also defines terms used in this and the following section.

***Section 400: Index-linked gilt-edged securities: adjustments for changes in index***

1216. This section applies to remove a profit or loss arising on an index-linked gilt-edged security by adjusting the value of the security in the accounts by the change in the retail prices index. It is based on section 94(2) to (6) of FA 1996. The section also provides for Treasury powers to amend the adjustments required under this section.

***Section 401: Gilt strips***

1217. This section gives the rules that apply when a gilt-edged security is converted into strips and when strips are consolidated into a single security; in each case there is a deemed redemption and acquisition. It is based on section 95(1) to (3) of FA 1996.
1218. Section 95(1) of FA 1996, which *subsection (1)* rewrites, refer to “a gilt-edged security or a strip of a gilt-edged security”. Section 103(1) of FA 1996 (rewritten in section 476(1)) adopts the definition of “gilt-edged security” in Schedule 9 to TCGA. Paragraph 1A of that Schedule brings strips within the definition of a gilt and subsection (1)(b) of this section reflects this by referring to any *other* gilt-edged security.

***Section 402: Market value of securities***

1219. This section explains what is meant by the market value of a security in section 401 and gives the Treasury power to amend that meaning. It is based on section 95(4) to (6) of FA 1996.
1220. *Subsection (3)* allows orders to be made for “such incidental, supplemental, consequential and transitional provision and savings”. This is a standard formulation in this Act for the additional amendments that can be introduced under an order and regulation-making power. It is not considered a change in the law.

***Section 403: Meaning of “strip”***

1221. This section gives the meaning of “strip” for this Chapter, rewriting in full the definition from FA 1942 instead of relying on a cross-reference to that section as does section 95(7) of FA 1996. It is based on section 47 of FA 1942 and section 95(7) of FA 1996.

***Section 404: Restriction on deductions etc relating to FOTRA securities***

1222. This section prevents debits arising on FOTRA securities where the profits are exempt under section 1279. It is based on section 154(6) and (8) of FA 1996 and section 161(1), (4) and (7) of FA 1998.

***Section 405: Certain non-UK residents with interest on 3½% War Loan 1952 Or After***

1223. This section restricts a debit for borrowing costs where a non-UK resident company holds 3½% War Loan for use in a business of banking, insurance or dealing in securities. It is based on section 475 of ICTA. Interest on 3½% War Loan is paid without deduction of tax and is exempt in the hands of a non-UK resident company. Because a company may borrow to acquire these securities an allowable debit may arise on the cost of the borrowing but without giving rise to a taxable credit. Consequently the appropriate proportion of the costs of borrowing is disallowed as a loan relationships debit.
1224. Step 2 in *subsection (3)* makes reference only to “interest which is not brought into account ... under this Part” (although section 475(2) and (4) of ICTA might be read as comprising other interest for corporation tax purposes) since interest can only be brought into account under loan relationships rules as a result of section 337A(2)(a) of ICTA.
1225. *Subsections (1), (3) and (4)* rewrite “3½% War Loan 1952 or after” as “3½% War Loan 1952 Or After” to prevent the reader attaching the words “or after” to any following words, thereby adopting the solution used in section 154(8)(b) of FA 1996.

***Section 406: Introduction***

1226. This section introduces the following six sections which all deal with deeply discounted securities. It is based on paragraphs 17(3) and (4) and 18(2B) and (3) of Schedule 9 to FA 1996.

***Section 407: Postponement until redemption of debits for connected companies' deeply discounted securities***

1227. This section provides that debits on a deeply discounted security are, in certain circumstances, only brought into account under this Part on redemption where the debtor and creditor are connected. It is based on paragraph 17(1) to (3) and (5) of Schedule 9 to FA 1996.

***Section 408: Companies connected for section 407***

1228. This section explains what is meant by two companies being connected for the previous section. It is based on paragraph 17(5) and (9) of Schedule 9 to FA 1996.

***Section 409: Postponement until redemption of debits for close companies' deeply discounted securities***

1229. This section provides that debits on a deeply discounted security can only be brought into account under this Part on redemption if the creditor is a participator, etc in the debtor company. It is based on paragraph 18(1) to (2B) of Schedule 9 to FA 1996.

***Section 410: Exceptions to section 409***

1230. This section provides exceptions to the preceding section, where either credits equalling debits are brought into account under this Part or where the debtor company is a CIS-based close company or a CIS limited partnership. It is based on paragraph 18(1ZA) to (1C) and (4) of Schedule 9 to FA 1996.

1231. "The debtor company" in paragraph 18(1C)(c) of Schedule 9 has been rewritten for consistency in *subsection (4)* as "the issuing company", the term used elsewhere in that paragraph.

***Section 411: Interpretation of section 409***

1232. This section provides definitions and deals with other matters necessary to interpret section 409. It is based on paragraph 18(3B) to (5) of Schedule 9 to FA 1996.

***Section 412: Persons indirectly standing in the position of creditor***

1233. This section enables sections 407 and 409 to apply where there is a series of loan relationships or money debts between the company issuing the deeply discounted security and the person in the creditor relationship. It is based on paragraphs 17(8) and (8A) and 18(2C) and (2D) of Schedule 9 to FA 1996.

1234. Paragraph 18(2D) of Schedule 9 refers to the term "corresponding creditor relationship" in sub-paragraph (1A)(c). That sub-paragraph was repealed by FA 2002. The reference to paragraph (1A)(c) has been rewritten as if it referred to sub-paragraph (1A)(b), the sub-paragraph containing the reference to the person standing in the position of a creditor.

***Section 413: Issue of funding bonds***

1235. This section treats issues of funding bonds as interest payments. It is based on section 582(1) and (3) to (4) of ICTA. The corresponding rule for income tax is in section 380 of ITTOIA.

*These notes refer to the Corporation Tax Act 2009  
(c.4) which received Royal Assent on 26 March 2009*

1236. *Subsection (2)* rewrites, for clarification, “value of the bonds at the time of their issue” in section 582(1)(a) as “market value of the bonds at their issue”.
1237. For the rewrite of the Schedule D Case VI charge in section 582(2A) of ICTA see *Change 59* in Annex 1.

#### ***Section 414: Redemption of funding bonds***

1238. This section prevents repayments of funding bonds from being a payment of interest if the issue was treated as such in the hands of an individual or company. It is based on section 582(1) and (4) of ICTA. The corresponding rule for income tax is in section 754 of ITTOIA.

#### ***Section 415: Loan relationships with embedded derivatives***

1239. Where GAAP requires separate treatment of a loan relationship and its embedded derivative, this section enables the loan relationship to be treated separately for the purposes of this Part also. It is based on section 94A(1) and (2) of FA 1996.
1240. *Section 585* in Part 7 (derivative contracts) rewrites as much of section 94A of FA 1996 as deals with the treatment of embedded derivatives under Schedule 26 to FA 2002.

#### ***Section 416: Election for application of sections 415 and 585***

1241. This section permits a company subject to old UK GAAP to make an election to apply the treatment allowed under section 415 even though separate treatment of loan relationship and derivative does not apply under that accounting policy. It is based on paragraph 7(1), (1A), (3), (4), (6) and (7) of Schedule 6 to F(No 2)A 2005.

#### ***Section 417: Further provisions about elections under section 416***

1242. This paragraph makes further provisions about elections under section 416. It is based on paragraph 7(2), (3) and (5) of Schedule 6 to F(No 2)A 2005.

#### ***Section 418: Loan relationships treated differently by connected debtor and creditor***

1243. This section applies where connected companies are debtor and creditor to a loan relationship which is treated as bifurcated by the debtor but not by the creditor. It is based on section 94B(1) to (6) of FA 1996. Where the debits brought into account by the debtor exceed the credits brought into account by the creditor additional credits must be brought into account by the creditor.

#### ***Section 419: Section 418: supplementary***

1244. This section explains terms used in section 418. It is based on section 94B(7) to (10) of FA 1996.

#### ***Section 420: Assumptions where options etc apply***

1245. This section deals with loan relationships accounted for under an amortised cost basis which are affected by options after the end of the accounting period. It is based on paragraph 3(1) and (2) of Schedule 9 to FA 1996. The debits and credits to be brought into account under this Part are those which would arise if the option were exercised in the way most favourable to the party to the loan relationship.

### ***Chapter 13: European cross-border transfers of business***

#### **Overview**

1246. This Chapter gives the rules that apply for loan relationships in the case of cross-border transfers of business within the European Community which is carried in the United Kingdom.

#### ***Section 421: Introduction to Chapter***

1247. This section sets out the two conditions required for the Chapter to apply together with the claim requirement. It is based on paragraphs 12D(1) to (4), 12G(1) and (2), 12H(1) and 12J(1) of Schedule 9 to FA 1996.

1248. *Subsection (3)(c)* rewrites paragraph 12D(1)(d) – that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA – as “within the charge to corporation tax” since the effect is the same.

#### ***Section 422: Transfer of loan relationship at notional carrying value***

1249. This section provides the rule that where either of the conditions in section 421 applies, credits and debits on loan relationships which are transferred as part of the business transfer are brought into account by both the transferor and transferee as if the loan relationships had been transferred at the carrying value in the accounts of the transferor. It is based on paragraph 12D(1), (2) and (6) of Schedule 9 to FA 1996.

1250. The definition of “notional carrying value” is taken from paragraph 12(2) of Schedule 9 to FA 1996.

#### ***Section 423: Transferor using fair value accounting***

1251. This section provides the rule to apply in place of section 422 where the transferor company uses fair value accounting. It is based on paragraph 12D(7) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

#### ***Section 424: Reorganisations involving loan relationships***

1252. This section provides for debits and credits to be brought into account as if the relevant loan relationships were disposed of at their carrying value where a reorganisation under sections 127 to 130 of TCGA arises as a result of a transfer of business within this Chapter. It is based on paragraph 12G(1), (2), (4) and (6) of Schedule 9 to FA 1996.

#### ***Section 425: Original holder using fair value accounting***

1253. This section provides the rule to apply in place of the rule in section 424 where fair value accounting is used by the original holder. It is based on paragraph 12G(5) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

#### ***Section 426: Tax avoidance etc***

1254. This section disapplies the Chapter if the transfer of business is not effected for genuine commercial reasons unless the Commissioners for HMRC are satisfied, following an application, that the Chapter should apply. It is based on paragraph 12F(1) and (2) of Schedule 9 to FA 1996.

1255. In *subsection (1)(a)* “bona fide commercial reasons” is rewritten as “genuine commercial reasons”.

***Section 427: Procedure on application for clearance***

1256. This section gives the rules that apply where a clearance application is made under section 426 to the Commissioners for HMRC. It is based on paragraph 12F(3) of Schedule 9 to FA 1996.
1257. Paragraph 12F(3) applies the rules in section 138(2) to (5) of TCGA which this and the following section write out in full.

***Section 428: Decision on application for clearance***

1258. This section gives the time limit within which HMRC must give a decision following a clearance application and procedures relating to appeals. It is based on paragraph 12F(3) of Schedule 9 to FA 1996.

***Section 429: Disapplication of Chapter where transparent entities involved***

1259. This section disapplies the Chapter under certain circumstances where transparent entities are involved in the transfer of business. It is based on paragraphs 12H(1) and (2) and 12J(1) of Schedule 9 to FA 1996.
1260. The last two words of paragraph 12H(2)(b) (“paragraph 12G does not apply in relation to it”) are not rewritten in *subsection (2)* because it is not considered that they add anything to paragraph (b). These words do not appear in paragraph 12H(2)(a) which states simply that “paragraph ... 12G [does] not apply to the transfer”.

***Section 430: Interpretation***

1261. This section defines company and company residence in a member State for the purposes of the Chapter. It is based on paragraph 12J of Schedule 9 to FA 1996.

***Chapter 14: European cross-border mergers***

**Overview**

1262. This Chapter gives the rules that apply for loan relationships in the case of mergers where the merging companies are resident in different member States of the European Community.

***Section 431: Introduction to Chapter***

1263. This section sets out the conditions (which include the different categories of merger) under which the Chapter applies. It is based on paragraphs 12B(1) and (2) and 12I(1) of Schedule 9 to FA 1996.
1264. *Subsection (6)* rewrites paragraph 12B(2)(c) – that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA – as “within the charge to corporation tax” since the effect is the same.

***Section 432: Meaning of “the transferee” and “transferor”***

1265. This section gives the meaning of the two terms for the different categories of merger set out in section 431(3). It is based on paragraph 12B(9) of Schedule 9 to FA 1996.

***Section 433: Transfer of loan relationship at notional carrying value***

1266. This section provides the rule that debits and credits on loan relationships transferred under the merger are brought into account as if the transfer had been for a consideration of an amount equal to the carrying value in the transferor company’s or companies’ accounts. It is based on paragraph 12B(3) of Schedule 9 to FA 1996.

***Section 434: Transferor using fair value accounting***

1267. This section provides the rule to apply in place of section 433 where the transferor company uses fair value accounting. It is based on paragraph 12B(4) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

***Section 435: Reorganisations involving loan relationships***

1268. This section provides for continuity of treatment in respect of loan relationships where a reorganisation under sections 127 to 130 of TCGA arises as a result of a merger within this Chapter. It is based on paragraph 12G(1), (2), (4) and (6) of Schedule 9 to FA 1996. Credits and debits are brought into account as if the loan relationships within the reorganisation were disposed of at their carrying value in the accounts of the company which holds them.

***Section 436: Original holder using fair value accounting***

1269. This section provides the rule to apply in place of the rule in section 435 where fair value accounting is used by the original holder. It is based on paragraph 12G(5) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

***Section 437: Tax avoidance etc***

1270. This section disapplies the Chapter if the merger is not effected for genuine commercial reasons unless the Commissioners for HMRC are satisfied, following an application, that the Chapter should apply. It is based on paragraph 12B(6) to (8) of Schedule 9 to FA 1996.

***Section 438: Disapplication of Chapter where transparent entities involved***

1271. This section disapplies the Chapter under certain circumstances where transparent entities are involved in the merger. It is based on paragraphs 12I(1) and (2) and 12J(1) of Schedule 9 to FA 1996.

1272. Paragraph 12I(2)(b) provides that paragraph 12G shall not apply in relation to shares or debentures issued by the transparent entity. This has been rewritten in *subsection (3)* to the effect that sections 435 and 436 do not apply to the new holding.

***Section 439: Interpretation***

1273. This section defines some terms used in the Chapter. It is based on paragraphs 12B(9) and 12J of Schedule 9 to FA 1996.

***Chapter 15: Tax avoidance***

**Overview**

This Chapter brings together provisions which counter avoidance, including avoidance which arises because transactions are not at arm's length.

***Section 440: Overview of Chapter***

1274. This section explains what the Chapter is about and the provisions it contains. It is new.

***Section 441: Loan relationships for unallowable purposes***

1275. This section prevents a company from bringing into account debits in respect of a loan relationship with an "unallowable purpose" (defined in the following section) or exchange gains on such a loan relationship. It is based on paragraph 13(1) and (1A) of Schedule 9 to FA 1996. Once such debits or credits are disallowed they are not brought into account for any other tax purposes.

**Section 442: Meaning of “unallowable purpose”**

1276. This section gives the meaning of “unallowable purpose” for section 441. It is based on paragraph 13(2) to (5) of Schedule 9 to FA 1996.

**Section 443: Restriction of relief for interest where tax relief schemes involved**

1277. This section prevents a company from bringing into account debits for interest paid as part of a scheme or arrangements, the sole or main benefit of which is the obtaining of the debit for that interest. It is based on section 787 of ICTA.

1278. [Section 787](#) differs from paragraph 13 of Schedule 9 to FA 1996, rewritten in sections 441 and 442, in the following ways:

- paragraph 13 covers all debits and not just interest;
- paragraph 13 looks at the purposes of a loan relationship and section 787 at the benefit that might be expected to accrue from a scheme or arrangements;
- where section 787 is in point the whole of the interest is disallowed whereas paragraph 13 restricts only so much of the debit on the loan relationship as on a just and reasonable apportionment is attributable to the unallowable purpose.

1279. For these reasons both paragraph 13 of Schedule 9 to FA 1996 and section 787 of ICTA are rewritten in full.

1280. Section 787(1A) of ICTA requires the reference in section 787(1) to giving relief in respect of a payment of interest to be read “as including” a debit for interest under Chapter 2 of Part 4 of FA 1996 (loan relationships). This must be interpreted as applying that subsection to loan relationships alone as debits for interest are only allowed under Chapter 2 of Part 4 of FA 1996 (section 337A(2)(a) of ICTA). *Subsection (1)* is worded accordingly.

**Section 444: Transactions not at arm’s length: general**

1281. This and the following seven sections provide rules for where transactions in respect of a loan relationship are not on arm’s length terms. It is based on section 103(1) of, and paragraph 11(1) to (3A) of Schedule 9 to, FA 1996. The section requires debits and credits to be determined as if the related transaction in respect of which they arise were on arm’s length terms. Exchange gains and losses are not affected. Schedule 28AA to ICTA (provision not at arm’s length) has priority where it also applies (see section 445).

1282. [Paragraph 11\(2\)](#) refers to debits arising from the acquisition of rights under a loan relationship. The 1996 notes on sections read “...[paragraph 11] specifically does not affect the buyer when it has paid less than the market price – we are quite happy when it comes to sell the loan relationship, in computing the profit, it only gets the amount it actually paid taken into account at cost rather than market value”. When the company comes to sell the loan relationship the transaction may not be at arm’s length, but the arm’s length value is clearly still intended to apply.

1283. It was therefore intended that the debits refer to the entries in the asset account on the acquisition of a loan relationship acquired at below market value.

1284. Paragraph 6204 of the Corporate Finance Manual reads:

[FA96/SCH9/PARA11\(2\)](#) provides that the Para 11(1) adjustment does not apply to *debts* arising from the purchase of a loan relationship at less than market value.

Although this rule is primarily aimed at cases where the vendor is not within the charge to corporation tax, it does apply in other cases too. So, when a company buys a debt at undervalue (not at arm’s length), there is *no* adjustment in its accounts; it brings in the lower value and is taxed on the full amount of any resulting profit. Para 11(1) does

apply to the vendor, however – where it sells a debt at undervalue (not at arm's length) it is taxed as if it had sold the loan relationship at the market value.

1285. Ghosh and Johnson's "Taxation of Loan Relationships and Derivatives", in referring to paragraph 11(2), agrees with this interpretation. Paragraph 6.351 reads:

However, there is no market value uplift for the purpose of computing any debits arising from the acquisition of rights under a loan relationship at less than market value (para 11(2)). "Debit" here means an "expense", ie acquisition cost.

1286. In most instances transactions other than at arm's length are between group companies and Schedule 28AA to ICTA will apply. Schedule 28AA has precedence as a result of paragraph 11(1A) of Schedule 9 to FA 1996 and paragraph 11(1) of Schedule 9 will not then apply.
1287. A rewrite change has not been introduced to reflect this meaning of paragraph 11(2) because some non-HMRC specialists on loan relationship disagree with this interpretation.

***Section 445: Disapplication of section 444 where Schedule 28AA to ICTA applies***

1288. This section provides an exception to section 444. Where Schedule 28AA to ICTA also applies in respect of the related transaction, section 444 does not apply. It is based on paragraph 11(1A) and (1B) of Schedule 9 to FA 1996. The section also excludes an adjustment to exchange gains and losses from any Schedule 28AA adjustments.

***Section 446: Bringing into account adjustments made under Schedule 28AA to ICTA***

1289. This section requires credits and debits under this Part to reflect adjustments made under Schedule 28AA of ICTA. It is based on paragraph 16(1) and (2) of Schedule 9 to FA 1996.

***Section 447: Exchange gains and losses on debtor relationships: loans disregarded under Schedule 28AA to ICTA***

1290. This and the following four sections provide rules for exchange gains and losses on loan relationships which are not on arm's length terms. It is based on paragraph 11A(1) to (3) of Schedule 9 to FA 1996 and paragraph 8(1) and (3) of Schedule 28AA to ICTA.
1291. The section leaves exchange gains and losses, or a proportion of them, out of account where, under Schedule 28AA to ICTA, the whole or part of a loan representing a debtor relationship is ignored.

***Section 448: Exchange gains and losses on debtor relationships: equity notes where holder associated with issuer***

1292. This section applies where interest is to be treated as a distribution under section 209(2) (e)(vii) of ICTA. It is based on paragraph 11A(1) of Schedule 9 to FA 1996. Exchange gains and losses on the security giving rise to that interest are left out of account in computing gains under this Part in respect of the debtor company.

***Section 449: Exchange gains and losses on creditor relationships: no corresponding debtor relationship***

1293. This section applies where a company is in a creditor relationship and the transaction giving rise to the loan would not have been made on arm's length terms. It is based on paragraph 11A(4) and (5) of Schedule 9 to FA 1996. The section leaves exchange gains and losses out of account where there is no corresponding debtor relationship (explained in section 450).

***Section 450: Meaning of “corresponding debtor relationship”***

1294. This section provides the meaning of “corresponding debtor relationship” for the purposes of section 449. It is based on paragraph 11A(4) of Schedule 9 to FA 1996.
1295. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals the words “or would apart from section 84A(2) to (10) of this Act” in paragraph 11A(4)(c) of Schedule 9 to FA 1996 (rewritten in *subsection (6)*) with effect from a day to be appointed. This subsection will therefore cease to have effect from an appointed day (see Part 8 (loan relationships) of Schedule 2 to this Act).

***Section 451: Exception to section 449 where loan exceeds arm’s length amount***

1296. Where a loan would, on arm’s length terms, have been of an amount more than nil but less than the full amount this section takes into account a suitable proportion of the exchange gains and losses for the purposes of this Part. It is based on paragraph 11A(5) and (6) of Schedule 9 to FA 1996.

***Section 452: Exchange gains and losses where loan not on arm’s length terms***

1297. This section provides that, where a guarantor company is connected to the creditor company, a claim under paragraph 6D of Schedule 28AA to ICTA is assumed to apply to exchange gains and losses as well as interest. It is based on paragraph 11A(7) to (10) of Schedule 9 to FA 1996.
1298. Paragraph 6D of Schedule 28AA to ICTA applies where a company has an interest payment reduced by the transfer pricing rules of that Schedule and the loan on which that interest is paid is guaranteed by another company. The guarantor company may make a claim to be treated as if it had itself paid the interest. The guarantor company then obtains the deduction that was disallowed to the paying company. This is called a “compensating adjustment”. The interest is allowed to the extent that an independent lender would take the guarantee into account in determining the borrower’s debt capacity.

***Section 453: Connected parties deriving benefit from creditor relationships***

1299. This section provides that if a company receives less than a commercial return under a loan relationship and, in consequence, a connected company derives benefit as a result of that relationship, credits representing that benefit are brought into account in computing the creditor company’s gains. It is based on section 93C of FA 1996. This counters an avoidance device whereby a company arranges for the equivalent value of interest that would otherwise be received to be passed by the borrower to a connected company which is not a party to the relationship.

***Section 454: Application of fair value accounting: reset bonds etc***

1300. This section provides rules for debits and credits on loan relationships represented by bonds on which the terms change after issue, to be determined on the basis of fair value accounting. It is based on section 88A of FA 1996.
1301. Principally, this section counters avoidance where companies subscribe for reset bonds which increase in value after issue and are transferred to another group company at cost under section 340 onwards. That company is then sold outside the group at market value with the profit on the bond reflected in the capital gain on the sale of the subsidiary and not as a credit under this Part.

***Section 455: Disposals for consideration not fully recognised by accounting practice***

1302. This section provides that rights disposed of under a creditor relationship are to be brought into account where the disposal is not wholly recognised in the accounts and there is an intention to avoid tax. It is based on paragraph 11B of Schedule 9 to FA 1996.

***Chapter 16: Non-trading deficits***

**Overview**

1303. This Chapter provides the rules for deficits on loan relationships which are not used for the company's trade.

***Section 456: Introduction to Chapter***

1304. This section provides a general introduction to the Chapter. It is based on section 83(1) of, and paragraph 5 of Schedule 8 to, FA 1996.

***Section 457: Basic rule for deficits: carry forward to accounting periods after deficit period***

1305. This section provides that deficits which are neither surrendered as group relief nor set-off against profits of the loss period or earlier periods are carried forward and set against the non-trading profits of the following accounting period. It is based on section 83(3A) of, and paragraph 4(1) to (3) and (6) of Schedule 8 to, FA 1996.

***Section 458: Claim to carry forward deficit to later accounting periods***

1306. This section allows a company to make a claim to carry forward the deficit from the period in which it arose without the need to set it against non-trading profits under section 457. It is based on paragraph 4(3) to (5) of Schedule 9 to FA 1996.
1307. The deficit is then treated as if it arose in the "first later period" and falls to be carried forward to the subsequent period (ie it cannot be set against total profits of that first later accounting period). This rule also applies where no claim is made but the deficit cannot be set against non-trading profits of the first subsequent period.

***Section 459: Claim to set off deficit against profits of deficit period or earlier periods***

1308. This section allows a company (unless it is a charity) to claim that deficits which have not been surrendered as group relief may be set off against other profits of the deficit period or carried back against profits from loan relationships in an earlier accounting period. It is based on section 83(2) and (5) of FA 1996.
1309. Section 83(2)(a) of FA 1996 (set-off against other profits of the deficit period) allows the deficit to be set off against "any profits... (of whatever description)". "Profits of any description" are the "total profits" in section 9(3) of ICTA and this is reflected in *subsection (1)(a)*.
1310. Section 83(2)(c) of FA 1996 (set-off carried back to earlier periods) refers only to set-off "against profits". Paragraph 3(4) of Schedule 8 to FA 1996 makes it clear that the profits in section 83(2)(c) are only profits on non-trading loan relationships. This restriction has been brought out in *subsection (1)(b)*. Full details of the profits against which a deficit can be set under subsection (1)(b) are given in section 463 (signposted in *subsection (6)*).
1311. Section 83(5) of FA 1996 has been rewritten in *subsection (3)* and excludes charities from making a claim under subsection (1) of this section. Before its repeal in FA 2002 section 83(2)(b) of FA 1996 allowed deficits to be surrendered as group relief.

Section 83(5) was not consequentially amended when section 83(2)(b) was repealed and continues to refer to group relief.

1312. The reference to group relief is unnecessary since section 403(2) of ICTA, which allows non-trading deficits for the purposes of group relief, only provides for deficits to which section 83 of FA 1996 applies (see section 403ZC of ICTA). So all that is necessary to prevent the deficit of a charitable company from being surrendered as group relief is to provide that claims under this section may not be made in respect of the deficits of a charitable company and this is what subsection (3) does.

#### ***Section 460: Time limits and procedure for claims under section 459(1)***

1313. This section provides the time limit for a claim under section 459. It is based on section 83(6) to (8) of FA 1996.
1314. *Subsection (1)(b)* rewrites “the Board” as “an officer of Revenue and Customs”. See *Change 1* in Annex 1.

#### ***Section 461: Claim to set off deficit against other profits for the deficit period***

1315. This section provides that, following a claim under section 459(1), the deficit is set off against the profits identified in the claim but after trade losses and before certain other reliefs. It is based on paragraph 1(1) to (4) of Schedule 8 to FA 1996.
1316. Although the set-off against profits of the deficit period is against total profits, the general rule in *subsection (2)* is that the set-off is against the profits of the company identified in the claim. In the figure of total profits any management expenses will already have been deducted under section 1219. The profits identified in the claim will therefore be after management expenses. If the company has more than one source of income together with a reduction for management expenses, an officer of Revenue and Customs will agree the amount of income specified in the claim on a just and reasonable basis.

#### ***Section 462: Claim to carry back deficit to earlier accounting periods***

1317. This section explains how a claim to carry back a deficit to an earlier period under section 459(1)(b) applies, allowing the deficit to be set against profits of later accounting periods before earlier ones. It is based on paragraph 3(1) to (3) of Schedule 8 to FA 1996.
1318. *Subsection (2)* does not rewrite paragraph 3(2)(a)(ii) of Schedule 8 to FA 1996, which refers to section 83(4) of FA 1996, as section 83(4) has been repealed.

#### ***Section 463: Profits available for relief under section 462***

1319. This section sets out which profits may be reduced by a deficit carried back against profits of an earlier period under section 459. It is based on paragraph 3(4) to (7) of Schedule 8 to FA 1996.
1320. The reliefs in *subsection (5)* are set against the profits before the apportionment required by *subsection (3)* to give the “amount available for relief”.

### ***Chapter 17: Priority rules***

#### **Overview**

1321. This Chapter gives the basic boundary rule for loan relationships in section 464 and excludes debits and credits on distributions.

***Section 464: Priority of this Part for corporation tax purposes***

1322. This section provides the main boundary provision applying to loan relationships. It is based on section 80(5) of, and paragraph 1(2) of Schedule 9 to, FA 1996.

***Section 465: Exclusion of distributions except in tax avoidance cases***

1323. This section excludes distributions from being brought into account under this Part unless they arise in consequence of avoidance arrangements. It is based on paragraph 1(1), (1A) and (2) of Schedule 9 to FA 1996.

***Chapter 18: General and supplementary provisions***

**Overview**

1324. This Chapter explains when companies are connected for the purposes of Parts 5 and 6 as well as providing definitions of “control”, “major interest” and other expressions used in those Parts.

***Section 466: Companies connected for an accounting period***

1325. This section explains when two companies are connected for an accounting period for the purposes of any provisions that apply it. It is based on sections 87(3) and (4) and 87A(1) of FA 1996.

***Section 467: Connections where partnerships are involved***

1326. This section explains when loan relationships are taken to be between connected companies in the case of debts owed by or to a partnership. It is based on section 87(5A) and (5B) of FA 1996.

1327. *Subsection (4)* adopts the language (“in accordance with the firm’s profit-sharing arrangements”) of section 1262 in Part 17 (partnerships) which rewrites section 114(2) of ICTA.

***Section 468: Connection between companies to be ignored in some circumstances***

1328. This section provides that a connection between a company in a creditor relationship and the company in the debtor relationship is ignored in certain circumstances. It is based on section 88(1), (5) and (6) of FA 1996. The circumstances are set out in sections 469 and 471. The section also provides that a company is treated for these purposes as being in a debtor relationship when the debt is “dog-legged” through intermediaries.

1329. Section 88(1) and (5) of FA 1996 refer to persons standing in a debtor relationship. “Persons” here has been rewritten as applying to companies only. See *Change 56* in Annex 1.

***Section 469: Creditors who are financial traders***

1330. This section sets out the circumstances under which connectedness between a company in a creditor relationship and one in a debtor relationship is ignored under section 468. It is based on section 88(2) and (3) of FA 1996. The section allows financial traders who buy and sell debt of connected companies in the same way that they buy and sell debt of non-connected companies to be exempt from the connectedness rules.

1331. Section 88(2)(f) of FA 1996 provides the condition that, for a three month period, the equivalent of 30% or more of the assets should not be in the beneficial ownership of “connected persons”. This has been rewritten as “connected companies”. See *Change 56* in Annex 1.

***Section 470: Section 469: supplementary provisions***

1332. This section explains terms used in the preceding section. It is based on section 88(4) of FA 1996.
1333. “Person” in section 88(4) has been rewritten as “company” only. See *Change 56* in Annex 1.

***Section 471: Creditors who are insurance companies carrying on BLAGAB***

1334. This section stops the connectedness rules from applying to insurance companies carrying on basic life assurance and general annuity business where certain conditions are met. It is based on section 88(3) of FA 1996.

***Section 472: Meaning of “control”***

1335. This section explains the meaning of control for the purposes of any provisions that apply it, for example section 466. It is based on section 87A(1) to (3) of FA 1996.
1336. *Subsection (6)(b)* adopts the language (“in accordance with the firm’s profit-sharing arrangements”) of section 1262 in Part 17 (partnerships) which rewrites section 114(2) of ICTA.

***Section 473: Meaning of “major interest”***

1337. This section gives the meaning of “major interest”. It is based on paragraphs 2(7), 17(10) and 20(1), (3) and (8) to (10) of Schedule 9 to FA 1996.

***Section 474: Treatment of connected companies and partnerships for section 473***

1338. This section explains how the rule in section 473(2) (meaning of “major interest”) on rights and powers is applied to partnerships with company members. It is based on paragraph 20(4) to (7) of Schedule 9 to FA 1996.

***Section 475: Meaning of expressions relating to exchange gains and losses***

1339. This section explains what is meant by a company’s exchange gains and losses and gives the Treasury powers to make regulations as to how such gains and losses are to be calculated where fair value accounting is used. It is based on section 103(1A) to (1B) of FA 1996.
1340. *Subsection (3)* does not rewrite section 103(1AA)(b) of FA 1996 (“any other profit or gains or losses”) because the regulations are in respect of the manner in which exchange gains and losses in section 103(1A)(a) are to be calculated and a reference to other profits and losses is superfluous.

***Section 476: Other definitions***

1341. This section gives a number of definitions used in this Part. It is based on section 103(1) and (4) of FA 1996.