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

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the Corporation Tax Act 2009 which received Royal Assent on 26 March 2009. They have been prepared by the Tax Law Rewrite project at HMRC in order to assist readers in understanding the Act. They do not form part of the Act and have not been endorsed by Parliament.

2. The notes need to be read in conjunction with the Act. They are not, and are not meant to be, a comprehensive description of the Act. So if a section or part of a section does not seem to require any explanation or comment, none is given.

3. The commentary on each section indicates the main origin or origins of the section. A full statement of the origins of each section is contained in the Act's Table of Origins.

4. At the end of the commentary there is supporting material in two annexes.

   - *Annex 1* contains details of the minor changes in the law made by the Act.
   - *Annex 2* contains lists of:
     - the Extra-Statutory Concessions to which the Act gives effect;
     - the minor changes made by the Act which involve giving statutory effect to principles derived from case law; and
     - provisions not included in the Act on the grounds of redundancy.

Summary

5. The main purpose of the Corporation Tax Act 2009 is to rewrite the charge to corporation tax and the primary corporation tax legislation used by companies in computing their income.

6. The Act does not generally change the meaning of the law when rewriting it. The minor changes which it does make are within the remit of the Tax Law Rewrite project and the Parliamentary process for the Act. In the main, such minor changes are intended to clarify existing provisions, make them consistent or bring the law into line with well established practice.

Background

The Tax Law Rewrite project

7. In December 1995 the Inland Revenue presented a report to Parliament on the scope for simplifying the United Kingdom tax system (*The Path to Tax Simplification*). The main recommendation was that United Kingdom direct tax legislation should be rewritten in clearer, simpler language.

8. This recommendation was warmly welcomed, both in Parliament and in the tax community. In his November 1996 Budget speech the then Chancellor of the Exchequer (the Rt Hon Kenneth Clarke QC MP) announced that the Inland Revenue would propose detailed arrangements for a major project to rewrite direct tax legislation in plainer language.

9. The project team has been carrying out this work. The aim is that the rewritten legislation should use simpler language and structure than previous tax legislation. The members of the project are drawn from different backgrounds. They include longstanding HMRC employees, former private sector tax professionals and parliamentary counsel including (as head of the drafting team) a senior member of the Parliamentary Counsel Office.

Steering Committee

10. The work of the project is overseen by a Steering Committee, chaired by the Rt Hon the Lord Newton of Braintree OBE DL. The membership of the Steering Committee as at 31 October 2008 was:

The Rt Hon the Lord Newton of Braintree OBE DL (Chairman)

Dr John Avery Jones CBE

Adam Broke

Baron Christopher of Leckhampton CBE

Nicholas Dee

Dave Hartnett CB

The Rt Hon Michael Jack MP

Eric Joyce MP

District Judge Rachel Karp

Professor John Tiley CBE

John Whiting CBE

Consultative Committee

11. The work is also reviewed by a Consultative Committee, representing the accountancy and legal professions and the interests of taxpayers. The membership of the Consultative Committee as at 31 October 2008 was:

Robina Dyall	Chairman
Brian Atkinson	100 Group
Adam Broke	Special Committee of Tax Law Consultative Bodies
Colin Campbell	Confederation of British Industry
Russell Chaplin	London Chamber of Commerce & Industry
Mary Fraser	Association of Chartered Certified Accountants
Malcolm Gammie CBE QC	The Law Society of England and Wales
Julian Ghosh QC	Revenue Bar Association

Keith Gordon	Chartered Institute of Taxation
Terry Hopes	Institute of Chartered Accountants in England and Wales
Bob McInerney	Federation of Small Businesses
Isobel d'Inverno	Law Society of Scotland
Amy Jones	Institute of Chartered Accountants of Scotland
Simon McKie	Institute of Chartered Accountants in England and Wales
Lakshmi Narain	Chartered Institute of Taxation
Francis Sandison	The Law Society of England and Wales
Michael Templeman	Institute of Directors
Professor David Williams	Office of the Social Security Commissioners
Mervyn Woods	Confederation of British Industry

Consultation

12. The work produced by the project has been subject to public consultation. This has allowed all interested parties an opportunity to comment on draft clauses.

13. This consultation took the form of a series of papers which published clauses in draft. There were 20 of these, published between July 2006 and November 2008 and a draft Bill was published for consultation in February 2008. All these documents are available on the Tax Law Rewrite website.

14. The project also held detailed informal discussions and workshops with leading private sector tax professionals and HMRC specialists to consider the drafting of the more complex areas of rewritten tax legislation, for example, loan relationships and derivative contracts.

15. Those who responded to one or more of the papers, or to the draft Bill, include:

    Alma Consulting Group

    Chartered Institute of Taxation

    Confederation of British Industry

    Deloitte & Touche LLP

    Ernst & Young LLP

    Institute of Chartered Accountants in England and Wales

    International Swaps and Derivatives Association, Inc.

    KPMG LLP

    Law Society

    London Investment Banking Association

    London Society of Chartered Accountants

    PricewaterhouseCoopers LLP

Note: this list excludes those who asked that their responses be treated in confidence.

This Act

The end of the Schedules

16. This Act repeals the Schedules so far as they remain for corporation tax and therefore marks the end of the use of the word "Schedule" to define types of income. Instead, the Act uses terms that describe the nature of the income, such as "trading income".

Features of the Act

17. The Act:

- contains the basic corporation tax provisions including the charge to tax, accounting periods and provisions relating to residence;
- contains provisions relating to trading and property income and income from other sources;
- contains special provisions for companies affecting the calculation of income, such as those for loan relationships, derivative contracts and intangible fixed assets;
- contains provisions governing particular types of expenditure, for example, expenditure on research and development and films; and
- will take the place of many provisions within ICTA, FA 1996, FA 2001 and FA 2002 as the main Act for the areas of corporation tax covered by this Act.

18. The Act has 1330 sections and four Schedules.

19. The sections are arranged as follows:

Part 1: Introduction

Part 2: Charge to corporation tax: basic provisions

Part 3: Trading income

Part 4: Property income

Part 5: Loan relationships

Part 6: Relationships treated as loan relationships etc

Part 7: Derivative contracts

Part 8: Intangible fixed assets

Part 9: Intellectual property: know-how and patents

Part 10: Miscellaneous income

Part 11: Relief for particular employee share acquisition schemes

Part 12: Other relief for employee share acquisitions

Part 13: Additional relief for expenditure on research and development

Part 14: Remediation of contaminated land

Part 15: Film production

Part 16: Companies with investment business

Part 17: Partnerships

Part 18: Unremittable income

Part 19: General exemptions

Part 20: General calculation rules

Part 21: Other general provisions

20. The Schedules are:

Schedule 1: Minor and consequential amendments

Schedule 2: Transitionals and savings

Schedule 3: Repeals and revocations

Schedule 4: Index of defined expressions

21. Tables of Origins and Destinations have also been prepared. The Table of Destinations shows the destination not only of repealed provisions but of all provisions rewritten in the Act.

Glossary

22. The commentary uses a number of abbreviations. They are listed below.

CAA	the Capital Allowances Act 2001
CAA 1990	the Capital Allowances Act 1990
CRCA	the Commissioners for Revenue and Customs Act 2005
ESC	Extra-statutory concession
HMRC	Her Majesty's Revenue and Customs
FA 1989	Finance Act 1989 (and similarly for other Finance Acts)
F(No 2)A	Finance (No 2) Act
FISMA	the Financial Services and Markets Act 2000
ICTA	the Income and Corporation Taxes Act 1988
IHTA	the Inheritance Tax Act 1984
ITA	the Income Tax Act 2007
ITEPA	the Income Tax (Earnings and Pensions) Act 2003
ITTOIA	the Income Tax (Trading and Other Income) Act 2005
NIC	national insurance contributions
PAYE	Pay As You Earn
R&D	research and development
TCGA	the Taxation of Chargeable Gains Act 1992
TMA	the Taxes Management Act 1970
VAT	value added tax

COMMENTARY ON SECTIONS

Part 1: Introduction

Section 1: Overview of Act

23. This section describes the content of the Act. It is new.

24. *Subsections (1)* and *(2)* make it clear that that a large part of the Act is directly concerned with the application of the charge to corporation tax on income.

25. *Subsection (3)* notes that Part 7 also includes provision for the charge to corporation tax on chargeable gains in relation to derivative contracts.

26. *Subsection (4)* notes that Parts 5 to 8 have a role in relation to the treatment of deficits and losses in connection with the matters to which the Parts relate.

27. *Subsections (5)* and *(6)* describe the particular cases covered by Parts 11 to 18 and *subsection (7)* the provisions of general application in Parts 19 to 21.

28. *Subsection (8)* notes where abbreviations and defined expressions used in the Act can be found.

Part 2: Charge to corporation tax: basic provisions

Chapter 1: The charge to corporation tax

Overview

29. The process of separating income tax and corporation tax began with ITTOIA and continued with ITA, which substantially completed the rewrite of income tax legislation for income tax purposes. Following that there were two parallel sets of income tax principles. Those in rewrite style apply only for income tax purposes and, for example, no longer include Schedules such as Schedule D and its Cases.

30. Prior to this Act corporation tax has been dependent on the continuing existence of the income tax rules in unrewritten style so that, for example, those Schedules and Cases continue to be applied for the purposes of corporation tax.

31. This Act continues and finalises the separation process so that the relevant principles apply separately for corporation tax. The adoption of this approach means that section 9 of ICTA (computation of income: application of income tax principles) is repealed by this Act (apart from section 9(5) which theoretically could have a continuing effect). Some of the provisions of section 9 of ICTA are rewritten in section 969 and there is a transitional provision in Schedule 2.

32. This Chapter deals with the charge to corporation tax on profits. The approach retains the principle of a single charge, currently under section 6 of ICTA. The charge under section 2 is on amounts of income and on chargeable gains that together form the "profits pot".

33. This contrasts with the multiple charges to income tax in the Income Tax Acts, primarily ITTOIA, and reflects the different history of the two taxes.

34. The way the charge on profits operates is explained in the commentary on section 2. This section rewrites both section 6(1) and (4) of ICTA and section 9(1) and (4) of that Act. In the light of the separation of corporation tax from income tax it is necessary to find a different way of expressing the relationship between the general charge to corporation tax on income and the provisions that deal with its application.

35. There are also other charges to corporation tax. These are charges to an amount of corporation tax and they do not feature in the "profits pot". There is an example of this

kind of charge in this Act – in section 75{j032704}(2) (retraining courses: recovery of tax).

36. These are provisions of an administrative nature mainly recovering excessive relief. In some of the charges of this kind there are references to the assessment being made under Schedule D Case VI. The Case VI label will disappear along with Schedule D and the other Cases with the repeal of section 18 of ICTA. The references are removed by consequential amendments in Schedule 1. An example is the amendment to paragraph 27(4) of Schedule 16 to FA 2002.

Section 2: Charge to corporation tax

37. This section provides the charge to corporation tax on profits. It is based on section 6(1) and (4) and section 9(1) and (4) of ICTA.

38. *Subsection (1)* states that corporation tax on profits is charged for a financial year for which an Act provides. It is based on the two overlapping propositions in section 6(1) of ICTA.

39. Under *subsection (2)* "profits" in Part 2 means "income and chargeable gains, except in so far as the context otherwise requires". This interpretation derives from section 6(4) of ICTA. This Act amends section 6(4) of ICTA in Schedule 1.

40. Chargeable gains are defined in section 1(1) of TCGA. In *subsection (3)* " the charge to corporation tax on income" is introduced as a label. The expression is defined for corporation tax purposes as a result of an amendment to section 834(1) of ICTA made by Schedule 1 to this Act.

41. *Subsection (4)* provides that the charge to corporation tax on income in effect depends on there being another provision of the Corporation Tax Acts that applies it.

42. This subsection is based on section 9(1) and (4) of ICTA. Section 9(1) in effect controls the meaning of "income" in section 6 of ICTA. As noted in the overview, this Act will complete the split between income tax and corporation tax and the formulation in section 9(1) of ICTA is no longer apposite since its wording is adapted to the circumstances of applying one body of tax law (income tax principles) for the purposes of another tax (corporation tax).

43. The effect of section 9 of ICTA is that the scope of the charge to income tax determines what is income for corporation tax purposes (except as otherwise provided by the Tax Acts). Income tax, although primarily a charge to tax on things which would be regarded as income in its ordinary sense, is not exclusively a charge on such things. Section 9(4) provides that anything that is within the charge to income tax is within the charge to corporation tax on income "whether expressed to be income or not and whether an actual amount or not".

44. So the effect of section 9 of ICTA is that (subject to the provisions of the Corporation Tax Acts) the charge to corporation tax on income is driven by the particular heads of the charge to income tax.

45. The purpose of this section is to achieve an equivalent effect, so that the charge to corporation tax on income is driven by the particular heads of the charge to corporation tax on income. In this way the section substitutes the provisions of the Corporation Tax Acts for the income tax provisions. For example section 35 applies the charge to corporation tax on income to the profits of a trade.

Section 3: Exclusion of charge to income tax

46. This section ensures that income of a company within the charge to corporation tax is not chargeable to income tax as well as corporation tax. It is based on section 6(2) of ICTA.

Section 4: Exclusion of charge to capital gains tax

47. This section ensures that chargeable gains of a company within the charge to corporation tax are not chargeable to capital gains tax as well as corporation tax. It is based on section 6(3) of ICTA.

Section 5: Territorial scope of charge

48. This section sets out the territorial scope for the charge to corporation tax. It is based on section 8(1) and section 11(1) and (2) of ICTA.

49. *Subsection (1)* deals with the position of companies resident in the United Kingdom. It restates section 8(1) of ICTA which, although expressed in general terms, only has effect in relation to UK resident companies (because of the exception under section 11 for non-UK resident companies).

50. Chapter 3 of this Part sets out the statutory rules for company residence. Chapter 4 explains what are chargeable profits in the case of non-UK resident companies.

Section 6: Profits accruing in fiduciary or representative capacity

51. This section deals with profits accruing directly to the company where it is acting in a fiduciary or representative capacity, for example as a nominee. It is based on section 8(2) of ICTA.

52. In this case the charge under section 2 only applies where the company has a beneficial interest in the profits.

53. When a company goes into liquidation it ceases to be the beneficial owner of its assets. The exception in *subsection (2)* means that in this case the company's profits remain within the charge to corporation tax.

Section 7: Profits accruing under trusts

54. This section sets out the treatment of profits that do not accrue to the company directly but in which the company has a beneficial interest under a trust. It is based on section 8(2) of ICTA.

55. The words "in any case in which it would be so chargeable if the profits accrued to it directly" are not reproduced because the treatment for which the section provides makes them unnecessary. Profits which are treated as accruing to a company directly are chargeable to corporation tax in the same circumstances that they would have been had they in fact accrued directly to the company.

56. There is no reference to profits arising under a partnership in contrast to section 8(2) of ICTA. Provisions for the charge to corporation tax on the profits of corporate partners are set out elsewhere in this Act and in particular in Part 17.

Section 8: How tax is charged and assessed

57. This section sets out how corporation tax is charged and assessed. It is based on section 8(3) and section 12(1) of ICTA.

58. The reference to deductions in section 8(3) and section 12(1) of ICTA and the words in brackets in section 12(1) "(whether or not received in or transmitted to the United Kingdom)" have not been rewritten since they do not add anything substantive to these provisions. There are rules elsewhere about what deductions can be made and this section together with section 5 make it clear that the charge is on profits wherever arising.

59. Section 70(1) is not rewritten in this Act but is reflected in *subsection (3)* of this section which contains the general rule about the basis of assessment.

Chapter 2: Accounting periods

Overview

60. This Chapter gives the definition of accounting period. It is based on section 12 of ICTA.

61. The accounting period is a basic building block of corporation tax because corporation tax is charged by reference to accounting periods. For nearly all established UK resident companies the accounting period coincides with the 12 month period for which it makes up its accounts. Most of the Chapter is taken up with rules explaining what happens outside the usual case.

62. The Chapter does not rewrite section 12(8) of ICTA. Section 12(8) is an administrative provision that deals with the validity of assessments. The Chapter is concerned with when accounting periods begin and end, and not with the circumstances in which an officer of Revenue and Customs may make an assessment or determination.

Section 9: Beginning of accounting period

63. This section identifies when an accounting period begins. It is based on section 12 and section 342A of ICTA.

64. *Subsection (1)(a)* deals with the case in which a company comes within the charge to corporation tax. Subsection (1)(a) states an important general rule. This Act does not reproduce the two examples given in section 12(2)(a) of ICTA of circumstances in which this general rule would apply (becoming UK resident, acquiring a source of income). The examples add nothing useful and might obscure the general rule.

65. *Subsection (1)(b)* deals with the usual case of a company that is already within the charge to corporation tax so that a new accounting period begins when the previous accounting period ends.

66. *Subsection (4)* disapplies this section in the case of a company being wound up. Section 12, which makes special provision about companies being wound up, applies instead.

67. *Subsection (6)* is a general signpost that, in certain circumstances, the rules in this section are modified by rules in other provisions of the Corporation Tax Acts that deal with particular cases. The implications for accounting periods will be clear when considering the cases in question (for example, paragraph 3 of Schedule 10 to FA 2006 (sale of lessor companies) and paragraph 52 of Schedule 22 to FA 2000 (tonnage tax)).

Section 10: End of accounting period

68. This section identifies the end of an accounting period. It is based on section 12 of ICTA.

69. The starting point for the section to apply is that the company has an existing accounting period. The occurrence of any one of the listed events brings that accounting period to an end. In many cases section 9(1)(b) then applies to start a new accounting period.

70. The opening words of *subsection (1)* provide that an accounting period ends "on the first occurrence of any of" the events listed in paragraphs (a) to (j). These words fall to be read in relation to each accounting period which is commenced. The effect of these words is not that the first event on that list to occur settles how all subsequent accounting periods of that company are to end. Rather, the effect is that each accounting period may be ended by the occurrence of a different event, depending on what happens in that particular accounting period.

71. The rules applying to companies in administration have been integrated into the general rules. The case is different from where a company is being wound up. In that case (see section 12) there is a self-contained set of rules about when a company's accounting periods end. In the case of a company in administration, the general rules

about when an accounting period of a company end continue to apply, but there are two additional circumstances in which an accounting period ends. These are the circumstances mentioned in subsection (1)(i) and (j).

72. The legislation rewritten by subsections (1)(i) and (j), (2), (3) and (4) only applies to companies that enter administration on or after 15 September 2003. This limitation is preserved in Schedule 2 (transitionals and savings).

Section 11: Companies with more than one accounting date

73. This section allows a company carrying on more than one trade to nominate the accounting date which marks the end of the accounting period. It is based on section 12 of ICTA.

74. The section is most likely to apply to a non-UK resident company carrying on more than one trade in the United Kingdom through a permanent establishment. If a UK resident company carries on more than one trade it prepares a single set of accounts to cover all the company's activities. A non-UK resident company may not be subject to these regulatory requirements. Without this section an accounting period would end at each separate accounting date.

75. The company is allowed to choose which accounting date is used for the purposes of the test in section 10(1)(b). The company's choice is subject to review by HMRC. In the source legislation this power is exercised by the Commissioners for HMRC. In practice it is exercised by an officer. *Subsection (3)* reflects that. See *Change 1* in Annex 1.

76. The source legislation does not provide for the situation where a company has one or more businesses in addition to its trades, or several businesses but no trade. The effect is that the company's choice and the officer of Revenue and Customs' discretion is limited to selection of an accounting date relating to one of the company's trades. In other words, neither the company nor the officer can choose as the accounting period end date an accounting date of one of the company's businesses which is not a trade.

Section 12: Companies being wound up

77. This section identifies the beginning and end of an accounting period if a company is being wound up. It is based on section 12 of ICTA.

78. Although the rules applying to companies in administration have been integrated into the general rules (see section 10(1)(i) and (j)), the separate exposition of the rules applying to companies being wound up have been preserved. This is because the scheme of section 12(7) of ICTA is to provide for a self-contained set of rules about when an accounting period ends. It follows that the accounting period of a company being wound up does not end on the occurrence of any of the events listed in section 10(1)(b) to (j). Accordingly, it is not appropriate to add the termination events listed in section 12 to the list of termination events in section 10(1).

79. *Subsection (5)* is new. It makes provision for when a new accounting period of a company being wound up begins. Section 12(7) of ICTA provides for an accounting period to begin on the commencement of winding up, but does not provide for the commencement of any subsequent accounting period. The rule in section 12(2)(b) of ICTA, now section 9(1)(b) of this Act, continues to apply for that purpose. It is preferable to make separate provision for the commencement of a new accounting period after the end of 12 months, rather than rely on section 9(1)(b) for this purpose.

80. The reason for this is that the rule in clause 9(1)(b) of this Act is that a new accounting period only begins at the end of 12 months if the company is still within the charge to corporation tax. However, section 12(7) of ICTA does not make the company's remaining within the charge to corporation tax a condition of a new accounting period starting on the company beginning to be wound up. Also, that provision states that "an accounting period shall not end otherwise than by the expiration of 12 months from its

beginning". Given that, section 12(2)(b) of ICTA must necessarily be modified in its application to companies being wound up.

Chapter 3: Company residence

Overview

81. This Chapter gives the statutory rules for company residence outside double taxation conventions.

82. The rules on company residence are both statutory and non-statutory. The oldest of the company residence rules ("central management and control") is based on common law.

83. The central management and control test is generally considered to be best expressed in De Beers Consolidated Mines v Howe (1905), 5 TC 198 HC. "A company resides, for the purposes of Income Tax, where its real business is carried on … I regard that as the true rule; and the real business is carried on where the central management and control actually abides". This has been endorsed by subsequent decisions and was described by Lord Radcliffe in Bullock v Unit Construction Company (1959), 38 TC 712 HL as being "as precise and unequivocal as a positive statutory injunction".

84. Residence may also be determined by the tie-breaker in a double taxation convention. When a company is resident in the territory of both parties a tie-breaker generally awards residence to the country where the effective management of the company is situated.

85. The two main statutory rules are found in section 66 of FA 1988 and section 249 of FA 1994. These two tests are rewritten in this Chapter.

86. Under section 66 of FA 1988 a company incorporated in the United Kingdom is, with some exceptions, regarded as resident here for all tax purposes. This overrides the rule in common law given above, although the common law test continues for companies outside section 66, that is to say companies which are not incorporated in the United Kingdom.

87. Section 249 of FA 1994 treats a company resident in the United Kingdom under the common law test or section 66 of FA 1998 as being non-UK resident if the tie-breaker in the double taxation treaty between the United Kingdom and that other territory would make the company resident outside the United Kingdom.

88. Both these statutory rules apply for the purposes of the Taxes Acts as defined in section 118 of TMA (see section 66(1) and 66A(2) of FA 1988 and section 249(1) of FA 1994). This Act rewrites the rules for the purposes of the Corporation Tax Acts only. Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, Schedule 1 to this Act inserts new sections into TMA, TCGA and ITA to apply the rules given in this Chapter to those Acts.

Section 13: Overview of Chapter

89. This section sets out which residence rules are dealt with in this Chapter. It is new.

90. Although this Chapter does not legislate the common law test on residence (see above), *subsection (3)* makes clear that section 15 applies where a company has been resident in the United Kingdom under that test.

Section 14: Companies incorporated in the United Kingdom

91. This section provides that a company incorporated in the United Kingdom is resident here for corporation tax purposes and, under section 5, is within the charge to corporation tax on all its income and chargeable gains. It is based on section 66(1) of FA 1988.

92. *Subsection (2)* makes it clear that a company which is resident in the United Kingdom under *subsection (1)* is not resident in any other territory.

93. Although section 66 of FA 1988 and section 249 of FA 1994 refer to a company being "regarded as" resident it is not considered necessary to adopt that or similar wording. A company is simply resident somewhere.

Section 15: Continuation of residence established under common law

94. This section gives rules on residence for companies which are not incorporated in the United Kingdom. Companies which were UK resident immediately before they ceased business or came under the control of a foreign liquidator continue to be treated as UK resident. The section is based on section 66(2) of FA 1988.

95. This section clarifies that the provision applies only to companies which are not incorporated in the United Kingdom. That is less clear in the source legislation. Any United Kingdom incorporated company which ceases business or is being wound up outside the United Kingdom is already UK resident under the rule in the previous section.

96. The purpose of the rule in this section is to provide that a company which is resident in the United Kingdom through central management and control (see above) remains resident here. Such a company could otherwise become non-UK resident if central management and control left the United Kingdom.

97. Section 66(4) of FA 1998 gives effect to Schedule 7 to that Act, the commencement and transitional provisions. Paragraphs of that Schedule which are not spent are rewritten in Schedule 2 (transitionals and savings) to this Act.

Section 16: SEs which transfer registered office to the United Kingdom

98. This section provides that once an SE ("Societas Europaea" – see section 1319) has transferred its registered office to the United Kingdom it becomes and remains resident there, notwithstanding its residence elsewhere under overseas law or the subsequent transfer of its office abroad. The section is based on section 66A of FA 1988.

99. This section applies only to SEs which transfer their registered office to the United Kingdom since SEs that are formed here are resident in the United Kingdom in any event under section 14.

100. Once the registered office is moved to the United Kingdom the SE is effectively treated as if it were incorporated there. It cannot cease to be resident at any time simply by transferring its registered office.

Section 17: SCEs which transfer registered office to the United Kingdom

101. This section provides the same rule for SCEs (European Cooperative Societies – see section 1319) that section 16 provides for SEs. It is based on section 66A of FA 1988.

Section 18: Companies treated as non-UK resident under double taxation arrangements

102. Under this section a company which is resident in the United Kingdom, but treated under a double taxation convention as resident in a territory outside the United Kingdom, is resident outside the United Kingdom for corporation tax purposes. The section is based on section 249 of FA 1994.

103. Section 250 of FA 1994 is spent. It is repealed by this Act.

Chapter 4: Non-UK resident companies: chargeable profits

Overview

104. This Chapter sets out which profits of a non-UK resident company are liable to corporation tax. It is based on sections 11 and 11AA of, and Schedule A1 to, ICTA.

105. The Schedules themselves contain rules on territorial scope. Section 18(1)(a)(i) and (ii) of ICTA brings within the charge to tax under Schedule D annual profits or gains accruing to a *UK resident* from (a) any kind of property whatever wherever situated and (b) from any trade wherever carried on. Section 18(1)(a)(iii) brings within the same charge to tax annual profits or gains accruing to a *non-UK resident* from any property in the United Kingdom or from any trade or profession exercised there. Section 18 of ICTA is not itself a charge but a method of computing and marshalling under a Schedule income that is charged to tax under section 6 of ICTA.

106. Section 9 and section 18(4A) of ICTA apply section 18(1) (Schedule D) of ICTA for corporation tax purposes. But section 11 of ICTA sets out another rule on the scope of the corporation tax charge on a non-UK resident company.

107. The scope of Schedule D in section 18 of ICTA is narrower than the charge in section 11 of ICTA. Under section 18 non-UK residents are only liable to tax in respect of annual profits or gains from property in the United Kingdom or from trades exercised there. Under section 11 a non-UK resident company is chargeable to corporation tax on all profits wherever arising that are attributable to its permanent establishment in the United Kingdom and on income from property or rights held by or for the permanent establishment through which it trades. There is no requirement that that property should be in the United Kingdom.

108. The seventh edition (1999) of *Taxation of Companies and Company Reconstructions* by Bramwell *et al* (footnote to page 421) says of section 11(2):

> These words appear to be rather wider than the income tax "profits or gains arising from any trade exercised within the United Kingdom". It is possible that the corporation tax charge on trading profits extends beyond the income tax charge, perhaps, for example, in the area of overseas activities connected with a United Kingdom branch.

109. Section 70(3) of ICTA enables a non-UK resident company to be charged to corporation tax under Schedule D Case V.

110. Prior to the removal of Case IV for corporation tax purposes in FA 1996, section 70(3) of ICTA extended Schedule D Cases IV and V to non-UK residents. (The replacement of "Case IV" by "Case III" as a consequential amendment in FA 1996 made little sense since section 18(3A) of ICTA already brought income arising outside the United Kingdom into Schedule D Case III for corporation tax purposes.)

111. The FA 1965 Notes on Clauses for the section on which section 70(3) of ICTA is based read:

> (This clause) provides machinery for charging any overseas income attributable to the branch in the United Kingdom of a non-resident company trading here through the branch. Such a branch may have funds which are recognisably attributable to branch operations but deposited abroad and earning interest whilst still held to the branch's account. The machinery selected is that of Cases IV and V (which applies to overseas income of residents of the United Kingdom).

112. Section 70(3) of ICTA would seem to confirm that non-UK resident companies can be charged on income arising outside the United Kingdom and thus confirm the wider scope and precedence of section 11 of ICTA over section 18(1)(a)(iii) of ICTA (see above).

113. Section 18(1)(a)(iii) of ICTA is therefore redundant for corporation tax purposes because it adds nothing to section 8 of ICTA, which deals with the scope of corporation tax generally, and section 11 of ICTA.

114. Section 70(3) is not rewritten. The section adds nothing to the basic position of a non-UK resident company under sections 5(3) and (4) and 19. Moreover the parenthetical words in section 70(3) ("but without prejudice to any provision of the Tax Acts especially exempting non-residents from tax on any particular description of income") apply on first principles to income falling within the definition of "chargeable profits".

115. A reordering of the sections on permanent establishments in this Chapter is intended to clarify the relationship between the various provisions. First comes the charge on the profits attributable to the permanent establishment followed by an introductory section explaining how the sections are set out and how they apply.

116. This is followed by the sections on the separate enterprise principle. Those that apply this principle specifically to banks are at the end of this group of sections. The special rules on deductions then appear at the end of the Chapter.

117. Much of the terminology employed in sections 11 and 11AA of, and Schedule A1 to, ICTA is shared in common with the Model Tax Treaty and Commentary of the Organisation for Economic Cooperation and Development (OECD). Indeed the legislation is intended to reflect to a considerable degree the Model Treaty and Commentary. This terminology is retained so that the relationship between the two is not lost.

Section 19: Chargeable profits

118. This section sets out what profits of the non-UK resident company are charged to tax. It is based on sections 11(1) to (2A) and 11AA(1) of ICTA.

119. *Subsection (2)* provides that income and chargeable gains form part of the non-UK resident company's chargeable profits only if they are of a type specified in *subsection (3)* and are attributable to the company's permanent establishment. This is a rather different approach to that in section 11(2A) of ICTA but, read with section 11AA(1) of ICTA, it seems that section 11(2A) of ICTA is merely identifying the types of income and gains that are capable of being attributed to the permanent establishment and not giving the amount of those income and gains.

120. Subsection (3)(c) brings into the chargeable profits of a company chargeable gains falling within section 10B of TCGA. The chargeable gains falling within that section are those accruing to a company on the disposal of assets situated in the United Kingdom. Such gains are relevant in this context if the assets in question are connected with the trade carried on by the company through the permanent establishment or are for use by or for the purposes of the establishment.

121. "Permanent establishment" is defined in section 148 of FA 2003 and appears in Schedule 4 (index of defined expressions).

122. Neither the words "subject to any exceptions provided for by the Corporation Tax Acts" nor the second sentence of section 11(2) of ICTA are rewritten as they are considered unnecessary.

Section 20: Profits attributable to permanent establishment: introduction

123. This section describes how the sections that follow are set out and how they apply. It is based on section 11AA(1) of ICTA.

Section 21: The separate enterprise principle

124. This section sets out the basic rule of the separate enterprise principle. It is based on section 11AA(2) and (3) of, and paragraph 1(2) of Schedule A1 to, ICTA.

125. The terms "distinct and separate enterprise" and "credit rating" in this section are unique to section 11AA of ICTA. The former term is taken from Article 7 of the Model Treaty and the latter from the commentary on that article. The meaning of the former is well understood from its use in double taxation conventions while the latter takes its normal commercial meaning, a meaning that is well established through credit ratings given by agencies such as Moody's or Standard and Poor.

Section 22: Transactions treated as being on arm's length terms

126. This section provides the rule for dealing with transactions between the permanent establishment and the rest of the non-UK resident company. It is based on paragraph 2 of Schedule A1 to ICTA.

Section 23: Provision of goods or services for permanent establishment

127. This section sets out the rule for goods and services provided by the non-UK resident company to the permanent establishment. It is based on paragraph 6(1) to (3) of Schedule A1 to ICTA.

128. Although this section deals with both a deduction (expense) – see *subsection (3)* – and the separate enterprise principle, it is grouped with other sections dealing with the separate enterprise principle as that is the main rule here and to separate these elements would be unhelpful.

Section 24: Application to insurance companies

129. This section provides the power for the making of regulations in respect of the application of section 21 to insurance companies. It is based on section 11AA(5) of ICTA.

Section 25: Non-UK resident banks: introduction

130. This section introduces sections 26 to 28 which contain particular provisions applying the separate enterprise principle to banks. It is based on paragraph 7(1) and (2) of Schedule A1 to ICTA.

131. While these provisions are an application of the separate enterprise principle with particular relevance to banks, the principles behind them are applicable to companies other than banks and *subsection (2)* clarifies this point.

Section 26: Transfer of financial assets

132. This section applies the separate enterprise principle to loans or financial assets transferred between the permanent establishment and any other part of the company. It is based on paragraphs 7(1) and 8(1) and (2) of Schedule A1 to ICTA.

133. Each of the sections applying the separate enterprise principle to banks contains the phrase "in accordance with the separate enterprise principle" to clarify that the provisions given are all within the general principle in section 21 and not expressing new principles.

134. *Subsections (3)* and *(4)* retain the term "valid commercial reasons" in paragraph 8(2) of Schedule A1 to ICTA notwithstanding that the usual phrase adopted in rewrite Bills is either "commercial reason" or "genuine commercial reason". This is because "valid commercial reason" is the term used in the Commentary (paragraph 15.2) to Article 7(2) of the treaty.

135. Subsection (4) also contains the term "tax advantage". The term is undefined (as in the source legislation) although its use elsewhere in the Taxes Acts refers to the definition in section 709 of ICTA. The absence of a definition in paragraph 8(2) of Schedule A1 is intentional. It was considered that any attempt to define all possible and future forms of tax advantage in this context would have added complexity for no good purpose.

Section 27: Loans: attribution of financial assets and profits arising

136. This section explains how a financial asset (eg a loan) made by the non-UK resident company and the profits arising from it should be attributed (whether to the permanent establishment or another part of the company). It is based on paragraphs 7(1) and 9(1) and (3) to (5) of Schedule A1 to ICTA. An example would be where a permanent establishment in the United Kingdom obtains new business and passes that business back to the overseas part of the company. Resulting loans, derivatives etc can be attributed to the permanent establishment under this section notwithstanding that they have been issued by an overseas office.

Section 28: Borrowing: permanent establishment acting as agent or intermediary

137. This section applies the separate enterprise principle where a permanent establishment of a non-UK resident bank acts as an agent or intermediary in borrowing funds for another part of the company. It is based on paragraphs 7(1) and 10(1) and (2) of Schedule A1 to ICTA.

Section 29: Allowable deductions

138. This section brings together some general rules on deductions allowable in arriving at the profits of a permanent establishment. It is based on section 11AA(4) of, and paragraph 3(1) and (2) of Schedule A1 to, ICTA.

139. "Executive and general administrative expenses" in *subsection (2)* are not defined. The term is borrowed from Article 7(3) of the OECD Model Treaty. The Commentary on the Model Treaty does not define the term further but "executive expenses" would seem to cover the expenses of higher management of the permanent establishment.

Section 30: Restriction on deductions: costs

140. This section is the first of three sections which restrict deductions in arriving at the attributable profits of a permanent establishment. It provides that no deduction for costs should exceed what would be payable under the separate enterprise principle. It is based on section 11AA(3) of ICTA.

Section 31: Restriction on deductions: payments in respect of intangible assets

141. This section disallows a deduction for inter-company payments for the use of intangibles where the intangible assets are held by the company. The reasoning here is that it is difficult to allocate ownership of intangibles to any one part of a company as if it were an independent enterprise. The section is based on paragraph 4(1) to (3) of Schedule A1 to ICTA.

Section 32: Restriction on deductions: interest or other financing costs

142. This section applies the same principle as the previous section but to interest payments. An exception is, however, made for companies dealing in loans, debts commodities and futures. It is based on paragraph 5(1) to (3) of Schedule A1 to ICTA.

Chapter 5: Supplementary

Section 33: Trade includes office

143. This section provides that trade includes an office in Part 2 of this Act, subject to context. It is based on section 6(4) of ICTA which applies the definition of "trade" in paragraph (b) of that subsection to various provisions of ICTA, except in so far as the context otherwise requires.

144. The reference to "carrying on a trade" in *paragraph (b)* is new. It reflects one of the usages of "trade" in Part 2.

145. The interpretation does not refer to employment or vocation. The treatment of vocations is discussed in *Change 2* in Annex 1. A company does not hold an employment but it is not uncommon for a company to hold an office such as that of company secretary and the charge to corporation tax on income from an office is set out in section 969.

146. Section 969 applies the charge to corporation tax on income under section 2 to income from the holding of an office.

Part 3: Trading income

Overview

147. This Part contains the rules relating to trading income. The Part charges:

- the profits of a trade (charged in the source legislation under Schedule D Case I or V); and
- post-cessation receipts (charged in the source legislation under Schedule D Case VI).

148. The structure of the Part is to:

- identify the income taxed as profits of a trade (Chapter 2);
- calculate the profits of the trade (Chapters 3 to 7);
- apply the rules for particular trades (Chapters 8 and 9);
- apply other rules affecting the calculation of profits of the trade (Chapters 10 to 14); and
- identify the other component of trading income – post-cessation receipts – (Chapter 15).

149. This Part is not an exhaustive statement of the rules for the calculation of trading income. Other regimes may affect that calculation. In particular, Parts 5 to 8 and 11 to 15 of this Act contain rules that may affect trade profits.

150. References to "profits or gains" in the source legislation which relate only to income are rewritten in this Part omitting the reference to "gains". This continues the tidying up of such references started in section 46(3) of, and Schedule 7 to, FA 1998.

Chapter 1: Introduction

Section 34: Overview of Part

151. This section provides an overview of this Part. It is new. The corresponding income tax rule is in section 3 of ITTOIA.

152. In contrast to section 3 of ITTOIA, this section makes no reference to adjustment income. This is because for corporation tax purposes adjustments on a change of basis

of accounting are brought into account in computing trading profits rather than being treated as a distinct category of income.

Chapter 2: Income taxed as trade profits

Overview

153. This Chapter explains what is taxed as profits of a trade. It identifies a number of activities and receipts and sets out how they are treated.

Section 35: Charge to tax on trade profits

154. This section applies the corporation tax charge on income to the profits of a trade. It is based on section 18 of ICTA. The corresponding rule for income tax is in section 5 of ITTOIA.

155. The section does not rewrite the reference to "profession or vocation" in Schedule D Case II. See *Change 2* in Annex 1.

156. Section 832(1) of ICTA provides that "trade" includes "every trade, manufacture, adventure or concern in the nature of trade". This brings within the meaning of trade an isolated transaction (or a small number of transactions) which, while in the nature of trade, is not sufficiently extensive to amount to a trade.

Section 36: Farming and market gardening

157. This section has two functions. First, it treats all farming or market gardening carried on in the United Kingdom as a trade. Second, it treats all farming carried on in the United Kingdom by a particular person as a single trade. It is based on section 53 of ICTA. The rules for income tax are rewritten in section 9 of ITTOIA.

158. *Subsection (1)* deals with the first function. In most cases there will be no doubt that farming is a trade on first principles. Like section 38 of this Act this section can trace its origins back to the time when there was a charge to income tax under Schedule B on the occupation of land. Farming was originally charged under Schedule B. The purpose of section 53 of ICTA and its predecessor provisions was to take the charge on farming out of Schedule B and into Schedule D. With the abolition of Schedule B that function is now spent.

159. But section 53 of ICTA does make clear that even uncommercial farming is treated as a trade. This section preserves that effect.

160. *Subsection (2)* deals with the second function of the section. It provides that all farming carried on by a company in the United Kingdom is treated as a single trade. It makes clear that farming carried on as part of another trade is not included in the single trade of farming.

161. The restriction of subsection (2) to farming in the United Kingdom is derived from the definition of "farming" in section 832(1) of ICTA.

162. Section 53(2) of ICTA uses the expression "particular company or partnership" to make clear that the single trade rule applies also to a firm. It follows that farming carried on by a company as a member of a firm is separate from any farming carried on by that company alone. This rule is dealt with in section 1270 in Part 17 (Partnerships). The corresponding provision for income tax is section 859 of ITTOIA.

163. The definition of "farming" and "market gardening" is given in section 1317 in Part 21 (Other general provisions). The corresponding provision for income tax is section 996 of ITA.

Section 37: Commercial occupation of woodlands

164. This section provides that the commercial occupation of woodlands is not treated as a trade for any corporation tax purpose. It is based on section 53 of ICTA and paragraph 3 of Schedule 6 to FA 1988. The corresponding rule for income tax is in section 11 of ITTOIA.

165. *Subsection (3)* makes clear that when this section is read together with related sections any profits and losses arising from the commercial occupation of woodlands are wholly outside the corporation tax code.

166. This section prevents any charge to tax as trading income and denies any claim for relief for a trade loss. Section 208(b) of this Act performs a similar function in relation to property income. Section 980 prevents there being any charge to tax under Chapter 8 of Part 10 (income not otherwise charged). The corresponding rule for income tax is in section 768 of ITTOIA.

Section 38: Commercial occupation of land other than woodlands

167. This section deals with the commercial occupation of land for purposes other than farming or woodlands. It is based on section 53 of ICTA. The corresponding rule for income tax is in section 10 of ITTOIA.

168. The section treats the commercial occupation of land in the United Kingdom as the carrying on of a trade. It provides certainty of treatment if land is occupied on a commercial basis in circumstances that do not amount to the carrying on of a trade on first principles.

169. The origins of section 53 of ICTA go back to the time when there was a charge to income tax under Schedule B on the occupation of land. The purpose of the Schedule B charge was to tax the profit that an occupier of the land could earn from the land itself, for example, by farming it. The tax was charged whether or not the occupier actually exploited the land.

170. The Schedule B charge was calculated by reference to the annual value of the land. This amount could be considerably less than the amount of profit an occupier could in fact derive from the land. For this reason the basis of charge was switched from Schedule B to Schedule D Case I if the land was farmed or otherwise managed on a commercial basis.

171. The last remnant of Schedule B was repealed by FA 1988. Schedule 6 to FA 1988 exempted any profits and losses from the occupation of commercial woodlands from corporation tax.

172. The provisions of section 53 of ICTA relating to farming are rewritten as section 36 of this Act. The provisions relating to the occupation of commercial woodlands are rewritten as section 37 of this Act.

Section 39: Profits of mines, quarries and other concerns

173. This section treats the profits and losses of certain concerns as if they were the profits and losses of a trade. It is based on section 55 of ICTA. The corresponding rule for income tax is in section 12 of ITTOIA.

174. The feature that most of these concerns have in common is that they exploit land for its natural resources. The section applies only if the activity carried on by the concern does not amount to a trade on first principles. If the activity is a trade on first principles the profits and losses will be taxed in accordance with section 35 of this Act.

175. The section does not deem the concern to be carrying on a trade. The company will not qualify for roll-over relief under section 152 of TCGA on any chargeable gain. That section requires the taxpayer to be carrying on a trade as defined in section 158(2) of

TCGA. If the concern is operated by a company not resident in the United Kingdom that company does not become liable to corporation tax through the application of section 5(2). Section 5(2) requires a trade to be carried on in the United Kingdom.

176. *Subsections (1)* and *(2)* provide that the profits and losses of the concern are calculated and charged to tax as if the concern were a trade. The source legislation was not explicit in this regard. See Part A of *Change 3* in Annex 1. This change reproduces Change 2 in ITTOIA and so brings the income tax and corporation tax codes back into line.

177. *Subsection (3)* provides that the normal loss rules apply. See Part B of *Change 3* in Annex 1.

178. *Subsection (4)* lists the concerns to which the section applies. It updates the reference to "fishings" to "rights of fishing".

179. *Subsection (5)* makes clear that section 38 of this Act has priority over section 39. This is because section 38 treats the activity as if it were a trade. This contrasts with the approach of this section, which is to treat the profits and losses as trade profits and losses. Section 38 may be more beneficial for the company. For example, the activity would qualify as a trade for chargeable gains purposes. See section 158(2) of TCGA.

Section 40: Credit unions

180. This section ensures that most credit unions are not treated as carrying on a trade for tax purposes. It is based on section 487 of ICTA.

181. Credit unions are profit-sharing financial co-operatives, owned and managed by their own members, which offer a convenient way of saving and loans to their members.

182. The members make regular savings, as little or as much as they wish. These savings then form a common pool of money from which loans are made to members. When members have been saving for a certain period of time (usually about 12 weeks) they can apply for a loan from the pool. Interest on the loan is charged at about 1% per month on the monthly reducing balance.

183. There are other rules about credit unions:

- in Part 5 (loan relationships);
- in section 133; and
- in section 1218.

184. *Subsection (1)* is the rule that the usual activities of a credit union are not to be treated as a trade. The rule applies only in the calculation of the credit union's income. So, if the carrying on of a trade is relevant for some other purpose (for instance, the taxation of chargeable gains), and the credit union is in fact carrying on a trade, the position is not disturbed by this rule.

Section 41: Effect of company starting or ceasing to be within charge to corporation tax

185. This section treats a company as starting or ceasing to carry on a trade in particular circumstances. It is based on section 337 of ICTA. The corresponding rule for income tax is in section 18 of ITTOIA.

186. Section 337 of ICTA requires the company's trade or property business income to be calculated as though it had started or ceased to carry on a trade or a property business in two cases. Section 41 deals with trades and section 289 with property businesses.

187. The first trade case is when the company begins or ceases to carry on the trade (section 337(1)(a) of ICTA). Then its profits from that trade are calculated as though the trade had, at that time, begun or ceased. It is not necessary to rewrite this case. It

is dealt with automatically in the rewritten rules because they are "person-based" and do not assume that a particular trade can continue independently of the person actually carrying it on.

188. The second case involves movement by the company into or out of the corporation tax regime (section 337(1)(b) of ICTA). Non-UK resident companies are within the charge to corporation tax only if they are trading, are trading in the United Kingdom, and through a permanent establishment in the United Kingdom. Then they are chargeable to corporation tax on all the profits attributable to that permanent establishment. First meeting or ceasing to meet those conditions can result in a change of taxing regime from income tax to corporation tax or vice versa.

189. Section 41 says what happens when a company enters or leaves the corporation tax regime in respect of the trade: then its trade profits are calculated as though it had started or ceased to carry on the trade. The corresponding income tax rule in section 18 of ITTOIA is a complementary, mirror-image rule which applies when the company enters or leaves the income tax regime in respect of the trade.

Section 42: Tied premises

190. This section treats rent received by a company carrying on a trade, for premises let to persons to whom the company supplies goods sold or used on those premises, as a receipt of the trade rather than a receipt of a property business. It is based on section 98 of ICTA. The corresponding rule for income tax is in section 19 of ITTOIA.

191. Section 98 of ICTA is expressed in general terms. But it most commonly applies to rent received by a brewing company which lets premises to tied tenants.

Section 43: Caravan sites where trade carried on

192. This section allows a company which carries on a trade associated with the operation of a caravan site to include in the receipts of that trade income from letting pitches or caravans where the letting does not itself constitute a trade. It is based on ESC C36. The corresponding rule for income tax is in section 20 of ITTOIA. See *Change 4* in Annex 1.

193. See section 1314 and *Change 96* in Annex 1 for the definition of "caravan".

Section 44: Surplus business accommodation

194. This section allows income from letting surplus business accommodation to be treated as a trade receipt instead of as rent. It is based on the practice known as "Revenue Decision 9" set out in the HMRC publication *Tax Bulletin* of 15 February 1994. The corresponding rule for income tax is in section 21 of ITTOIA. See *Change 5* in Annex 1.

Section 45: Payments for wayleaves

195. This section applies if a trader receives rent from a wayleave granted in respect of land on which a trade is carried on. It is based on section 120 of ICTA. The corresponding rule for income tax is in section 22 of ITTOIA.

196. Rent received in respect of a wayleave is normally taxed as property income either by Chapter 2 of Part 4 of this Act (property businesses) or by section 277 (charge to tax on rent receivable for a UK electric-line wayleave). But if the rent is received in respect of land on which a trader carries on a trade and the trader receives no other rent in respect of the same land the rent, and any associated expenses, can be included in the calculation of the trade profits. See *Change 6* in Annex 1. This change enacts a non-statutory practice, and also makes changes to both practice and the law. It reproduces Change 5 in ITTOIA and so brings the income and corporation tax codes back into line.

197. *Subsection (4)* defines "rent". Section 120 of ICTA uses the definition of "rent" in section 119(3) of ICTA (rent etc. payable in connection with mines, quarries and

similar concerns). Section 119 of ICTA is rewritten in Chapter 7 of Part 4 of this Act. The definition of rent in that Chapter and in this section must be the same. See the commentary on section 271 of this Act for a fuller description of the rewrite of the word "rent" in Chapter 7 of Part 4 of this Act.

198. *Subsection (5)* defines "wayleave". Section 120 of ICTA uses the word "easement" as defined in section 119(3) of ICTA to describe the nature of the right for which the rent is paid. This section uses "wayleave" as that is how most of the payments covered by this section are usually described in practice. The definition of "easement" in section 119(3) of ICTA gives that word a meaning that is much wider than its usual legal meaning. See the comments of Uthwatt J at pages 329 and 330 of Mosley v George Wimpey & Co Ltd (1945), 27 TC 314 CA.

199. The definition of "wayleave" preserves the generality of the words in section 119(3) of ICTA and includes a reference to the Scottish equivalent, "servitude".

200. The definition has no territorial limitation. So the section covers services other than UK electric-line wayleaves.

201. The section does not rewrite the reference to "profession or vocation" in Schedule D Case II. See *Change 2* in Annex 1.

Chapter 3: Trade profits: basic rules

Section 46: Generally accepted accounting practice

202. This section sets out the starting point for the calculation of trade profits. It is based on section 42 of FA 1998. The corresponding rule for income tax is in section 25 of ITTOIA.

203. *Subsection (1)* is the general rule that requires profits to be calculated "in accordance with generally accepted accounting practice", an expression defined in section 50 of FA 2004. In particular, such practice generally requires account to be taken of debtors and creditors and of the value of stock. The general rule is subject to any special rule of law whether expressed in statute or explained by the courts.

204. The relevant statutory laws are mainly those that are rewritten in this Part. But there are also provisions not included in Part 3 of this Act which may affect the calculation of profits: for example, the pension contributions deductions provisions in FA 2004 and some anti-avoidance provisions in ICTA that apply to all income types.

205. *Subsection (2)* makes clear that subsection (1) does not bring with it any of the other accounting requirements, such as a formal audit.

206. *Subsection (3)* sets out exceptions to the general rule in subsection (1). Lloyd's underwriters have their own special rules (mostly in Chapter 3 of Part 2 of FA 1993); there are special rules for insurance companies (mostly in Chapter 1 of Part 12 of ICTA and Chapter 1 of Part 2 of FA 1989); and tonnage tax companies (see Schedule 22 to FA 2000) are subject to "special rules" for the calculation of profits.

Section 47: Losses calculated on same basis as profits

207. This section ensures that profits and losses are calculated on a consistent basis. It is based on section 46 of FA 1998. The corresponding rule for income tax is in section 26 of ITTOIA.

Section 48: Receipts and expenses

208. This section is based on section 46 of FA 1998. The corresponding rule for income tax is in section 27 of ITTOIA.

Section 49: Items treated as receipts and expenses

209. This section signposts rules affecting trade profits that are elsewhere in the Corporation Tax Acts. It is new. The corresponding rule for income tax is in section 28 of ITTOIA.

210. In particular the CAA rules override the rules against the inclusion of capital items in sections 53 and 93 of this Act.

Section 50: Animals kept for trade purposes

211. This section contains the basic rule for the corporation tax treatment of animals. It is based on paragraphs 1, 7 and 9 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 30 of ITTOIA. The animals are treated as trading stock unless a herd basis election is made under Chapter 8 of this Part.

Section 51: Relationship between rules prohibiting and allowing deductions

212. This section makes clear the interaction between those provisions that allow a deduction and those provisions that prohibit a deduction. It is new. See *Change 7* in Annex 1. The corresponding rule for income tax is in section 31 of ICTA.

213. The general principle is that a rule allowing a deduction takes priority over a rule prohibiting a deduction. But this is subject to a number of exceptions.

Section 52: Apportionment etc of profits and losses to accounting period

214. This section provides for apportionment of profits and losses when a company's period of account does not coincide with an accounting period. It is based on section 72 of ICTA. That section is rewritten for income tax purposes in sections 203 and 871 of ITTOIA.

215. This section does not carry over the rewrite change in sections 203(4) and 871(5) of ITTOIA whereby apportionment is permitted by a measure of time other than the days permitted by section 72(2) of ICTA. HMRC has a long-established view that days cannot be split into accounting periods. That helps prevent exploitation of the wider range of reliefs available in the rather different context of corporation tax.

Chapter 4: Trade profits: rules restricting deductions

Overview

216. This Chapter contains provisions prohibiting various deductions in calculating the profits of a trade or restricting the extent to which such deductions can be made.

Section 53: Capital expenditure

217. This section prohibits deductions for capital expenditure and is based on section 74(1)(f) of ICTA. The corresponding rule for income tax is in section 33 of ITTOIA.

218. It is a long-established and generally accepted principle that capital items are ignored in calculating the profits of a trade and the question whether a sum is income or capital is ultimately a question of law, not accountancy. For judicial authority for this proposition, see, for example the words of Brightman J on page 173 of ECC Quarries Ltd v Watkis (1975), 51 TC 153 ChD[1]:

> …unchallenged evidence, or a finding, that a sum falls to be treated as capital or income on principles of correct accountancy practice is not decisive of the question whether in law the expenditure is of a capital or an income nature.

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1 STC [1975] 578

219. A sum which is of a capital nature may however be allowed as a deduction in calculating the profits of a trade because of a statutory exception to the general rule on the deduction of such items in this section. See, for example, section 89 (expenses connected with patents).

220. In the absence of general agreement on what constitutes capital expenditure "items of a capital nature" is not defined.

221. Section 74(1)(g) of ICTA is redundant as the deduction of capital employed in the improvement of premises is covered by the general prohibition on the deduction of "items of a capital nature". So this Act repeals section 74(1)(g) of ICTA without rewriting it.

Section 54: Expenses not wholly and exclusively for trade and unconnected losses

222. This section contains rules for the deduction of expenses and losses in calculating the profits of a trade. It is based on section 74(1)(a) (expenses) and (e) (losses) of ICTA. The corresponding rules for income tax are in section 34 of ITTOIA.

223. Section 74(1)(a) of ICTA provides that in calculating the profits of a trade no deduction is allowed for expenditure which is not incurred "wholly and exclusively" for the purposes of that trade. This could be construed to mean that if expenditure is incurred partly for trade purposes and partly for some other purposes, no part of that expenditure can be deducted in arriving at the trade profits.

224. But section 74(1)(c) of ICTA, which prohibits any deduction in respect of the rent of premises used for residential or "domestic" purposes, provides for the *apportionment* of rent paid for premises used partly as residential accommodation and partly for the purposes of a trade. And in practice a deduction is allowed for any expenditure which can be apportioned between trade and non-trade expenditure – for example, expenditure on a car used partly for trade and partly for private purposes.

225. There is judicial support for allowing a deduction where expenditure incurred for more than one purpose can reasonably be apportioned between expenditure incurred for the purpose of the trade and non-trade expenditure. See, for example, Lochgelly Iron and Coal Company Ltd v Crawford (1913), 6 TC 267 CS, in which a deduction was allowed for part of a subscription to a trade association and Copeman v William Flood & Sons Ltd (1941), 24 TC 53 KB, in which the High Court remitted the case to the Commissioners to find as a fact whether the remuneration paid to certain directors who were also shareholders in the family company was wholly and exclusively expended for the purpose of the Company's trade, and if not, how much of the remuneration was so expended.

226. Conversely, the courts have held that if it is not possible to identify any part of the expenditure that is incurred wholly and exclusively for the purposes of the trade, no apportionment is possible. See, for example, Mallalieu v Drummond (1983), 57 TC 330 HL[2] in which no deduction was allowable for clothing worn for warmth and decency as well as being required by the taxpayer's profession.

227. So *subsection (2)* of this section provides for the deduction of any part or proportion of expenses incurred partly for the purposes of the trade and partly for some other purpose that can be identified as incurred wholly and exclusively for the purposes of the trade. Rent on dual purpose accommodation can be apportioned under subsection (2) of this section. So this Act repeals section 74(1)(c) of ICTA without rewriting it.

Section 55: Bad debts

228. This section is based on the rule restricting relief for some debts in section 88D of ICTA. It also rewrites the relief in section 89 of ICTA for debts proved irrecoverable after a

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trade is treated as having ceased. See *Change 8* in Annex 1. The corresponding rule for income tax is in section 35 of ITTOIA.

229. *Subsection (2)(a)* refers to a deduction "by way of impairment loss". That expression is not defined for the purpose of this section. But section 476(1) defines "impairment loss" for the purposes of the loan relationships legislation as "a debit in respect of the impairment of a financial asset". "Impairment" includes "uncollectability".

230. *Subsection (2)(b)* deals with debts released as part of a "statutory insolvency arrangement", which is defined in section 834(1) of ICTA.

231. *Subsection (3)* provides a definition that clarifies the scope of the section. All money debts (see section 303) arising in a trade that produce an impairment loss are within the loan relationships rules (see section 479). Even if a money trade debt is released as part of a statutory insolvency arrangement any loss on the debt is within the extended meaning of "impairment" in section 476(1).

232. There is a corresponding rule for income from holding an office in section 970.

Section 56: Car or motor cycle hire

233. This section restricts the amount that a company can deduct in respect of the cost of hiring certain cars or motor cycles with a retail price (when new) of more than £12,000. The restriction increases in line with the retail price. The section is based on sections 578A and 578B of ICTA. The corresponding rule for income tax is in section 48 of ITTOIA.

234. Section 578B(1) of ICTA says that for the purposes of section 578A of ICTA "car" includes a motor cycle. So this section and section 57 refer to a "car or motor cycle" throughout.

235. Section 578A(4) of ICTA provides for amounts in respect of hire charges brought into account as a receipt of the trade under section 94 of ICTA (see section 94 of this Act) to be reduced in the same proportion as the deduction in respect of those charges is reduced under section 578A(3) of ICTA. *Subsection (4)* of this section extends the same treatment to amounts in respect of hire charges taxed as a post-cessation receipt under section 193 (debts released after cessation). See *Change 9* in Annex 1.

Section 57: Car or motor cycle hire: supplementary

236. This section defines various terms and is based on section 578B of ICTA. The corresponding rule for income tax is in section 49 of ITTOIA.

237. Section 578B(2) of ICTA defines "qualifying hire car" for the purposes of section 578A of ICTA as a car hired under a hire-purchase agreement subject to an option to purchase which is exercisable for a nominal amount.

238. Not all hire-purchase agreements require the hirer to exercise an option at the end of the hire period. Under some types of agreement, ownership of the vehicle passes automatically to the hirer at the end of the hire period. So *subsection (2)(a)* of this section extends the definition of "qualifying hire car or motor cycle" to include a car or motor cycle where ownership passes without the exercise of an option to purchase. See *Change 10* in Annex 1.

Section 58: Hiring cars (but not motor cycles) with low CO2 emissions before 1 April 2013

239. This section excludes certain cars hired before 1 April 2013 under a contract entered into before that date from the restriction in section 56. It is based on section 578A(2A) and (2B) of ICTA and section 60 of FA 2002. The corresponding rule for income tax is in section 50 of ITTOIA.

240. *Subsection (2)* defines low emissions by reference to section 45D of CAA. A transitional rule in Schedule 1 to this Act provides that, for a car hired on or before 31 March 2008, the carbon emissions limit in section 45D(4) of CAA remains 120 grams instead of the new limit of 110 grams.

Section 59: Patent royalties

241. This section prohibits a deduction for patent royalties. It is based on section 74(1)(p) of ICTA.

242. For most patent royalties this rule is overridden by the rules of the intangible fixed assets regime (rewritten in Part 8 of this Act) which provide relief for trades as well as other commercial activities (see, in particular, section 728(5) and Chapter 6 of Part 8 of this Act). But for a minority of cases, this section will remain relevant and will continue to prevent a deduction. That includes, for example, cases where the royalty is in respect of an intangible asset that is not a fixed asset of the payer's trade.

Section 60: Expenditure on integral features

243. This section draws attention to the rule in section 33A(3) of CAA. There is a signpost to that rule in section 74(1)(da) of ICTA. That subsection is repealed. The signpost is not formally rewritten but it is replaced in this section (and in the property income section 263).

Chapter 5: Trade profits: rules allowing deductions

Overview

244. This Chapter contains provisions allowing various deductions in calculating the profits of a trade.

Section 61: Pre-trading expenses

245. This section gives relief for expenses incurred before a trade starts. It is based on section 401 of ICTA. The corresponding rule for income tax is in section 57 of ITTOIA.

246. *Subsection (1)* sets the scene. Consistent with other rules in this Part, it refers to the "date" on which (instead of the "time" when) a company starts to trade.

Section 62: Tenants under taxed leases: introduction

247. This section provides for the following five sections to apply where a tenant, under a taxed lease, uses land for the purposes of a trade. It is based on section 87(1), (2), (8) and (9A) of ICTA. The corresponding provision for income tax is in section 60 of ITTOIA.

248. Chapter 4 of Part 4 (profits of property businesses: lease premiums etc) contains provisions (in sections 217 to 222) treating certain premiums, and other amounts, relating to a lease ("the taxed lease") as giving rise to receipts of a property business (of amount X). Chapter 4 of Part 4 also provides that in certain cases a tenant under the taxed lease obtains relief in respect of all, or part, of X:

- by reducing the amount of another property business receipt (sections 227 to 230), or
- by being treated as an expense of a property business (sections 231 to 234).

249. Sections 62 to 67 provide for certain cases in which a tenant under the taxed lease obtains relief as a trading expense in respect of all, or part, of X.

250. *Subsection (1)* extends relief to cases in which X arose in relation to a lease of land outside the United Kingdom. See *Change 11* in Annex 1. This is in accordance with

the policy of treating UK and overseas property businesses in the same way as far as possible.

251. The amount which a tenant can deduct in respect of rent which it is treated as paying under section 87(2) of ICTA is qualified by:

- the general rules as to deductions not allowable in computing the profits of a trade in section 74(1) of ICTA; and
- rules prohibiting or restricting the deduction of specific expenditure elsewhere in ICTA.

252. In this Act, the rules restricting deductions are in Chapter 4 of this Part and section 74(1)(a) of ICTA is rewritten in that Chapter in section 54. *Subsection (3)* preserves the interaction of section 87(2) of ICTA and the general and specific rules restricting deductions in ICTA by providing that a deduction for an expense which a tenant is treated as incurring under section 63 is subject to the application of any provision of Chapter 4 of this Part.

Section 63: Tenants occupying land for purposes of trade treated as incurring expenses

253. This section treats a tenant under a lease, in respect of which an amount is brought into account by the landlord, (a "taxed lease") as incurring an expense for each day on which the property held under the lease is occupied for the purposes of the tenant's trade. It is based on section 87(2), (3) and (9) of ICTA. The corresponding rule for income tax is in section 61 of ITTOIA.

254. Sections 217 to 222 provide for a company to bring an amount into account as a receipt of a property business in cases where the company has granted a short-term lease at a premium (or in certain other cases).

255. Sections 277 to 282 of ITTOIA make corresponding provision for a person to bring an amount into account as a receipt of a property business for income tax.

256. *Subsection (1)* treats a tenant which, for a qualifying day, occupies land for the purposes of a trade as incurring an expense. This corresponds to the treatment of the landlord who has been, or would have been (see section 227(4)), treated as receiving a receipt ("taxed receipt") of the landlord's property business.

257. The formula in *subsection (4)* calculates the expense for each qualifying day by spreading an amount in respect of the taxed receipt evenly over the receipt period of that receipt. Defining "A" in that formula as "the unreduced amount of the taxed receipt" makes clear that the amount of the expense which the tenant is treated as incurring for each qualifying day is calculated by reference to the amount of the taxed receipt *before* any reductions or deductions.

258. *Subsection (5)* modifies that formula for a qualifying day on which the tenant occupies only part of the land subject to the taxed lease for the purposes of a trade. The subsection requires the fraction of the land which is occupied by the tenant for the purposes of the trade to be calculated "on a just and reasonable basis", where section 87(3) of ICTA requires a "just apportionment". See *Change 12* in Annex 1.

Section 64: Limit on deductions if tenant entitled to mineral extraction allowance

259. This section prevents a double deduction where a tenant is entitled under section 403 of CAA to an allowance in respect of qualifying expenditure on acquiring a mineral asset. It is based on section 87(7) of ICTA. The corresponding rule for income tax is in section 62 of ITTOIA.

Section 65: Tenants dealing with land as property employed for purposes of trade

260. This section applies to a tenant which, while not occupying a property, uses the property for the purposes of a trade – for example a company which lets premises held under a taxed lease to a person who sells only goods supplied by that company. It is based on section 87(4) and (6) of ICTA. The corresponding rule for income tax is in section 63 of ITTOIA.

261. *Subsection (2)* treats the tenant as if it occupied the property, or part of it, for the purposes of relief under section 63.

262. *Subsection (3)* prevents the tenant obtaining relief under section 63 to the extent that relief for the same day is allowed in calculating the profits of the tenant's property business under section 232.

Section 66: Restrictions on section 63 expenses: lease premium receipts

263. This section restricts the expenses that section 65 treats a tenant as incurring, under section 63, by reference to the unreduced amount of a taxed receipt under a taxed lease if:

- a sublease has been granted out of the taxed lease; and
- in respect of the sublease, the unreduced amount of the taxed receipt reduces an amount which is brought into account as a receipt under Chapter 4 of Part 4 of this Act or the corresponding provisions in ITTOIA (the "lease premium receipt").

This section is based on sections 87(5) and 87A of ICTA. The corresponding rule for income tax is in section 64 of ITTOIA.

264. The restriction in this section extends to cases where the unreduced amount of the taxed receipt reduces a lease premium receipt of an overseas property business. See *Change 11* in Annex 1.

265. Section 63 treats the tenant as incurring an expense for each qualifying day in the receipt period of the taxed receipt relating to the taxed lease. The expense is calculated by reference to the unreduced amount of the taxed receipt.

266. If, in respect of the sublease, the unreduced amount of the taxed receipt is used to reduce:

- under section 228, the amount brought into account as a lease premium receipt under Chapter 4 of Part 4 of this Act; or
- under section 288 of ITTOIA, the amount brought into account as a lease premium receipt under Chapter 4 of Part 3 of ITTOIA,

this section makes a corresponding reduction to the amount of the expense which section 63 treats as incurred by the tenant for a qualifying day in the receipt period of the lease premium receipt.

267. *Subsections (3)* to *(5)* treat the tenant as incurring an expense for a qualifying day of the amount, if any, by which the "daily amount" of the taxed receipt exceeds:

- the "daily reduction" of the lease premium receipt; or
- if the qualifying day falls within the receipt period of more than one lease premium receipt, the "*total* of the daily reductions" of those lease premium receipts.

268. This corresponds to the treatment in section 233 of cases where lease premium receipts, with overlapping receipt periods, are reduced by reference to the unreduced amount of a single taxed receipt. See *Change 13* in Annex 1.

269. *Subsection (6)* contains formulas for calculating the "daily amount" of a taxed receipt and the "daily reduction" of a lease premium receipt. The subsection provides that the

"daily reduction" only takes account of the taxed receipt in question. This corresponds to the treatment in section 233 of cases where more than one taxed receipt reduces a single lease premium receipt. See *Change 13* in Annex 1.

Section 67: Restrictions on section 63 expenses: lease of part of premises

270. This section adapts section 63 if section 66 applies but the sublease does not extend to the whole of the premises subject to the taxed lease. It is based on sections 87(5) and 87A of ICTA. The corresponding rule for income tax is in section 65 of ITTOIA.

271. *Subsection (4)* deals with the case where, for a qualifying day, there is more than one lease premium receipt, relating to subleases that do not extend to the whole of the premises, that has been reduced by the taxed receipt. This corresponds to the treatment in section 234(5) of expenses under sections 232 and 233 where more than one lease premium receipt falls to be reduced by reference to the same taxed receipt. See *Change 13* in Annex 1.

272. *Subsection (5)* adapts the formulas in sections 63(4) and 66(6) by multiplying the unreduced amount of the taxed receipt in those formulas ("A") by the fraction of the premises to which the sublease relates.

273. *Subsection (6)* requires the fraction in subsection (5) to be calculated "on a just and reasonable basis", where section 87(5) of ICTA, which applies section 37(6) of ICTA, is not explicit about the necessary basis of apportionment. See *Change 12* in Annex 1.

Section 68: Replacement and alteration of trade tools

274. This section allows a deduction for the cost of replacing or altering trade tools if the *only* reason a deduction would not be allowed is that the expenditure is of a capital nature. It is based on that part of section 74(1)(d) of ICTA which relates to deductions in respect of the replacement ("supply") or alteration of implements, utensils or other articles employed for the purposes of the trade. The corresponding rule for income tax is in section 68 of ITTOIA.

275. Expenditure on repairing trade premises or tools is revenue under the normal rules. And following the Special Commissioners decision in Jenners Princes Street Edinburgh Ltd v CIR (1998), SpC000166[3], it is generally accepted that the reference in section 74(1)(d) of ICTA to expenditure "beyond the sum actually expended" does not prohibit the deduction of a provision for repairs if the cost of the repairs would be allowable. So that part of section 74(1)(d) of ICTA which deals with repairs is redundant and is not rewritten.

Section 69: Payments for restrictive undertakings

276. This section allows a company to deduct certain amounts paid to employees for restrictive undertakings. Such amounts might not otherwise be deductible to the extent that they are capital in nature or fall foul of the "wholly and exclusively" rule. The section is based on section 73(2) of FA 1988. The corresponding rule for income tax is in section 69 of ITTOIA.

277. Section 73(2) of FA 1988 applies only to amounts brought into charge on the employee as earnings under section 225 of ITEPA. The former cross-refers to the latter where the definition of the amounts concerned is set out:

In this section "restrictive undertaking" means an undertaking which restricts the individual's conduct or activities.

For this purpose it does not matter whether or not the undertaking is legally enforceable or is qualified.

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278. *Subsection (1)* provides for the deduction. In so doing it focuses on the key element for the rule to apply: the fact of payment.

279. *Subsection (2)* provides a timing rule. The deduction allowed by section 73 of FA 1988 is taken in the accounting period in which the payment is made and no deduction is allowed in any other period. Similar words are used in sections 77 and 88. This ensures that the timing rules for deductions in this Chapter which depend on payment are explicit and consistent.

Section 70: Employees seconded to charities and educational establishments

280. This section allows a company carrying on a trade to deduct the cost of an employee seconded to a charity or educational establishment in calculating the trade profits. It is based on section 86 of ICTA. The corresponding rule for income tax is in section 70 of ITTOIA.

281. Section 86 of ICTA allows a company which seconds an employee to a charity or educational establishment to deduct the cost of employing the seconded person *to the extent that* those costs would have been deductible if the employee continued to be employed for the purposes of the employer's trade. This section allows the employer to deduct *all* costs attributable to the seconded employee during the period of the secondment, regardless of whether those costs would have been allowed if the employee had not been seconded. See *Change 14* in Annex 1.

Section 71: Educational establishments

282. This section defines "educational establishment" for the purposes of section 70. It is based on section 86 of ICTA. The corresponding rule for income tax is in section 71 of ITTOIA.

283. Section 86(4)(c) of ICTA refers to an independent school registered under section 465 of the Education Act 1996. Section 465 of the Education Act 1996 was repealed by the Education Act 2002. So *subsection (1)(c)* of this section refers instead to an independent school registered under section 161 of the 2002 Act.

284. Schedule 1 to this Act makes corresponding amendments to section 71 of ITTOIA.

Section 72: Payroll deduction schemes: contributions to agents' expenses

285. This section allows an employer a deduction for expenses incurred in operating a payroll deduction scheme. It is based on section 86A of ICTA. The corresponding rule for income tax is in section 72 of ITTOIA.

286. The main rules for payroll deduction schemes are found in Part 12 of ITEPA. Under such a scheme an employer deducts charitable donations from employees' salaries and pays them to an agent, who distributes them to the employees' chosen charities.

287. The agent's administrative costs may be deducted from the donations. But many employers voluntarily pay the costs themselves so that the employees' full donations can go to the chosen charities.

288. Normally, payments made voluntarily to meet someone else's expenses are not made wholly and exclusively for the purposes of a trade and therefore would not be deductible. Employers might get relief for donations to charitable agencies under the Gift Aid scheme. But there are restrictions on the operation of that scheme and relief would not be available if the agent was not itself a charity.

289. This section gives relief for the expenses as a trading deduction.

290. The section does not rewrite the reference to "profession or vocation" in Schedule D Case II. See *Change 2* in Annex 1.

Section 73: Counselling and other outplacement services

291. This section allows a deduction for certain expenses of counselling provided for employees. It is based on sections 589A and 589B of ICTA. The corresponding rule for income tax is in section 73 of ITTOIA.

292. *Subsection (3)* cross-refers to ITEPA for the conditions that need to be met for the deduction to be allowed (section 310 of ITEPA exempts the employee from tax in respect of counselling received).

Section 74: Retraining courses

293. This section allows a deduction for certain expenses of retraining provided for employees. It is based on section 588 of ICTA. The corresponding rule for income tax is in section 74 of ITTOIA.

294. *Subsection (2)* cross-refers to ITEPA for the conditions that need to be met for the deduction to be allowed (section 311 of ITEPA exempts the employee from tax in respect of qualifying retraining courses).

295. The section does not rewrite section 588(3)(b) of ICTA. That provision makes a deduction in calculating the employer's trade profits conditional on the employee's exemption under section 311 of ITEPA in respect of the expenditure in question. This condition is not consistent with the similar provision rewritten in section 73 and does not serve any material purpose. See *Change 16* in Annex 1.

Section 75: Retraining courses: recovery of tax

296. This section allows the recovery of tax when a deduction under section 74 proves to have been wrongly allowed. It is based on section 588 of ICTA. The corresponding rule for income tax is in section 75 of ITTOIA.

297. *Subsection (2)*, like section 74(2) of this Act, cross-refers to the relevant provisions in ITEPA to refer to the conditions that have not been met.

Sections 76 to 81: Redundancy payments etc

Overview

298. These six sections are based on the trading income rules relating to redundancy payments in sections 90, 579 and 580 of ICTA. The rules that deal with the employee's liability are in section 309 of ITEPA. The corresponding rules for income tax are in sections 76 to 80 of ITTOIA.

299. The trading income rules were introduced to reverse the decisions in CIR v Anglo Brewing Co Ltd (1925), 12 TC 803 and Godden v A Wilson's Stores (Holdings) Ltd (1962), 40 TC 161. In those cases the courts held that certain payments to employees on the closing down of a trade were not deductible in arriving at trading profits. In neither case was the payment made in accordance with a pre-existing obligation.

300. In 1999 HMRC announced (Tax Bulletin 39G, February 1999) that they would be guided by the decision in Commissioner of Inland Revenue v Cosmotron Manufacturing Co Ltd (1997), 70 TC 292[4].

301. In that Hong Kong case the Privy Council decided that redundancy payments made under a pre-existing obligation are deductible. Although that decision is merely persuasive in the United Kingdom, HMRC do not argue that payments made under a pre-existing obligation (including a statutory obligation) are covered by the Anglo Brewing and Wilson's Stores decisions. The announcement in Tax Bulletin means

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that it may not be necessary to give the employer a statutory right to a deduction in calculating trading profits. But these sections put the matter beyond doubt.

Section 76: Redundancy payments and approved contractual payments

302. This section sets out the circumstances in which the following three sections apply and explains the terms used in the main provisions. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 76 of ITTOIA.

303. The sections retain the label "redundancy payment" (from section 579 of ICTA) and the expression "additional payment" (from section 90 of ICTA). This section also introduces the label "approved contractual payment" to describe the payments that may replace redundancy payments in some cases.

Section 77: Payments in respect of employment wholly in employer's trade

304. This section sets out the main rule governing redundancy payments made by an employer. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 77 of ITTOIA.

305. If a payment is otherwise allowable (possibly as a result of the Cosmotron decision – see the overview for this group of sections), this section does not interfere with the accountancy treatment of the payment. In that case, the normal accounting basis applies.

306. The deduction allowed by section 579 of ICTA is for "a redundancy payment ... made". It is clear that a deduction is allowed only if a payment has been made. It follows that the deduction is to be taken in the accounting period in which the payment is made and that no deduction is allowed in any other period.

307. Section 579(2)(b) of ICTA sets out the rule that applies if a redundancy payment is made after the discontinuance of the employer's trade. The rule applies if the company ceases to carry on a trade or to be within the charge to corporation tax (see section 41 of this Act).

308. In the case of a trade carried on by a company in partnership, section 114(1)(c) of ICTA deals with a change of membership of a partnership. The profits of the trade are calculated as if there is a transfer of the trade from one deemed company to another, unless a particular company carries on the trade before and after the change. Such a transfer means that the first deemed company ceases to carry on the trade. This brings it within the rule in section 579(2)(b) of ICTA.

309. *Subsection (5)* of the section sets out the partnership rule.

310. *Subsection (6)* has a timing rule expressed in words similar to those used in sections 69 and 88 of this Act. This ensures that the timing rules for deductions in Chapter 5 of Part 3 of this Act which depend on payment are explicit and consistent. This special timing rule applies if the payment is allowable only as a result of this section.

Section 78: Payments in respect of employment in more than one capacity

311. This section deals with the case where the employee is employed in more than one capacity. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 78 of ITTOIA. The section covers the case where there is a non-trade element in the employment and makes clear what part of the payment is allowed as a deduction in calculating trade profits.

312. Section 579(5) of ICTA does not specify the basis on which to apportion the payment. This section adopts the "just and reasonable" apportionment that is used consistently in this Act. See *Change 12* in Annex 1.

Section 79: Additional payments

313. This section deals with any voluntary payments that an employer makes in addition to the statutory (or approved) payments dealt with in section 77. It is based on section 90 of ICTA. The corresponding rule for income tax is in section 79 of ITTOIA.

314. Unlike the payments in section 77, these additional payments are allowable only if the sole reason for their disallowance is the cessation of the trade.

315. The section applies to payments in connection with the cessation of *part* of a trade in the same way as it applies to payments in connection with the cessation of a whole trade. See *Change 17* in Annex 1.

Section 80: Application of section 79 in cases involving partnerships

316. This section clarifies what happens on a change of partnership. It is based on sections 90 and 114 of ICTA. The corresponding rule for income tax is in section 79A of ITTOIA (inserted by Schedule 1 to this Act).

317. Section 90(3) of ICTA refers to the "discontinuance" of a trade. That word has to be interpreted in the light of sections 114 and 337 of ICTA: the trade is not treated as discontinued unless there is a complete change in the companies carrying it on.

318. A redundancy payment is not disallowable solely on account of a partial change of companies carrying on a trade. This section puts it beyond doubt that a partial change of companies carrying on a trade does not count as a cessation.

Section 81: Payments made by the Government

319. This section sets out what happens if it is not the employer who makes the redundancy payment to the employee. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 80 of ITTOIA.

320. In some cases the Government makes the payment and is reimbursed by the employer. This section ensures that the employer is allowed a trading deduction.

321. The references in ICTA to section 166 of the Employment Rights Act 1996 and Article 201 of the Employment Rights (Northern Ireland) Order 1996 (SI 1996/1919 (NI 16)) are corrected to section 167 and Article 202.

322. *Subsection (1)(b)* reflects the effect of the devolution settlements. See *Change 15* in Annex 1.

Section 82: Contributions to local enterprise organisations or urban regeneration companies

323. This is the first of five sections that allow deductions for contributions to local enterprise agencies, training and enterprise councils, local enterprise companies in Scotland, business links and urban regeneration companies. The sections are based on sections 79, 79A and 79B of ICTA. The corresponding rules for income tax are in sections 82 to 86 of ITTOIA.

324. Contributions to these bodies are generally donations and are likely to be made for benevolent reasons, rather than wholly and exclusively for the purposes of the trade (see section 54 of this Act).

325. *Subsection (3)* is an anti-avoidance rule. It prevents a company using the section to obtain a deduction for non-trade expenditure, such as funding the training of a member of a shareholder's family, by passing funds through one of these bodies. The source legislation disallows any deduction if there is a benefit to the company (or a connected person). This section merely restricts the deduction by the value of the benefit. See *Change 18* in Annex 1.

326. *Subsections (5)* and *(6)* set out what happens if the company (or a connected person) receives a benefit in connection with the contribution. The charge on the benefit applies if the benefit is received by a person "connected with" the company. That expression is explained in section 1316.

327. Subsection (6)(b) deals with the case where the recipient's trade has ceased before the benefit is received. It treats the benefit explicitly as a post-cessation receipt. See *Change 19* in Annex 1.

328. *Subsection (7)* makes clear the extent of the disallowance under subsection (3) or charge under subsection (6).

329. The subsection limits the "disqualifying benefit" in accordance with HMRC practice. See *Change 18* in Annex 1.

Section 83: Meaning of "local enterprise organisation"

330. This section lists some of the organisations that qualify for deductions to be allowed under section 82. It is based on the definitions in sections 79(4) and 79A(5) of ICTA. The corresponding rule for income tax is in section 83 of ITTOIA.

331. *Subsection (2)* deals with local enterprise agencies. These agencies may take a number of forms and do not have an approval procedure for any other purpose. So the tax legislation specifies that they must be approved for this purpose.

332. The subsection introduces the expression "relevant national authority". The expression is used also in sections 84 and 85.

333. The subsection reflects the effect of the devolution settlements. See *Change 15* in Annex 1. The National Assembly for Wales (Transfer of Functions) Order 1999 (SI 1999/672) devolves the functions of the Secretary of State under section 79 of ICTA to the National Assembly for Wales. So the "relevant national authority" may be the Assembly. But the Order does not refer to section 79A of ICTA. So the equivalent functions in subsections (3) and (5) of this section are still exercised only by the Secretary of State.

334. *Subsections (3)* to *(5)* deal with other bodies to which section 82 applies. These other bodies have to be set up in a particular way for other reasons and the tax legislation merely follows the existing procedures.

Section 84: Approval of local enterprise agencies

335. This section and section 85 set out the detailed rules that apply for the approval of local enterprise agencies and the withdrawal of such approval. They are based on section 79 of ICTA. The corresponding rule for income tax is in section 84 of ITTOIA.

336. The section sets out the basic procedure for approving a local enterprise agency. The references to "relevant national authority" are explained in section 83(2).

Section 85: Supplementary provisions with respect to approvals

337. This section and section 84 set out the detailed rules that apply for the approval of local enterprise agencies and the withdrawal of such approval. They are based on section 79 of ICTA. The corresponding rule for income tax is in section 85 of ITTOIA.

338. The references to "relevant national authority" in this section are explained in section 83(2).

Section 86: Meaning of "urban regeneration company"

339. This section sets out the detailed rules that apply for the designation of urban regeneration companies. It is based on section 79B of ICTA. The corresponding rule for income tax is in section 86 of ITTOIA.

Section 87: Expenses of research and development

340. This section gives relief for the cost of research and development undertaken by or on behalf of a company carrying on a trade. It is based on section 82A of ICTA. The corresponding rule for income tax is in section 87 of ITTOIA.

Section 88: Payments to research associations, universities etc

341. This section gives relief for payments by a company carrying on a trade to various bodies engaged in scientific research. It is based on section 82B of ICTA. The corresponding rule for income tax is in section 88 of ITTOIA.

342. The amendments to section 82B of ICTA in section 15 of F(No 2)A 2005 have effect in relation to sums paid to an association within *subsection (1)(a)* of this section during any accounting period of the association beginning on or after a day to be appointed by the Treasury under section 13(6) of F(No 2)A 2005.

343. Section 82B(1) of ICTA allows a deduction for "the sum paid". So *subsection (2)* allows a deduction for the accounting period in which the payment is made. The wording is similar to that used in sections 69 and 77. This ensures that the timing rules for deductions in Chapter 5 of this Part of this Act which depend on payment are explicit and consistent.

344. Section 82B(4) of ICTA provides that "the Board" shall refer any question as to whether, or to what extent, activities constitute scientific research for the purposes of section 82B to the Secretary of State. Section 832(1) of ICTA defines "the Board" as "the Commissioners of Inland Revenue".

345. In practice, the function in section 82B of ICTA is exercised by an officer of Revenue and Customs. So s*ubsection (6)* of this section provides that any question as to what constitutes scientific research must be referred to the Secretary of State by "an officer of Revenue and Customs". This Change corresponds to Part B of Change 149 in ITTOIA (as amended by CRCA) and so brings the income tax and corporation tax codes back into line. See *Change 1* in Annex 1.

Section 89: Expenses connected with patents

346. This section allows a deduction for expenses connected with patents. It is based on section 83 of ICTA. The corresponding rule for income tax is in section 89 of ITTOIA.

347. The section sets out the expenses that are allowable. The deduction is on the basis of expenses incurred. This relaxes any requirement in the source legislation that fees have to be paid before a deduction can be made. See *Change 20* in Annex 1.

348. For most expenses connected with patents this rule is overridden by the rules of the intangible fixed assets regime (rewritten in Part 8 of this Act) which provide relief for trades as well as other commercial activities (see Chapter 6 of that Part). But, for a minority of cases, this section remains relevant and allows a deduction.

Section 90: Expenses connected with designs or trade marks

349. This section allows a deduction for expenses connected with designs or trade marks. It is based on section 83 of ICTA. The corresponding rule for income tax is in section 90 of ITTOIA.

350. The section sets out the expenses that are allowable. The deduction is on the basis of expenses incurred. This relaxes any requirement in the source legislation that fees have to be paid before a deduction can be made. See *Change 20* in Annex 1.

351. For most expenses connected with designs or trade marks this rule is overridden by the rules of the intangible fixed assets regime (rewritten in Part 8 of this Act) which provide

relief for trades as well as other commercial activities (see Chapter 6 of that Part). But, for a minority of cases, this section remains relevant and allows a deduction.

Section 91: Payments to Export Credits Guarantee Department

352. This section allows a company carrying on a trade to deduct the cost of certain payments to the Export Credits Guarantee Department ("ECGD"). It is based on section 88 of ICTA. The corresponding rule for income tax is in section 91 of ITTOIA.

353. Section 88 of ICTA refers to payments made under arrangements made by the Secretary of State in pursuance of section 11 of the Export Guarantees and Overseas Investment Act 1978. This section refers instead to arrangements made under section 2 of the Export and Investment Guarantees Act 1991 which replaced the 1978 Act.

354. Section 13(1) of the Export and Investment Guarantees Act 1991 delegates the functions of the Secretary of State under section 2 of the 1991 Act to the ECGD. So the reference to the Secretary of State in section 88 of ICTA is not rewritten in this section.

355. Section 88 of ICTA allows a trader to deduct "sums paid" to the ECGD. This section instead allows a deduction for any "sum payable" by the trader. See *Change 21* in Annex 1.

Section 92: Levies etc under FISMA 2000

356. This section provides for the inclusion, in a calculation of trading profits, of certain payments arising from FISMA. It is based on section 76A of ICTA. The corresponding rule for income tax is in section 155 of ITTOIA.

357. *Subsection (1)* applies the section to any company that pays a "levy" and removes three minor restrictions.

- Section 76A of ICTA applies only to an "authorised person". This section removes that restriction.
- The section does not reproduce the restriction in section 76A(2)(e) of ICTA for some "costs".
- A trading company that also has investment business may qualify for a deduction under this section which is denied by section 76A(1)(b) of ICTA.

See *Change 22* in Annex 1.

358. Subsection (1) provides for a deduction. Most FISMA levies would be allowable expenses under the basic trade profit calculation rules. The purpose of this provision is to deal with the exceptional case where deduction of a levy would otherwise be prevented by a prohibitive rule.

359. The expenses allowable are determined by reference to FISMA. *Subsections (2)* and *(3)* provide the links with FISMA.

360. There is a similar rule about FISMA repayments in section 104.

Chapter 6: Trade profits: receipts

Overview

361. This Chapter contains provisions on how various receipts are to be treated in calculating the profits of a trade.

Section 93: Capital receipts

362. This section is the mirror image of section 53 (capital expenditure). It is new. The corresponding rule for income tax is in section 96 of ITTOIA.

363. *Subsection (1)* sets out the general rule that items of a capital nature are not to be treated as receipts of a trade.

364. It is a long-established principle that capital receipts are ignored in calculating tax on income.

365. *Subsection (2)* disapplies the general rule in subsection (1) where there is statutory provision for a capital sum to be taken into account as a receipt in calculating the profits of a trade. See, for example, section 103 (sums recovered under insurance policies etc) and the rules in Part 5 (loan relationships), Part 7 (derivative contracts) and Part 8 (intangible fixed assets).

Section 94: Debts incurred and later released

366. If an amount owed by a company is released, this section treats the amount released as a trading receipt. The section is based on section 94 of ICTA. The corresponding rule for income tax is in section 97 of ITTOIA.

367. *Subsection (1)(c)* sets out the exception that applies if the debt is released as part of a "statutory insolvency arrangement", which is defined in section 834(1) of ICTA.

368. The source legislation treats the sum as a receipt "in the period in which the release is effected". The section makes it clear that the period in question is an accounting period. If the company is no longer carrying on the trade when the debt is released, the amount released is charged to tax as a post-cessation receipt (see section 193 of this Act).

Section 95: Acquisition of trade: receipts from transferor's trade

369. This section sets out what happens if a successor to a trade receives a sum that arose from the trade when it was carried on by the predecessor. It is based on section 106 of ICTA. The corresponding rule for income tax is in section 98 of ITTOIA.

370. If a sum arises from a trade that has ceased, the usual rule is that the sum is a post-cessation receipt (see Chapter 15 of this Part). But, if the right to receive the sum is transferred with the trade to a company which takes over the trade, this section applies instead.

371. *Subsection (1)* refers to a "person" ceasing to carry on a trade. That person may be one of the partners in a firm. If a firm ceases to carry on a trade, all its partners must also cease. So the section applies in either case.

372. *Subsection (2)* treats the sum as a receipt of the successor's trade. It is not charged on the predecessor. The source legislation treats the sum as a receipt "in the period in which it is received". The section makes it clear that the period in question is an accounting period.

373. Different rules apply if the right to receive sums is transferred to a person who does not take over the trade (see section 194 of this Act).

Section 96: Reverse premiums

374. This is the first of a group of five sections based on section 54 of, and Schedule 6 to, FA 1999. This legislation was introduced following the decision of the Privy Council in Commissioner of Inland Revenue v Wattie and another (1998), 72 TC 639[5]. An inducement (a "reverse premium") paid to a tenant to take a lease of land is taxed as income in the hands of the tenant. The corresponding rules for income tax are in sections 99 to 103 of ITTOIA.

375. *Subsection (2)* introduces the term "the recipient", which is used throughout this group of sections.

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376. *Subsection (3)* identifies the transaction which gives rise to a reverse premium.

377. *Subsection (4)* refers to an interest in land being "granted". This distinguishes such a transaction from one in which an interest is assigned. The general rule is that a charge to tax on a reverse premium arises on the grant of an interest in land but not on its assignment. But assignment can give rise to a charge if the assignor is connected with the grantor.

378. The meaning of "reverse premium" in this section is applied for the purpose of section 250 by subsection (6) of that section.

379. Schedule 2 to this Act rewrites the transitional provision in section 54(2) of FA 1999. These sections do not apply to pre-1999 reverse premiums.

Section 97: Excluded cases

380. This section brings together the various exclusions from the charge on reverse premiums. It is based on paragraphs 5 and 7 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 100 of ITTOIA.

381. *Subsection (2)* rewrites the rule in paragraph 6 of Schedule 6 to FA 1999 as it was before it was repealed by ITTOIA. It is possible for a company to receive a reverse premium in connection with a property transaction entered into by an individual involving the individual's only or main residence. The income tax relief is rewritten in section 100(2) of ITTOIA. It was not intended that ITTOIA should withdraw this relief from a company. So this subsection restores the position as it was before ITTOIA. See *Change 23* in Annex 1.

Section 98: Tax treatment of reverse premiums

382. This section treats a reverse premium as a revenue receipt, rather than a capital item. It is based on paragraph 2 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 101 of ITTOIA.

383. If the transaction giving rise to the reverse premium is at arm's length there is no statutory timing rule; the normal accountancy treatment applies. If the transaction is not at arm's length, there is a timing rule in section 99.

Section 99: Arrangements not at arm's length

384. If a property transaction is not at arm's length there is a special timing rule. This section provides that the whole of the reverse premium is taxed when the property transaction is entered into. It is based on paragraph 3 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 102 of ITTOIA.

385. *Subsection (1)* refers to "connected persons". That expression is defined for the purpose of this section in section 100.

386. *Subsection (5)* deals with the case where the recipient enters into a property transaction for the purposes of a trade but the trade has not yet started. In that case, the reverse premium is brought into account when the trade starts.

Section 100: Connected persons and property arrangements

387. This section sets out the special meaning of "connected persons" that applies for the group of sections on reverse premiums. The basic definition is in section 1316, which imports the definition of "connected persons" in section 839 of ICTA. The section is based on paragraph 8 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 103 of ITTOIA.

Section 101: Distribution of assets of mutual concerns

388. This section deals with the consequences for a trader of receiving a distribution from a mutual concern that is a corporate body. It is based on section 491 of ICTA. The corresponding rule for income tax is in section 104 of ITTOIA.

389. *Subsection (1)* sets out the circumstances in which a distribution may give rise to a tax charge. It refers to a distribution out of assets that "represent profits" of the concern. This is not quite the same as "assets of a body corporate, other than assets representing capital", as identified in section 491(1) of ICTA. The difference is that the section excludes assets that represent capital gains of the concern. See *Change 24* in Annex 1.

390. *Subsection (2)* is the general rule: the distribution is treated as a receipt of the trade.

391. *Subsection (3)* deals with the case where the distribution is received after the trade has ceased. The section treats the distribution explicitly as a post-cessation receipt. See *Change 19* in Annex 1.

392. In this Part the rules apply to the company carrying on a trade rather than to the trade itself. So section 337(1)(a) of ICTA is not needed to treat a trade as ceasing when there is a change of company carrying it on. Subsection (3) of this section reproduces the combined effect of section 491(3)(b) and (4) of ICTA.

393. *Subsection (5)* is a special rule that applies if the right to receive a distribution is transferred other than at arm's length. Market value is substituted for the actual amount received.

394. The section omits the references to mutual insurance and industrial and provident societies in section 491(9) and (11) of ICTA. Those examples were intended to help readers but there is no comprehensive definition of "mutual business". The subsections were intended to deal with particular doubts which were common when the provision was enacted in 1964. Those doubts do not exist today.

Section 102: Industrial development grants

395. This section deals with the treatment of certain grants under the Industrial Development Act 1982 or the corresponding provision in Northern Ireland. It is based on section 93 of ICTA. The corresponding rule for income tax is in section 105 of ITTOIA.

396. This section does not rewrite the references in section 93(2)(a) of ICTA to section 7 or 8 of the Industry Act 1972 or in section 93(2)(b) to section 1 of the Industries Development Act (Northern Ireland) 1966 and section 4 of the Industries Development Act (Northern Ireland) 1971. These enactments were repealed or replaced in 1982 and there are no outstanding instalments under the old enactments.

397. Section 93(3) of ICTA disapplies section 93(1) of ICTA in the case of grants towards the payment of all or part of a corporation tax liability made under Article 7 of the Industrial Development (Northern Ireland) Order 1982. Grants in respect of corporation tax liabilities cannot be made under any of the enactments listed in *subsection (1)* of this section other than Article 7 of the Industrial Development (Northern Ireland) Order 1982. So *subsection (2)* excludes *all* grants in respect of corporation tax liabilities.

Section 103: Sums recovered under insurance policies etc

398. This section concerns insurance recoveries. It is based on section 74(1)(l) of ICTA. The corresponding rule for income tax is in section 106 of ITTOIA.

399. Section 74(1)(l) of ICTA prohibits the deduction in computing a trader's profits of "any sum recoverable under an insurance or contract of indemnity". This is regardless of whether the sum is revenue or capital in nature.

400. When a sum is recovered under an insurance policy or contract of indemnity in an accounting period *other than* the accounting period in which the event in respect of which it is received occurs, section 74(1)(l) of ICTA requires any deduction made in respect of that event to be adjusted to reflect the recovery.

401. This section provides instead that a capital sum recovered by a trader under an insurance policy or a contract of indemnity is brought into account as a receipt in calculating the profits of the trade to the extent that the loss or expense has been deducted in calculating those profits. This means that the timing of the receipt will follow the accountancy treatment. See *Change 25* in Annex 1.

402. No special provision is needed for sums of a revenue nature.

Section 104: Repayments under FISMA 2000

403. This section provides for the inclusion in a calculation of trading profits of certain receipts arising from FISMA. It is based on section 76A of ICTA. The corresponding rule for income tax is in section 155 of ITTOIA.

404. *Subsection (2)* provides for a repayment under FISMA to be treated as a trade receipt. Most FISMA repayments would be charged to tax under the basic trade profit calculation rules. The purpose of this provision is to deal with the exceptional case where the FISMA repayment would not otherwise be a trade receipt.

405. The receipts chargeable are determined by reference to FISMA. *Subsections (3)* and *(4)* provide the links with FISMA.

406. There is a similar rule about FISMA levies etc in section 92.

Chapter 7: Trade profits: gifts to charities etc

Section 105: Gifts of trading stock to charities etc

407. This section sets out the main rule for gifts of trading stock. It is based on sections 83A and 84 of ICTA, which give relief for gifts to charities and educational establishments respectively. The corresponding rule for income tax is in section 108 of ITTOIA.

408. When a company disposes of trading stock other than in the course of a trade the general rule is that the market value of the stock is taken into account in calculating the profits of the trade (see Chapter 10 of this Part of this Act). This section sets out an exception to this general rule and applies if the company disposes of trading stock by way of gift to a charity etc.

409. There is a test for gifts to educational establishments in section 84(1)(a) of ICTA concerning the use to which the gift is put in the business of the educational establishment. There is no equivalent test in the rules for the relief for gifts to charities, in section 83A of ICTA. This section does not reproduce the condition in section 84(1)(a) of ICTA. See *Change 26* in Annex 1.

410. *Subsection (1)* combines the ICTA reliefs for gifts to charities and gifts to educational establishments. It includes the extension of the relief to registered clubs in Part 3 of Schedule 18 to FA 2002. The relief covers gifts "for the purposes of" charities etc. See *Change 27* in Annex 1.

411. The section does not require a claim by the company. In this respect, the section is different from section 84(3) of ICTA (but not from section 83A). See *Change 28* in Annex 1.

412. *Subsection (4)* does not reproduce the references to the British Museum and the Natural History Museum. These bodies are charities within subsection (1)(a) of the section.

Section 106: Meaning of "designated educational establishment"

413. This section defines "designated educational establishment" for the purpose of section 105. It is based on section 84 of ICTA. The corresponding rule for income tax is in section 110 of ITTOIA.

414. Section 84(6) of ICTA provides that "the Board" shall refer any question as to whether a particular establishment is a designated educational establishment for the purposes of the section to the Secretary of State or the Department of Education for Northern Ireland. Section 832(1) of ICTA defines "the Board" as "the Commissioners of Inland Revenue" (to be taken as a reference to the Commissioners for Her Majesty's Revenue and Customs, in accordance with section 50(1) of CRCA).

415. In practice, the function in section 84 of ICTA is exercised by an officer of Revenue and Customs. So s*ubsection (3)* of this section provides that any question as to whether a particular establishment is a designated educational establishment must be referred to the Secretary of State by "an officer of Revenue and Customs". See *Change 1* in Annex 1.

416. The National Assembly for Wales (Transfer of Functions) Order 1999 (SI 1999/672) devolves the functions of the Secretary of State under section 84 of ICTA to the Welsh Ministers. So this section refers to the Welsh Ministers (and the Assembly).

Section 107: Gifts of medical supplies and equipment

417. This section sets out the main rule for gifts of medical supplies and equipment. It is based on section 55 of FA 2002. It also gives a trading deduction for expenses connected with such gifts.

418. As in section 105, this section overrides the rule in Chapter 10 of this Part of this Act that the market value of a gift should be treated as a trade receipt.

419. *Subsection (3)* is the special rule that the costs of getting the medical supplies and equipment to the recipient are allowed as a deduction.

420. *Subsection (5)* is based on section 55(6) of FA 2002. The power of the Treasury to exclude certain medical supplies and equipment has not been used.

421. There is no corresponding rule for income tax. So section 55 of FA 2002 is repealed by Schedule 1 to this Act. See *Change 29* in Annex 1.

Section 108: Receipt of benefits by donor or connected person

422. This section sets out what happens if a company receives a benefit in connection with a gift of trading stock or plant and machinery. It is based on sections 83A and 84 of ICTA and section 55 of FA 2002. The corresponding rule for income tax is in section 109 of ITTOIA.

423. *Subsection (1)* applies the section if a benefit is received by the company or a connected person. Section 82 of this Act (contributions to local enterprise organisations or urban regeneration companies) uses the same approach. The benefit must be in connection with a gift for which relief has been given under section 105, section 107 or the corresponding capital allowances rule.

424. *Subsection (2)* extends the recovery charge to a benefit attributable to the costs associated with making a gift of medical supplies and equipment.

425. If the donor is still carrying on the trade when the benefit is received the value of the benefit is treated as a trading receipt.

426. If the donor has ceased to carry on the trade when the benefit is received the value of the benefit is treated as a post-cessation receipt. This treatment replaces the general charge under Schedule D Case VI. See *Change 19* in Annex 1.

Chapter 8: Trade profits: herd basis rules

Overview

427. This Chapter gives the rules for what is commonly known as the "herd basis". It is based on Schedule 5 to ICTA. The corresponding rules for income tax are in Chapter 8 of Part 2 of ITTOIA.

428. The object of the herd basis is to treat a herd of animals in a similar fashion to a capital asset. Without the election the individual animals in the herd would be treated as separate items of trading stock. With the election:

- there is no tax allowance for the initial cost of, or any subsequent increase in the size of, the herd;
- the net cost of replacing animals in the herd is allowable;
- any profit or loss on the sale of a single animal or a small number of animals from the herd without replacement is included in the profits of the trade; and
- if the whole, or a substantial part, of the herd is sold and not replaced the resulting profit or loss is not included in the profits of the trade.

429. An election can be made only in respect of animals kept for their produce.

Section 109: Election for application of herd basis rules

430. This section allows a taxpayer to elect for the "herd basis rules" to apply and introduces some basic concepts. It is based on paragraphs 1, 2, 3 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 111 of ITTOIA.

431. *Subsection (1)* allows a company or firm of which a company is a member to make a "herd basis election" if it keeps, or has kept, a "production herd". "Production herd" is defined in section 110(1)(c). The effect of a "herd basis election" is that the "herd basis rules" apply. These rules are set out in sections 112 to 121. The time limits for making the election are set out in sections 122 to 124.

Section 110: Meaning of "animal", "herd", "production herd" etc

432. This section provides various definitions used in the Chapter. It is based on paragraphs 8 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 112 of ITTOIA.

433. This section would be the natural home for the rule in paragraphs 7 and 9(5) of Schedule 5 to ICTA that prevents the herd basis rules applying to working animals. Paragraphs 7 and 9(5) of Schedule 5 to ICTA exclude certain animals from being part of a production herd. These are animals kept for the work they do in connection with the trade or those kept for public exhibition, or racing or other competitive purposes. This rule is unnecessary because animals in a production herd must be kept wholly or mainly for the sake of their produce. So the exclusions are not rewritten.

434. *Subsection (1)(a)* rewrites the definition of "animal" in paragraph 9 of Schedule 5 to ICTA. Most of the definitions in paragraph 9 of Schedule 5 to ICTA refer to "animals and other living creatures". The main reason for the reference to "other living creatures" is to make clear that the Schedule applies to birds.

435. Subsection (1)(c) rewrites the definition of "production herd" in paragraph 8(5) of Schedule 5 to ICTA. Herd basis elections are made by reference to classes of production

herd. See section 122. Section 111(2) identifies when different production herds are treated as being of the same class.

436. *Subsection (6)* makes clear that an immature animal can be treated as added to the herd when it becomes mature. There is a definition of maturity for female animals in section 111(5).

Section 111: Other interpretative provisions

437. This section provides further definitions. It is based on paragraphs 3, 8 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are section 113 of ITTOIA.

438. *Subsection (2)(a)* applies if production herds of animals of different species are kept for the same product; for example, a herd of cows and a herd of goats both kept for milk production. Each herd satisfies the definition of production herd. Subsection (2)(a) prevents them being treated as of the same class.

439. Subsection (2)(b) prevents animals of the same species being treated as of the same class if they are kept for different products; for example, one herd of cows kept for milk production and another herd of cows kept for its calves.

440. *Subsection (6)* clarifies what is meant by "a substantial part of the herd". This is a question of fact depending on the circumstances. But 20% of the herd is always regarded as substantial. This change clarifies this practice. This change reproduces Change 32 in ITTOIA. See *Change 30* in Annex 1.

441. The following sections refer to "a substantial part of the herd".

- Section 116(1) (sale of animals from the herd);
- Section 117(1) (sale of whole or substantial part of herd);
- Section 118(4) and (5) (acquisition of new herd begun within five years of sale);
- Section 120(1) (replacement of part sold within five years of sale); and
- Section 124(1) (slaughter under disease control order).

Section 112: Initial cost of herd and value of herd

442. This section sets out the treatment of the initial cost, and value, of the herd. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 114 of ITTOIA.

Section 113: Addition of animals to herd

443. This section sets out the treatment of additions to the herd. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 115 of ITTOIA.

444. *Subsection (1)* makes clear that there is a difference between additions, to which this section applies, and replacements dealt with in section 114.

445. *Subsection (2)* prevents a deduction for the cost of the additional animal. It is a similar rule to section 112(1).

Section 114: Replacement of animals in herd

446. This section sets out the treatment if an animal in the herd is replaced. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 116 of ITTOIA.

447. *Subsection (1)* introduces the terms "old animal" to describe an animal leaving the herd and "new animal" to describe the animal that replaces it. The circumstances in which an animal is treated as sold and the meaning of "sale proceeds" are extended by the definitions in section 111(3) and (4).

448. *Subsection (4)* deals with the deduction due for the replacement animal. The basic principle in paragraph 3(4)(b) of Schedule 5 to ICTA is that the cost of the second animal is deducted as a trading expense. But paragraph 3(4)(b) of Schedule 5 to ICTA provides for an exception - "in so far as that cost consists of such costs as are allowable apart from the provisions of this Schedule as deductions in computing profits of farming under Case I of Schedule D".

449. It is not clear from ICTA what these costs are. In fact the exception is aimed at the case where the replacement animal comes from trading stock. Here the costs of breeding or acquiring it and, if relevant, rearing it to maturity have already been allowed. The farmer is not allowed a double deduction for costs that have already been allowed.

450. This section does not reproduce that part of paragraph 3(4)(b) of Schedule 5 to ICTA which refers to the cost of the new animal being subject to paragraph 3(6) of Schedule 5 to ICTA. This reference appears to be an error made in the 1988 consolidation of ICTA. It is generally accepted that it is the rule in paragraph 3(4)(a), and not paragraph 3(4)(b), of Schedule 5 to ICTA which should be qualified by paragraph 3(6) of Schedule 5 to ICTA.

Section 115: Amount of receipt if old animal slaughtered under disease control order

451. This section limits the amount of the receipt taxed under section 114 if the old animal is slaughtered under a disease control order. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 117 of ITTOIA.

452. Paragraph 3(6) of Schedule 5 to ICTA restricts the amount of the receipt to "the amount allowable as a deduction". It is not immediately clear what this amount is. This section makes clear that it is the amount allowable as a deduction in respect of the new animal. This is called "the equivalent amount for the new animal".

453. *Subsections (4)* and *(5)* define "the equivalent amount for the new animal". Subsection (4) deals with the case in which the replacement animal comes from the farmer's trading stock. Subsection (5) deals with all other cases.

Section 116: Sale of animals from herd

454. This section sets out the rules that apply if an animal is sold from the herd and not replaced. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 118 of ITTOIA.

Section 117: Sale of whole or substantial part of herd

455. This is the first of three sections that set out the rules relating to the sale of all or a substantial part of the herd within 12 months. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 119 of ITTOIA.

456. The section merges the rules in paragraph 3(7) to (9) of Schedule 5 to ICTA. This Change reproduces Change 33 in ITTOIA. See *Change 31* in Annex 1.

Section 118: Acquisition of new herd begun within 5 years of sale

457. This section sets out the rules that apply if, following the sale of the herd (either all at once or within 12 months), the farmer begins to acquire a new herd within five years. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 120 of ITTOIA.

458. *Subsection (4)* applies if the number of animals in the new herd is smaller than the number of animals in the old herd but the difference is not substantial. See *Change 31* in Annex 1.

459. *Subsection (7)* clarifies what is meant by a "substantial difference". See *Change 30* in Annex 1.

Section 119: Section 118: sale for reasons outside farmer's control

460. This section limits the amount taxed as a trade receipt under section 118 if the sale is for reasons outside the farmer's control and the replacement animal is of a worse quality. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 121 of ITTOIA.

461. The section is similar to section 115 although it is not limited, as that section is, to disposals under a disease control order. The source legislation for both sections refers to the amount of the trading receipt being restricted to "the amount allowable as a deduction". It is not immediately clear what this amount is.

462. *Subsection (2)* makes clear that it is the amount allowable as a deduction in respect of the new animal. The section calls this "the equivalent amount for the new animal".

463. *Subsections (3)* and *(4)* define "the equivalent amount for the new animal". Subsection (3) deals with the case in which the replacement animal comes from the farmer's trading stock. Subsection (4) deals with all other cases.

Section 120: Replacement of part sold begun within 5 years of sale

464. This section sets out the rules that apply if, following the sale of a substantial part of a herd (either all at once or within a year), the farmer begins to replace it within five years. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 122 of ITTOIA.

Section 121: Section 120: sale for reasons outside farmer's control

465. This section limits the amount taxed as a trade receipt under section 120 if the sale is for reasons outside the farmer's control and the new animal is of a worse quality. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 123 of ITTOIA.

466. The section is similar to section 115 although it is not limited, as that section is, to disposals under a disease control order. The source legislation for both sections refers to the amount of the trading receipt being restricted to "the amount allowable as a deduction". It is not immediately clear what this amount is.

467. *Subsection (2)* makes clear that it is the amount allowable as a deduction in respect of the new animal. The section calls this "the equivalent amount for the new animal".

468. *Subsections (3)* and *(4)* define "the equivalent amount for the new animal". Subsection (3) deals with the case in which the replacement animal comes from the farmer's trading stock. Subsection (4) deals with all other cases.

Section 122: Herd basis elections

469. This section sets out the rules for the making of herd basis elections. It is based on paragraph 2 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 124 of ITTOIA.

470. Paragraph 2 of Schedule 5 to ICTA requires that the election must be made "in writing" and to an officer of Revenue and Customs. The general rules in Part 7 of Schedule 18 to FA 1998 that apply to claims and elections mean it is not necessary to repeat these requirements.

471. *Subsection (2)* sets out the time limits for making the election. The election is made by the farmer. The farmer can be a company or a firm in which one of the partners is a company. The time limits are different depending on whether the farmer is a company or a firm.

472. If the farmer is a firm the same time limit applies whether the partners are all income tax payers, all corporation tax payers or a combination of the two. Because of the possible involvement of income tax payers the time limit is set by reference to income tax years. The time limit in section 122(2)(b) is the same as that in section 124(2)(a) of ITTOIA.

473. The different time limits for a company or a firm are reflected in the other two sections that deal with herd basis elections, sections 123 and 124. Those sections identify the difference by referring to the "accounting period" (company) or the "period of account" (firm).

474. *Subsection (4)* expands on *subsection (1)*, which provides that an election must specify the class of production herd to which it relates. This means separate elections must be made for each class of production herd and that an election may not relate to more than one class of production herd. Separate elections may be made for different classes.

475. *Subsection (7)* identifies the period for which the herd basis election has effect. This depends on whether the farmer is a company (accounting period) or firm (period of account).

476. *Subsection (8)* deals with the case in which the farmer is a firm and there is a change in the partners in the firm. Paragraph 2 of Schedule 5 to ICTA refers to "the farmer making the election". If the farming trade is carried on in partnership, the "farmer" means the firm. If there is a change in the members of a firm, the question arises whether there is a new "farmer". Subsection (8) makes clear that there is.

Section 123: Five year gap in which no production herd kept

477. This section deals with the case where there is a period of at least five years when the farmer does not keep a production herd of the particular class for which a herd basis election has been made. It is based on paragraph 4 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 125 of ITTOIA.

478. *Subsection (2)* explains the consequences for the herd basis rules if the farmer starts to keep another production herd of the same class after the end of the five year period. Subsection (2) enacts an extra-statutory practice. See *Change 32* in Annex 1. This Change reproduces Change 36 in ITTOIA.

Section 124: Slaughter under disease control order

479. This section sets out the rules for making an election outside the normal time limits following slaughter under a disease control order. It is based on paragraph 6 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 126 of ITTOIA.

Section 125: Preventing abuse of the herd basis rules

480. This section provides anti-avoidance rules that may apply if a farmer transfers the whole or part of a production herd in a transaction that is not an open market sale. It is based on paragraph 5 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 127 of ITTOIA.

481. Section 164(3) in Chapter 11 of this Part (trade profits: valuation of stock) makes clear that this section takes priority over the provisions of that Chapter.

Section 126: Information if election made

482. This section allows an officer of Revenue and Customs to obtain information about the animals kept for the purposes of the trade. It is based on paragraph 10 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 128 of ITTOIA.

Section 127: Further assessment etc if herd basis rules apply

483. This section enables effect to be given to a herd basis election made after an assessment has become final, either by amendment or by repayment of tax. It is based on paragraph 11 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 129 of ITTOIA.

Chapter 9: Trade profits: other specific trades

Overview

484. This Chapter contains special rules for the taxation of particular trades.

Section 128: Taxation of amounts taken to reserves

485. This section contains a special rule for the treatment of securities held by a company carrying on a banking or insurance business, or a business of dealing in securities, and on which profits and losses are calculated by reference to the "fair value" of the securities rather than on a realisation basis. It is based on section 472A of ICTA. The corresponding rule for income tax is in section 149 of ITTOIA.

486. Financial assets can be dealt with in a number of ways for accounting purposes.

487. Where a company dealing in securities uses United Kingdom generally accepted accountancy practice ("UK GAAP"), profits and losses calculated by reference to the fair value of securities treated as trading assets are taken to profit and loss account. "Fair value" is an accounting term, the meaning of which is broadly equivalent to market value. UK GAAP is defined in section 50(4) of FA 2004.

488. Where a company dealing in securities prepares accounts in accordance with international accounting standards, the securities would usually fall to be accounted for as at fair value, in accordance with paragraph 9 of International Accounting Standard 39 ("IAS 39"), and any profits and losses calculated by reference to the fair value of securities taken to the profit and loss account. But the company may instead account for certain securities as "available for sale" if they do not meet the conditions for being treated as at fair value through profit or loss. In such a case profits and losses calculated by reference to the fair value of securities are taken initially to a statement of changes in equity.

489. Since 2005, UK GAAP in this area follows IAS 39. Under UK GAAP the profits and losses on "available for sale" assets are taken to the statement of total recognised gains and losses.

490. Section 46 of this Act provides that the calculation of profits or losses from a trade must be based on accounts drawn up in accordance with generally accepted accountancy practice, subject to any adjustment authorised by law. Implicit in this rule is that the profits must appear in the profit and loss account. There is no tax law (apart from this section) which allows profits on equity securities taken to any form of reserve to be treated for corporation tax purposes as if they were taken to profit and loss account.

491. *Subsection (3)(b)* provides that subsection (2) does not apply to "an amount recognised for accounting purposes by way of correction of a fundamental error". This refers to the requirement in International Accounting Standard 8 (Accounting Policies, Changes in Accounting Estimates and Errors) that the correction of a fundamental error should be treated as a prior period adjustment. "For accounting purposes" is defined in

section 832(1) of ICTA as "for the purposes of accounts drawn up in accordance with generally accepted accounting practice".

492. Section 472A(4)(a) of ICTA defines "securities" to include rights, interests or options treated as shares for the purposes of sections 126 to 136 of TCGA by virtue of sections 135(5) or 136(5) of TCGA. Sections 135(5) and 136(5) of TCGA define "shares" in the case of a company with no share capital as "any interests in the company possessed by members of the company." So *subsection (4)(c)* of this section defines "securities" to include such interests.

Section 129: Conversion etc of securities held as circulating capital

493. This section provides for relief on the conversion or exchange of securities held as part of the circulating capital of a company dealing in securities. It is based on section 473 of ICTA. The corresponding rule for income tax is in section 150 of ITTOIA.

494. Section 473(1) of ICTA applies to securities to which a company carrying on a banking or insurance business, or a business of dealing in securities, is beneficially entitled, the profits from the sale of which would "form part of the trading profits of that business". This section does not stipulate that the company must be beneficially entitled to the securities in question. See *Change 33* in Annex 1.

495. *Subsection (3)* excludes securities brought into account at "fair value" in calculating the profits for the period in which the relevant transaction takes place. These are instead dealt with in section 128.

496. Section 137(1) of TCGA provides that sections 135 and 136 of TCGA do not apply to an exchange of shares unless the exchange is:

> effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax.

497. *Subsection (7)* of this section adapts the rule in section 137(1) of TCGA to include the avoidance of income tax. This covers, for example, a scheme or arrangement the purpose of which is the avoidance of income tax by a director of, or participator in, the company rather than the avoidance of corporation tax by the company itself.

Section 130: Traders receiving distributions etc

498. This section provides that distributions of a UK resident company, and payments "representative of" such distributions, are brought into account in calculating the profits of a trade if those distributions and payments are receipts or expenses of the trade on first principles. It is based on section 95 of ICTA. The corresponding rule for income tax is in section 366(1) of ITTOIA.

499. A payment "representative of" a distribution may arise, for example, if shares are on loan at the dividend date. The dividend is received by the person to whom the shares are lent. A payment made by that person to compensate the lender for the dividend which would have been received if the shares had not been lent "represents" that dividend.

500. Section 95 of ICTA operates by bringing the distribution or representative payment into account in calculating the profits of a company which is a dealer in relation to that distribution or payment. That company holds the shares in respect of which the distribution is received (or the payment made) as assets on current account rather than as investments.

501. *Subsections (1)* and *(2)* focus on the nature of the receipt rather than on the recipient. Similarly, *subsections (3)* and *(4)* focus on the nature of the payment. See *Change 34* in Annex 1.

502. Section 1285 of this Act is the general rule that no liability to corporation tax arises on dividends or other distributions of a UK resident company. Subsection (2) of this section disapplies section 1285 in the case of a UK distribution or a payment representing such a distribution.

503. Section 1305 of this Act is the general rule that no deduction is allowed in respect of a dividend or other distribution. Schedule 23A to ICTA contains special rules for the treatment of amounts representative of dividends on UK shares. In accordance with paragraph 2(2)(b) of Schedule 23A, a payment representative of a UK dividend is treated, in relation to the company by which it is paid, as if it were a dividend on its own shares.

504. Subsections (3) and (4) override section 1305. So a payment representative of a UK distribution is to be taken into account in calculating the corporation tax profits of the company making the payment.

505. Subsection (3) applies to a payment which would be allowed but for section 1305. A payment in respect of which a deduction is disallowed under paragraph 7A of Schedule 23A of ICTA is not within subsection (3). So it is not necessary to rewrite section 95(1C) ICTA in this section.

Section 131: Incidental costs of issuing qualifying shares

506. This section allows a deduction to building societies for the incidental costs of issuing shares. It is based on section 477B of ICTA.

507. Most shares issued by building societies fall with the loan relationship rules in Parts 6 and 7 of this Act. This is because they are excluded from the definition of "share" in section 476(1) of this Act. The result is that most of the incidental costs associated with the issue of the shares are relieved under section 307 of this Act.

508. But it is possible for some building society shares not to qualify as loan relationships. And, even if they do, some incidental costs may not fall within section 307. So this section deals with the costs that are not relieved under the loan relationship rules.

Section 132: Dividends etc granted by industrial and provident societies

509. This section ensures that a "divi" paid by an industrial and provident society is allowed as a trading deduction. It is based on section 486 of ICTA.

510. The main rules about industrial and provident societies are in Chapter 5 of Part 6 of this Act (loan relationships).

511. A definition of "registered industrial and provident society" is inserted into section 834(1) of ICTA (see Schedule 1).

512. *Subsection (1)* sets out the sort of society to which the section applies. An example is an agricultural co-operative that sells (or buys) on behalf its farming members.

513. *Subsection (2)* is the trading income rule. In practice it is likely that the payments with which the section is concerned would be allowable under the normal trading income rule. But this section puts the matter beyond doubt.

514. The source legislation refers to the calculation of any profits "for the purpose of any provision of the Tax Acts relating to profits chargeable under Case I of Schedule D". It is probable that the quoted words, read with sections 21A and 21C of ICTA, apply the rule for the purpose of a calculation of Schedule A profits. But, in the context of a property business, a "divi" is not paid "on account of the recipient's transactions with the society". So in practice the rule does not apply to a property business and the section refers simply to calculating the profits of the trade.

515. *Subsection (5)* is a signpost to the rule (inserted into ICTA by Schedule 1) that the "divi" is not a distribution.

Section 133: Annual payments paid by a credit union

516. This section denies a trading deduction for an annual payment made by a credit union. It is based on section 487 of ICTA.

517. Most credit unions do not carry on a trade for tax purposes. This is the consequence of section 40. But it is possible that some of the activities of a credit union fall outside the scope of the rule in that section. In that case, a calculation of the profits of the trade is required.

518. It is also possible that a credit union carries on a property business. So section 210(2) applies the trading income rule to property businesses.

Section 134: Purchase or sale of woodlands

519. This section applies to a person carrying on a trade of dealing in land who buys and sells land on which trees are growing. It is based on section 99 of ICTA. The corresponding rule for income tax is in section 156 of ITTOIA.

520. Any profit on the sale of the trees and underwood is tax-free because of the exemption for the occupation of commercial woodlands. See section 37 of this Act. *Subsection (2)* prevents the dealer in land obtaining a trade deduction for that part of the cost of the land that is attributable to the cost of the trees.

521. The legislation rewritten by subsection (2) only applies to woodlands purchased under a contract entered into on or after 1 May 1963. This limitation is preserved in Schedule 2 (transitions and savings). The corresponding provision for income tax is paragraph 42 of Schedule 2 to ITTOIA.

Section 135: Relief in respect of mineral royalties

522. This section gives relief if trade receipts include mineral royalties. It is based on section 122 of ICTA. The corresponding rule for income tax is in section 157 of ITTOIA.

523. Most mineral royalties are taxed under Chapter 7 of Part 4 of this Act. That Chapter rewrites the charge under Schedule D Case VI if rents are received from a concern listed in section 55 of ICTA. That list includes mines and quarries. In nearly all cases the rents are taxed under Chapter 7 of Part 4 of this Act as they are not received in respect of a trade. But it is possible that the receipt of the rent will be incidental to a trade. In that case section 287 of this Act provides that the rent is taxed under Part 3 of this Act. This is only likely to happen if the rent is received by a property developer in respect of land held as trading stock.

524. The mineral royalties are halved. The relief is rewritten under the italicised heading "dealers in land" because they are the traders who are most likely to benefit from the relief. But the relief is not confined to dealers in land.

Section 136: Lease premiums etc: reduction of receipts

525. This section prevents a person, carrying on a trade of dealing in land, from being taxed on all or part of a lease premium, or of certain other amounts received in respect of a lease, both as a receipt of the trade under this Part and as a receipt of a property business under Part 4 of this Act. It is based on section 99(2) and (3) of ICTA. The corresponding rule for income tax is in section 158 of ITTOIA.

Section 137: Mineral exploration and access

526. This section deals with intangible drilling costs of production wells in the oil and gas industry. It is based on section 91C of ICTA. The corresponding rule for income tax is in section 161 of ITTOIA.

527. Intangible costs are those which do not result in the acquisition or creation of machinery or plant. An example would be the cost of hiring a drilling rig. Production wells are wells that are drilled after the presence of oil in an area has been established and which are used to extract the oil.

528. Before the enactment of section 91C of ICTA, a deduction was allowed for the intangible drilling costs of the second and subsequent production wells in any area. This reflected a Special Commissioners decision in 1920 that this expenditure is of a revenue nature. This section disallows a deduction for such costs. It does this by denying a deduction for expenditure which, if it had been carried out while exploring for oil, would not have been allowed as a deduction.

529. These costs are capital expenditure and qualify for mineral extraction capital allowances (see Part 5 of CAA).

Section 138: Payments by companies liable to pool betting duty

530. This section gives a special deduction to companies which pay pool betting duty. It is based on those parts of section 126 of FA 1990 and section 121 of FA 1991 which relate to the calculation of the profits of traders. The corresponding rule for income tax is in section 162 of ITTOIA.

531. In 1990, following the Hillsborough disaster, pool betting duty was reduced on condition that the money saved be paid to the Football Trust 1990 to implement Lord Justice Taylor's recommendations on safety and comfort at football grounds. In 1991 the duty was reduced again, this time on condition that the money be paid to the Foundation for Sport and the Arts, a charitable trust which supports athletic sports and games and promotes the arts. The reductions were initially for a limited period, but have so far been maintained.

532. *Subsection (1)* sets out the circumstances in which the section applies. It introduces the expression "qualifying payment".

533. *Subsection (2)* defines a "qualifying payment" to which the section applies. It does not specify that payments in consequence of the 1990 reduction in pool betting duty must be paid for football safety and comfort, and that payments in consequence of the 1991 reduction must be paid to the Foundation for Sport and the Arts. Instead the section applies to a payment for either purpose in consequence of any reduction in pool betting duty. See *Change 35* in Annex 1.

534. The section retains a general description of the payments, without identifying the bodies which were the targets of the original legislation. It is clear that payments made as a consequence of a reduction in pool betting duty to either body would qualify for relief under the section.

535. The source legislation is restricted to the 1990 and 1991 reductions in pool betting duty. This section applies to payments made in consequence of any reduction in the duty. See *Change 36* in Annex 1.

536. *Subsection (3)* is the rule that allows the payments as a trading deduction. Without this rule the payments might be disallowed because they are not made wholly and exclusively for the purposes of the company's trade.

Section 139: Deduction for deemed employment payment

537. This section sets out the trading income rules that were originally part of the "IR35" scheme for the taxation of workers supplied by an intermediary. It is based on paragraph 17 of Schedule 12 to FA 2000. The corresponding rule for income tax is in section 163 of ITTOIA.

538. The worker is treated as receiving a "deemed employment payment" and is taxed accordingly (see Chapter 8 of Part 2 of ITEPA). This section ensures that an equivalent amount is allowed as a trading deduction in calculating the profits of the intermediary.

539. *Subsection (3)* is a timing rule. Generally, the deemed employment payment is treated as made at the end of the tax year (see section 50(3) of ITEPA). In some circumstances the payment is treated as made earlier (see section 57 of ITEPA). In either case, the trading deduction is given for the period of account in which the payment is treated as made.

540. *Subsection (4)* is the rule that prevents any double deduction. It caters for the possibility that the payment may qualify as a trading deduction on first principles and also qualify as a trading deduction in a period of account different from that specified in subsection (3).

Section 140: Special rules for partnerships

541. This section sets out two additional rules that apply if a deduction under section 139 is to be given in calculating the trading profits of a firm. It is based on paragraph 18 of Schedule 12 to FA 2000. The corresponding rule for income tax is in section 164 of ITTOIA.

542. Section 1257 of this Act explains that "firm" is used in this Act to refer to persons carrying on a trade in partnership. It includes a limited liability partnership (see section 1273).

543. *Subsection (2)* is the rule that a deduction under section 139 of this Act cannot be used to create a loss in a firm. It operates by reference to the firm's period of account. See *Change 37* in Annex 1.

544. *Subsection (3)* is the rule that limits the trading deduction to the amount that would have been deductible if the worker had been an employee of the intermediary, plus a margin to cover the expenses of the firm.

545. In accordance with paragraph 244 of Schedule 6 to ITEPA, "deemed Schedule E payment" in paragraph 18 of Schedule 12 to FA 2000 is replaced by "deemed employment payment". Similarly, in the same paragraph, "Schedule E" is replaced by "the employment income Parts of the Income Tax (Earnings and Pensions) Act 2003".

546. But the specific statutory references, such as those to "paragraph 7" (of Schedule 12 to FA 2000), are covered by the general rule in paragraph 5 of Schedule 7 to ITEPA. That general rule is that any reference to a repealed provision is to be read as a reference to the rewritten provision.

547. Paragraph 7 of Schedule 12 to FA 2000 has been repealed and rewritten as section 54(1) of ITEPA. So the reference to that paragraph in paragraph 18 of Schedule 12 is to be read as a reference to section 54(1) of ITEPA. This section updates the references to paragraph 7.

Section 141: Deduction for deemed employment payments

548. This section gives a trading deduction if a managed service company ("MSC") makes a "deemed employment payment" to a worker under section 61D of ITEPA. It is based on paragraph 10 of Schedule 3 to FA 2007. The corresponding rule for income tax is in section 164A of ITTOIA.

549. The worker is treated as receiving a "deemed employment payment" and is taxed accordingly (see Chapter 9 of Part 2 of ITEPA). This section ensures that an equivalent amount (and no more) is allowed as a trading deduction in calculating the profits of the MSC.

550. *Subsection (5)* prevents any double deduction. It caters for the possibility that the payment may qualify as a trading deduction on first principles and also qualify as a trading deduction in a period of account different from that specified in subsection (3).

Section 142: Deduction for site preparation expenditure

551. This section sets out the rules for expenditure on preparing a site so that it can be used for waste disposal. It is the first of four sections that deal with waste disposal. They are based on sections 91B and 91BA of ICTA. The corresponding rules for income tax are in sections 165 to 168 of ITTOIA.

552. This section covers expenditure which is not deductible because it is capital and which is not eligible for capital allowances; in other words, expenditure that would otherwise go unrelieved for corporation tax purposes.

553. *Subsection (1)* introduces the concept of waste materials being deposited on a "waste disposal site", an expression defined in section 144.

554. *Subsection (2)* is the link to section 143, which calculates the amount of expenditure that is allowed as deduction.

555. A deduction under section 91B of ICTA is allowed only if the company makes a claim (in such form as the Commissioners for HMRC may direct) and submits such plans and other documents (if any) as the Commissioners may require. This section drops the requirement for a claim. See *Change 38* in Annex 1.

556. Schedule 2 to this Act rewrites the transitional provision in section 91BA(1) of ICTA. Expenditure cannot be "inherited" if the site changed hands before March 2000.

557. *Subsection (4)* treats the company's trade as the same as that of its predecessor. This is necessary because the activities taken over may amount to less than the whole of the predecessor's trade (see subsection (3)(a)).

Section 143: Allocation of site preparation expenditure

558. This section spreads site preparation expenditure over the useful life of the site. It is based on section 91B of ICTA. The corresponding rule for income tax is in section 166 of ITTOIA.

559. Some waste disposal sites, notably in the nuclear waste industry, have preparation expenditure dating from before 6 April 1989. So this section preserves the rules for the pre-1989 expenditure.

Section 144: Site preparation expenditure: supplementary

560. This section contains the definitions of the expressions used in the waste disposal sections and sets out the rules for pre-trading expenditure. It is based on sections 91A, 91B and 91BA of ICTA. The corresponding rule for income tax is in section 167 of ITTOIA.

561. Although the definitions are expressed to apply "for the purposes of sections 142 and 143", the definition of "waste disposal licence" is also used to define a "site restoration payment" in section 145(5).

562. In *subsection (1)(b)* the corresponding Northern Ireland provision is Part 2 of the Waste and Contaminated Land (Northern Ireland) Order 1997 (SI 1997/2778 (N.I.19)).

563. *Subsection (1)(c)* identifies more specifically the provisions described in section 167(1)(c) of ITTOIA. It reflects the amendments to section 91A(6) of ICTA made by:

- the Pollution Prevention and Control (England and Wales) Regulations (SI 2000/1973);
- the Pollution Prevention and Control (Scotland) Regulations (SI 2000/323); and
- paragraph 3 of Schedule 11 to the Pollution Prevention and Control Regulations (Northern Ireland) 2003 (SR 2003/46).

Section 145: Site restoration payments

564. This section deals with payments for the restoration of a site after it has been used for waste disposal. It is based on section 91A of ICTA. The corresponding rule for income tax is in section 168 of ITTOIA.

565. In *subsection (6)(a), (c)* and *(d)* the corresponding Northern Ireland provision is Article 40 of the Planning (Northern Ireland) Order 1991 (SI 1991/1220 (N.I. 11)).

Section 146: Cemeteries and crematoria: introduction

566. This section, and the following three sections, contain special rules for companies carrying on a trade of operating a cemetery or crematorium. They are based on section 91 of ICTA. The corresponding rules for income tax are in sections 169 to 172 of ITTOIA.

567. Without special provisions, no allowance would be due for the cost of land sold for interments, memorial gardens attached to crematoria or the surrounding land and buildings because expenditure on such land and buildings is in the nature of capital. The provisions in sections 146 to 149 recognise that most land and buildings in a cemetery or memorial garden are of little value when the cemetery or memorial garden is full.

568. This section introduces the provisions in sections 147 to 149 and defines some of the terms used in those sections.

569. Section 91(7)(a) of ICTA adapts the rules for cemeteries in section 91 of ICTA to crematoria and treats "land which is devoted wholly to memorial garden plots" as a cemetery, or as land in a cemetery. *Subsection (1)* of this section instead includes the carrying on of a crematorium, and the maintenance of "memorial gardens plots" in the trades to which sections 146 to 149 apply.

570. Section 91(5) of ICTA provides that a change of ownership is ignored in calculating the relief due to the person then carrying on the trade. So *subsection (4)* of this section includes expenditure incurred by "a predecessor" of the company carrying on the trade in the definition of ancillary capital expenditure.

Section 147: Deduction for capital expenditure

571. This section provides for a deduction for certain capital expenditure incurred by the trader or a predecessor. It is based on section 91 of ICTA. The corresponding rule for income tax is in section 170 of ITTOIA.

572. Section 91 of ICTA refers to "land" in a cemetery or crematorium. *Subsection (1)* refers instead to "an interest in" such land. This accommodates better the possibility that operators of cemeteries and crematoria might sometimes hold land in leasehold rather than in freehold form.

Section 148: Allocation of ancillary capital expenditure

573. This section contains special rules for allocating ancillary capital expenditure to a period of account. It is based on section 91 of ICTA. The corresponding rule for income tax is in section 171 of ITTOIA.

574. See section 146(4) for the definition of "ancillary capital expenditure".

Section 149: Exclusion of expenditure met by subsidies

575. This section excludes certain expenditure for the purposes of section 147. It is based on section 91 of ICTA which applies the provisions of section 532 of CAA for the purposes of section 91 of ICTA. The corresponding rule for income tax is in section 172 of ITTOIA.

576. *Subsection (3)* refers to a grant made under Northern Ireland legislation and declared by the Treasury to correspond to a grant under Part 2 of the Industrial Development Act 1982. The term "Northern Ireland legislation" is defined by Schedule 1 to, and section 24(5) of, the Interpretation Act 1978.

577. The Capital Allowances (Corresponding Northern Ireland Grants) Order 2001 (SI 2001/810) lists various grants made in Northern Ireland and declared by the Treasury to correspond to a grant under Part 2 of the Industrial Development Act 1982 in so far as they are made towards capital expenditure. The Industrial Development Act 1982 has been repealed. But a deduction under section 147 of this Act continues to be allowed for expenditure met by a grant corresponding to a grant under Part 2 of the 1982 Act incurred by the trader, or by a predecessor.

Section 150: Revenue nature of expenditure

578. This section provides for the trader's expenditure, on producing or acquiring the original master version of a sound recording, to be treated as expenditure of a revenue nature. It is based on section 48 of FA 2006.

579. Where this section applies to a sound recording any of the trader's receipts from it are treated as having a revenue nature.

Section 151: Allocation of expenditure

580. This section provides for the allocation of a trader's expenditure on producing or acquiring the original master version of a sound recording except where that master version is trading stock. It is based on section 49 of FA 2006.

581. *Subsection (3)* sets out the basis for the allocation and *subsection (4)* provides for an enhanced allocation in certain cases.

Section 152: Interpretation of sections 150 and 151

582. This section provides definitions of terms used in the previous two sections. It is based on sections 31 and 50 of FA 2006.

Section 153: Reserves of marketing authorities and certain other statutory bodies

583. This section, and the following two sections, contain special rules for the treatment of the statutory reserve funds which must in certain circumstances be maintained by certain statutory authorities. It is based on section 509 of ICTA.

584. This section allows a qualifying statutory body a deduction in calculating its trade profits for any amount of its trade surplus that it is required to pay into a reserve fund. Any amount withdrawn from the fund is taxed as a trade receipt unless it is a repayment of the levy or paid to the producers or a Government Department.

585. *Subsections (1)* and *(2)* identify the statutory bodies to which this section applies.

586. *Subsection (5)* provides definitions for the purposes of this section.

587. The roll of statutes which confer functions that are relevant to these sections and the population of statutory authorities to which these sections might apply has declined in recent years. The Cereals Marketing Act 1965 and the Agriculture Act 1967 still confer functions that are relevant for the purposes of these sections. See, in particular, the powers to make schemes under section 16 of the 1965 Act and section 13 of the 1967 Act.

Section 154: Conditions to be met by reserve fund

588. This section contains conditions which must be met by the reserve fund if the relief under section 153 is to be available. It is based on section 509 of ICTA.

Section 155: Interpretation of sections 153 and 154

589. This section provides definitions of constitutional authorities for the purposes of the two previous sections. It is based on section 509 of ICTA, paragraph 11 of Schedule 12 to the Northern Ireland Act 1998 and section 85 of the Government of Wales Act 2006.

590. *Subsections (1)* and *(2)* rewrite the source legislation to reflect the effect of devolution settlements. See *Change 15* in Annex 1.

591. The Government of Wales Act 2006 created a new devolution settlement for Wales. It replaced the National Assembly for Wales constituted under the Government of Wales Act 1998 ("the old Assembly") with a new National Assembly for Wales. Schedule 11 to the 2006 Act provides for functions conferred on the old Assembly (with certain exceptions that are not relevant here) to be transferred to the Welsh Ministers. It is in theory possible that schemes such as are mentioned in section 509(1) of ICTA could have been approved by the old Assembly before its functions were transferred to the Welsh Ministers. A paragraph in Schedule 2, the Schedule of transitionals and savings (reserves of marketing authorities etc), affecting section 153(5), covers this possibility.

592. Subsection (1) refers to "a Minister within the meaning of the Northern Ireland Act 1988". This rewrites the reference in section 509(3) of ICTA to a "head of department" read with paragraph 11(1) of Schedule 12 to the Northern Ireland Act 1998.

Chapter 10: Trade profits: changes in trading stock

Overview

593. This Chapter rewrites the rules in Part 2 of Schedule 15 to FA 2008. The rules relate to the corporation tax consequences of taking stock from, or introducing stock to, a trade.

Section 156: Meaning of "trading stock"

594. This section provides a definition for the purposes of this Chapter. It is based on paragraph 5 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172A of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

595. *Subsection (2)* sets out the main difference between this definition and the one used in Chapter 11 of this Part.

Section 157: Trading stock appropriated by trader

596. This section sets out the rule for trading stock taken by a trader. It is based on paragraph 6 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172B of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

Section 158: Trading stock supplied by trader

597. This section sets out the rule for something that is supplied by a trader for use as trading stock. It is based on paragraph 7 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172C of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

Section 159: Disposals not made in the course of trade

598. This section sets out the rule for trading stock disposed of by a trader. It is based on paragraph 8 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172D of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

599. The rule in this section applies to non-trading disposals to a person other than the trader. If the stock is taken by the trader section 157 applies instead.

Section 160: Acquisitions not made in the course of trade

600. This section sets out the rule for trading stock acquired by a trader. It is based on paragraph 9 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172E of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

601. The rule in this section applies to non-trading acquisitions from a person other than the trader. If the stock is acquired from the trader section 158 applies instead.

Section 161: Transfer pricing rules to take precedence

602. This section gives priority to the transfer-pricing rules in Schedule 28AA to ICTA. It is based on paragraph 10 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172F of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

603. The rule in this section ensures that none of the exemptions in Schedule 28AA to ICTA can be overridden by an adjustment imposed by this Chapter of the Act.

Chapter 11: Trade profits: valuation of stock on cessation of trade

Overview

604. This Chapter sets out the rules for valuing stock when a company ceases to carry on a trade. The rules for valuing work in progress are not rewritten because, for tax purposes, a company cannot carry on a profession (see *Change 2* in Annex 1). If a company has incomplete services when it ceases to carry on a trade they are included in its trading stock (see section 163(2) of this Act) and valued in accordance with the rules in this Chapter.

Section 162: Valuation of trading stock on cessation

605. This section sets out two general propositions. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 173 of ITTOIA. The first proposition is that a valuation has to be made. The second is that the valuation has to be made in accordance with the rules in this Chapter.

606. *Subsection (3)* is the rule for trades carried on in partnership. The general rule in ICTA is that a change in the companies carrying on a trade is treated as the cessation of the trade. But, in the case of a trade carried on in partnership, section 114(1) of ICTA provides that there is a cessation for the purpose of calculating the profits of the firm's trade only if there is a complete change in the companies carrying on the trade.

Section 163: Meaning of "trading stock"

607. This section defines trading stock. It is based on sections 100 and 101 of ICTA. The corresponding rule for income tax is in section 174 of ITTOIA.

608. The definition of trading stock applies:

- in section 151 (sound recordings);
- in this Chapter;
- in section 185 (adjustment on change of basis); and
- in section 195 (post-cessation receipts).

609. Section 101(3) of ICTA is invoked by section 100(2) of that Act and is concerned with valuation of incomplete services "at the discontinuance". So the definition in this section refers to incomplete services "at the time of the cessation".

Section 164: Basis of valuation of trading stock

610. This section introduces the five sections that follow. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 175 of ITTOIA.

611. The five sections (including section 168 which defines "connected persons") deal with the valuation of stock that is transferred to another trader. In each case, the requirement in section 100 of ICTA that the transferee carries on a trade is relaxed to include transfers to a person carrying on a profession or vocation. The income tax rules are amended to bring the income tax and corporation tax codes into line. See *Change 39* in Annex 1.

612. *Subsection (4)* of this section deals with the case where the stock is not transferred to a person carrying on a trade, profession or vocation.

Section 165: Sale basis of valuation: sale to unconnected person

613. This section sets out the rule for the common case where the trading stock is transferred to an unconnected trader. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 176 of ITTOIA.

614. The section leads directly to the use of the sale price of the stock as the basis of valuation. If the transfer is other than by sale, section 170 explains how the expressions used in this section are to be interpreted.

Section 166: Sale basis of valuation: sale to connected person

615. This section sets out the rule for the case where the stock is transferred to a connected person. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 177 of ITTOIA.

616. The section preserves the concept of an arm's length price. This will usually be the same as the open market value (see section 164(4)) but sometimes there will be a difference.

617. For example, in a capital transfer tax case, IRC v Spencer-Nairn [1991] STC 60, the Court of Session considered the meaning of an arm's length price and distinguished it from open market value. This was on the basis that the seller in that case had imperfect information. A sale at arm's length by that seller would not assume that the seller had better information; a sale in the open market would assume perfect information on both sides of the bargain.

618. Furthermore, in the case of an actual sale to a connected trader, there is no need to *assume* there is a sale. It is enough to treat the sale as made at arm's length. This leaves open the possibility that the stock is worth something different from open market value to a person who intends to use the stock in the trade.

Section 167: Sale basis of valuation: election by connected persons

619. This section allows the seller and purchaser of stock that would otherwise be valued at arm's length under section 166 to elect to use instead the price paid for the stock. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 178 of ITTOIA.

620. The election cannot be made unless the arm's length value of the stock is greater than its "acquisition value" in the hands of the seller.

621. The "acquisition value" of the stock for the company which ceases to trade is effectively book value, but the definition in *subsection (5)* is more complicated than this. In the case where the net realisable value of stock has fallen below cost in the period leading up to cessation, a new period is deemed to start just before the deemed sale. That allows the new, lower, net realisable value to be used. It may be possible to manipulate net realisable value by selling the stock at an undervalue after the accounting date. So paragraph (a) of the definition assumes that the sale is at an arm's length value.

622. The election substitutes the price paid for the arm's length value of the stock. But the price paid must be higher than the acquisition value. Otherwise, the election substitutes the acquisition value for the arm's length value.

623. This section does not specify that the election is to be made to "the inspector". But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

Section 168: Connected persons

624. This section provides a definition of connected persons for the stock valuation sections. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 179 of ITTOIA.

625. This section is one of the exceptions to the general rule in section 1258 that a firm is not to be regarded for tax purposes as a separate entity. If a firm is connected with the seller or purchaser of its stock, section 166 (rather than section 165) applies but the firm may make an election under section 167.

Section 169: Cost to buyer of stock valued on sale basis of valuation

626. This section sets out the rule for the buyer of the stock. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 180 of ITTOIA.

627. In a "sale basis" case, the value given to the trading stock of the company whose trade has ceased is also used to calculate the profits of the buyer of the stock.

628. The reference to ITTOIA caters for the case where the stock is acquired from a person liable to income tax. The valuation under that Act for income tax purposes is used as the cost to the buyer who is liable to corporation tax.

Section 170: Meaning of "sale" and related expressions

629. The stock valuation sections refer to a sale of stock. This section explains how the sections are to be interpreted if the stock is transferred other than by way of sale. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 181 of ITTOIA.

Section 171: Determination of questions

630. This section treats any "question" arising under sections 164 to 167 as an appeal (to be determined by the tribunal). It is based on section 102 of ICTA. The corresponding rule for income tax is in section 186 of ITTOIA.

Chapter 12: Deductions from profits: unremittable amounts

Overview

631. This Chapter gives statutory effect to ESC C34. The corresponding rules for income tax are in Chapter 13 of Part 2 of ITTOIA. See part (A) of *Change 40* in Annex 1. This change reproduces Change 50 in ITTOIA and so brings the income tax and corporation tax codes back into line.

632. The extra-statutory concession provides relief for trade debts that cannot be remitted to the United Kingdom. It is similar in scope to section 584 of ICTA (relief for unremittable overseas income), which is rewritten as Part 18 of this Act (unremittable income). The corresponding provision for income tax is Chapter 4 of Part 8 of ITTOIA.

633. Section 584 of ICTA provides relief for unremittable income arising outside the United Kingdom, including unremittable trade profits. But relief under section 584 of ICTA does not extend to trade debts owed to, or paid to, the company outside the United Kingdom if the profits of the trade arise in the United Kingdom. This Chapter provides relief for such debts and payments.

634. ESC C34 requires the relief to be claimed. Under this Chapter the relief is allowed as a deduction without the need for a formal claim. See part (B) of *Change 40* in Annex 1.

635. The deduction is not mandatory if the qualifying conditions are met. A company can choose whether or not to include the deduction in its tax return. If a deduction is taken the recovery provisions in section 175 follow automatically.

Section 172: Application of Chapter

636. This section defines the basic concepts. It is based on ESC C34. The corresponding rule for income tax is in section 188 of ITTOIA.

637. The relief applies both to amounts owed to the company and to amounts that have been paid to the company. Relief is allowed if some, or all, of those amounts cannot be remitted to the United Kingdom because of foreign exchange restrictions. The different definitions of "unremittable" in *subsections (2)* and *(3)* reflect the differences between an amount that has been paid and an amount owed.

638. The relief is available to any company, including a company carrying on a financial trade.

639. *Subsection (4)* provides a definition of "foreign exchange restrictions". Local foreign exchange restrictions are not defined in the extra-statutory concession but are clearly a key concept in the operation of the concession. This subsection introduces a definition based on section 584(1)(a) of ICTA. That subsection is rewritten as section 1274 (unremittable income: introduction) in Part 18. The corresponding provision for income tax is section 841(3) of ITTOIA. By basing the definition on section 584 of ICTA this Act brings the two reliefs into line.

640. This section and the rewrite of section 584 of ICTA in Part 18 of this Act clarify the scope of section 584 of ICTA and the extra-statutory concession in two ways.

641. First, sections 584(1)(a) of ICTA refers to "the impossibility of obtaining foreign currency in that territory". It could be argued that this condition is not met if it is possible to obtain foreign currency in the overseas territory regardless of whether that currency may be transferred to the United Kingdom. Section 1274 of Part 18 of this Act makes clear that it must not be possible to obtain foreign currency that could be transferred to the United Kingdom.

642. Second, section 1274 of Part 18 of this Act makes clear that the reference to foreign currency in section 584(1)(a) of ICTA does not include currency of the overseas country

or territory. In relation to sterling the currency of the overseas country or territory clearly is foreign but in this context "foreign" means foreign to the local territory.

643. *Subsection (5)* deals with the interaction with the loan relationship rules. Most of the amounts in this Chapter will be within the scope of Chapter 2 of Part 4 of FA 1996 because they are loan relationships (rewritten in Parts 5 and 6 of this Act). In particular section 100 of FA 1996 treats trade debts as loan relationships (see Chapter 2 of Part 6).

644. Section 80(5) of FA 1996 is a wide-ranging rule which provides that only Chapter 2 of Part 4 of FA 1996 applies to any loan relationship unless there is an express provision to the contrary. Section 80(5) of FA 1996 has been rewritten as section 464(1). This rule would prevent relief being given under section 173 or recovered under section 175. Subsection (5) overrides section 464(1).

Section 173: Relief for unremittable amounts

645. This section sets out how the relief is given. It is based on ESC C34. The corresponding rule for income tax is in section 189 of ITTOIA.

646. The section has more detail than the extra-statutory concession about the mechanics of the relief. This is necessary to give the certainty required for corporation tax self assessment. Relief can be given only against the profits of the trade that include the unremittable amount. It cannot be used to create or increase a loss. But any excess relief is not lost. It is carried forward and set against future profits of the trade.

Section 174: Restrictions on relief

647. This section describes the various circumstances in which relief is not allowed. It is based on ESC C34. The corresponding rule for income tax is in section 190 of ITTOIA.

648. *Subsection (1)* denies a deduction if the funds are applied outside the United Kingdom.

649. *Subsection (2)* denies a deduction if the company has received an insurance recovery in respect of the debt. This differs from the approach in the extra-statutory concession. Paragraph 4 of the concession denies relief if any part of the debt is insured. This Act denies, or recovers, relief only if an insurance recovery is received. See part (C) of *Change 40* in Annex 1.

650. *Subsection (3)* denies a deduction if the company can make a claim under section 1275 (claim for relief for unremittable income) in Part 18 that the income is unremittable. The corresponding provision for income tax is section 842 of ITTOIA.

651. This restriction will apply only if the profits of the trade that include the unremittable amounts arise outside the United Kingdom, for example, because the profits arise in an overseas branch.

Section 175: Withdrawal of relief

652. This section sets out the circumstances in which relief is withdrawn and the machinery by which it is withdrawn. It is based on ESC C34. The corresponding rule for income tax is in section 191 of ITTOIA.

653. *Subsection (2)* lists the events that trigger a withdrawal of the relief. Paragraphs (a) and (e) deal with the straightforward cases in which the amount, or part of it, ceases to be unremittable or is exchanged for an amount that can be remitted. Paragraphs (c), (d), and (f) deal with the events listed in section 174 that would have prevented relief being given if they had occurred before the deduction was allowed.

654. Paragraph (f) deals with the case of insurance recoveries. It differs from the approach in the extra-statutory concession, which denies any relief if the debt is insured. This Chapter denies or recovers relief only if an insurance recovery is received (see the commentary on section 174). See part (C) of *Change 40* in Annex 1.

655. This follows the approach in section 584 of ICTA when a payment is received from the Exports Credit Guarantee Department. The withdrawal of relief under section 584 of ICTA is rewritten as section 1276 (unremittable income: withdrawal of relief) in Part 18. The corresponding provision for income tax is section 843 of ITTOIA.

656. *Subsection (3)* sets out the way the relief is recovered. The amount identified in subsection (2) is treated as a trade receipt for the accounting period in which the event occurs. It is possible that more than one event will apply to the same amount. Subsection (3)(b) ensures the relief is withdrawn only once.

657. *Subsection (4)* applies if the amount of the insurance recovery is less than the amount that is unremittable. In that case the amount of the recovery is limited to the amount of the insurance recovery.

Chapter 13: Disposal and acquisition of know-how

Overview

658. This Chapter sets out the rules for calculating trade profits if a trading company receives a payment for know-how. Payments to non-traders are dealt with by the rules in Chapter 2 of Part 9 of this Act.

659. Part 8 of this Act sets out rules for the taxation of gains and losses on companies' intangible fixed assets. Those rules take priority over any other tax rules (see section 906). So the Part 8 rules generally apply instead of the rules in this Chapter. But Chapter 16 of Part 8 ensures that the new rules apply only to assets created or acquired on or after 1 April 2002.

660. The Chapter refers to the "disposal" of know-how. As Walton J pointed out in John and E Sturges Ltd v Hessel (1975), 51 TC 183 ChD[6] (on page 206):

> the mere imparting of "know-how" cannot be equated with the disposal of a capital asset. Just like the schoolmaster's knowledge, it remains the property of the person imparting it as well after as before another is told.

661. This Act retains "disposal" because "disclosure" gives rise to difficulties in identifying the person to whom the disclosure is made (who may not be the person who buys the know-how).

Section 176: Meaning of "know-how" etc

662. This section sets out the meaning of know-how and explains other concepts used in the Chapter. It is based on sections 531 and 533 of ICTA and section 572 of CAA. The corresponding rule for income tax is in section 192 of ITTOIA.

663. The definition of "mineral deposits" in *subsection (2)* is restored to what it was before the enactment of CAA. See *Change 41* in Annex 1.

664. *Subsections (5)* and *(6)* extend the meaning of "sale" to include an exchange. This rule is based on section 572 of CAA, which applies to section 531 of ICTA in accordance with section 532 of ICTA.

Section 177: Disposal of know-how if trade continues to be carried on

665. This section sets out a general rule for the treatment of payments received for the disposal of know-how. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 193 of ITTOIA.

6 [1975] STC 127

666. *Subsections (3)* to *(6)* deal with the case where know-how is disposed of with other assets. The rules are based on sections 562 and 563 of CAA, which apply to section 531 of ICTA in accordance with section 532 of ICTA.

Section 178: Disposal of know-how as part of disposal of all or part of a trade

667. This section sets out the main exception to the general rule in section 177. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 194 of ITTOIA.

668. *Subsection (2)* provides that a payment for know-how as part of the disposal of a trade is generally treated as a capital receipt for goodwill. This rule applies only if the person making the disposal is liable to corporation tax. If that person is liable to income tax the rule in section 194 of ITTOIA applies, with the same result.

669. *Subsection (5)* allows the parties to the transaction to elect for the payment not to be treated as one for goodwill. The effect of an election for the purchaser is that the payment may qualify for capital allowances under Part 7 of CAA. Or, exceptionally, the purchaser may be able to treat the payment as a trading expense. As such an election may affect both parties to the transaction the election has to be made by both.

670. The question whether the election is made under this section or under section 194(5) of ITTOIA is decided by reference to the position of the person disposing of the know-how. If that person is liable to corporation tax this section applies; if the person is liable to income tax, ITTOIA applies.

671. This section does not specify that the election is to be made to "the inspector". But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

672. *Subsection (6)* gives the time limit for the election. Most elections in this Act have to be made "not later than two years after the end of the accounting period …". But in this case one of the persons making the election may be chargeable to income tax. So the time limit for an election is based on the date of the disposal.

673. *Subsection (7)* deals with a disposal by an income tax payer to a corporation tax payer. An election under section 194(5) of ITTOIA is treated as an election under this section. The corresponding rule for a disposal by a corporation payer to an income tax payer is in section 194(7) of ITTOIA.

Section 179: Seller controlled by buyer etc

674. This section ensures that if the seller and buyer are under common control:

- the general rule in section 177 does not apply; and
- the parties to the transaction may not elect for the payment for know-how not to be treated as a capital payment for goodwill.

675. The section is based on section 531 of ICTA. The corresponding rule for income tax is in section 195 of ITTOIA.

676. For the purposes of this section, "control" is defined in section 840 of ICTA (as applied by section 1316 of this Act). The ICTA definition of "control" is identical in effect to that in section 574 of CAA. But, as the relevance of "control" in this Act goes wider than this Chapter, the ICTA definition is used here.

677. This section is one of the exceptions to the general rule in section 1258 of this Act that a firm is not to be regarded for tax purposes as a separate entity. If a firm is connected with the seller or purchaser of its know-how the payment for know-how is treated as one for goodwill.

Chapter 14: Adjustment on change of basis

Overview

678. This Chapter sets out the rules for dealing with two sorts of changes in the way profits of a trade are calculated.

679. The first sort of change is in the way the accounts are drawn up. The rule is that profits must be calculated on the basis of accounts drawn up in accordance with generally accepted accounting practice (see section 50 of FA 2004 and section 46 of this Act).

680. If there is a change in the basis on which accounts are drawn up, some receipts and expenses may fall out of account for tax purposes. This sort of change was dealt with originally in the rules that became section 104(4) to (7) of ICTA. Those rules were replaced by the rules in section 44 of, and Schedule 6 to, FA 1998. The 1998 rules were replaced by section 64 of, and Schedule 22 to, FA 2002.

681. The second sort of change is in the way tax adjustments are made. These are the adjustments "required or authorised by law in calculating profits for tax purposes" (section 46). This sort of change was dealt with for the first time by the 2002 legislation.

682. Section 1267 of this Act applies the rules to trades carried on in partnership.

683. The corresponding rules for income tax are in Chapter 17 of Part 2 of ITTOIA. The title of that Chapter is "adjustment income" because there is a charge on such income in section 228(2) of ITTOIA. For corporation tax a positive adjustment is treated as a trade receipt. So the title of this Chapter is more general.

Section 180: Application of Chapter

684. This section sets out the circumstances in which an adjustment may arise. It is based on section 64 of FA 2002. The corresponding rule for income tax is in section 227 of ITTOIA.

685. Section 64 of FA 2002 refers to a change of the basis on which profits are calculated. This might mean *any* change of basis. But paragraph 3(2) of Schedule 22 to FA 2002 makes clear that it does not include a change which occurs on a change of ownership of a trade.

686. The trading income rules in this Part are generally "company-based". So this section applies when *a company* changes the basis. That company must be the same before and after the change of basis. So this section reproduces the effect of paragraph 3(2) of Schedule 22 to FA 2002.

687. An adjustment has to be made if:

- the "old basis" accorded with the law *or* practice at the time; and
- the "new basis" accords with the current law *and* practice.

688. The difference in wording is to cater for a case in which a decision of the Courts makes it clear that a previously accepted view of the law was wrong. In that case, the old basis accorded with the practice but not the law. The 1998 rules did not cater for this. But the 2002 rules (and the rules in this Chapter) do.

689. The section refers to "a trade". So the rules apply to trades carried on wholly outside the United Kingdom as they apply to trades carried on at least partly in the United Kingdom.

Section 181: Giving effect to positive and negative adjustments

690. This section sets out the treatment of the adjustment. It is based on paragraphs 4 and 5 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 228 of ITTOIA.

691. If the adjustment is positive it is treated as a trade receipt; if the adjustment is negative it is treated as a trade expense.

692. In both cases the treatment is the same whether the trade is taxable under Case I or Case V of Schedule D in the source legislation. The adjustment is treated as arising on the first day of the first period of account for which the new basis is adopted. This contrasts with the income tax treatment which is that the adjustment arises on the last day of the period (see sections 232 and 233 of ITTOIA).

Section 182: Calculation of the adjustment

693. This section contains the main rules for calculating the adjustment. It is based on paragraph 2 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 231 of ITTOIA. The section presents the rules as a method statement.

694. In item 3 of each of Step 1 and Step 2 there is a reference to work in progress as an alternative to trading stock. This follows the source legislation and is needed because the extended meaning of "trading stock" in section 163 of this Act does not apply outside Chapter 11.

Section 183: No adjustment for certain expenses previously brought into account

695. This section deals with the case where the old basis of calculation allowed a tax deduction but the new basis requires the deduction to be spread over several periods. It is based on paragraph 6 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 234 of ITTOIA.

696. In the absence of this section there would be a positive adjustment within item 2 of Step 1 of the calculation of the adjustment in section 182. That would produce the right result overall but the rule would take effect too early. Instead, no adjustment is calculated but no deduction is allowed in future for expenses that have already been taken into account.

Section 184: Cases where adjustment not required until assets realised or written off

697. This section is a timing rule for an adjustment which results from any of the amounts in subsection (2). It is based on paragraph 7 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 235 of ITTOIA.

698. The amounts in subsection (2) are:

- closing trading stock;
- opening trading stock; and
- depreciation.

699. The general timing rule is that any adjustment is made at the start of the first period of account on the new basis (see section 181(2) and (3)). But any adjustment for stock or depreciation is made when the asset is realised or written off.

Section 185: Change from realisation basis to mark to market

700. This section is concerned with a change from the realisation basis to "mark to market" accounting. It is based on paragraph 8 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 236 of ITTOIA.

701. "Mark to market" is a basis of accounting used by traders in financial assets. Instead of carrying the assets in the books at cost, financial traders draw up accounts to show the assets at fair value at the accounting date. But for tax purposes the realisation basis may have been used.

702. In the first period in which mark to market is adopted for tax purposes, the opening stock may be valued at a higher (market) value than the closing stock of the previous period. Or a financial asset may have been carried in the accounts at cost but appear as a deduction in a later period at fair value. In either case, there is an adjustment within section 182.

703. As in section 184, the adjustment is postponed until the asset is realised.

Section 186: Election for spreading if section 185 applies

704. This section provides for an election to be made if there is a receipt (following a change to mark to market) under section 185. It is based on paragraph 9 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 237 of ITTOIA.

705. The election is to spread the adjustment receipt over six periods of account beginning with the first one in which the new basis is adopted. As the receipt is postponed under section 185 until the asset is realised, this first period is not necessarily the one in which the charge would be made without the election.

706. "Period of account" is defined in section 832(1) of ICTA.

Section 187: Transfer of insurance business

707. This section further postpones the charge on an adjustment in the case of assets to which section 185 or 186 applies. It is based on paragraph 10 of Schedule 22 to FA 2002. It is the only section in this Chapter that has no corresponding section in Chapter 17 of Part 2 of ITTOIA.

708. The section applies only to insurance companies. If the asset of an insurance company is transferred to another insurance company in accordance with a relevant transfer scheme, it is not treated as "realised" for the purpose of sections 185 and 186 until it is realised by the transferee company.

Chapter 15: Post-cessation receipts

Overview

709. This Chapter charges receipts which are derived from a trade but are not received until after the trade has ceased and have not been brought into the calculation of profits.

710. The Chapter rewrites sections 103 and 104 of ICTA without distinguishing between trade profits calculated on an earnings basis and trade profits calculated on a "conventional basis" (see section 110(4) of ICTA). One consequence of this approach is that there is no need to rewrite section 104(3) or section 110(3) to (5) of ICTA.

Section 188: Charge to tax on post-cessation receipts

711. This section applies the corporation tax charge on income to post-cessation receipts. It is based on sections 103 and 104 of ICTA. This application of the charge is separate from that on the profits of a trade (see section 35 of this Act). The corresponding rule for income tax is in section 242 of ITTOIA.

Section 189: Extent of charge to tax

712. This section sets out the charge to tax. It is based on sections 103 and 104 of ICTA, which create a charge under Schedule D Case VI on post-cessation receipts. This Act

deals with the income where it logically belongs. In this case the income is trading income. The corresponding rule for income tax is in section 243 of ITTOIA.

713. The charge in the source legislation under Schedule D Case VI has consequences for loss relief. This Act preserves the position for loss relief by amending section 396 of ICTA and listing this Chapter in section 834A of ICTA (see Schedule 1 to this Act).

714. *Subsection (3)* deals with a company which has become non-UK resident after the trade has ceased. A trade carried on at least partly in the United Kingdom may include income that arises abroad. When the company was resident in the United Kingdom all the profits of the trade would have been within the charge under Part 2 of this Act (see section 5). This subsection removes the charge on a non-UK resident company if the receipt arises abroad.

Section 190: Basic meaning of "post-cessation receipt"

715. This section sets out the basic meaning of "post-cessation receipt". It is based on sections 103, 104 and 110 of ICTA. The corresponding rule for income tax is in section 246 of ITTOIA.

716. *Subsection (2)* deals with the unusual case of a company receiving a "sum" which arises from the carrying on of a trade by a person liable to income tax.

717. Paragraph (a) deals with a non-UK resident company liable to income tax. If a company becomes liable to corporation tax it is treated as ceasing to carry on the income tax trade. A post-cessation receipt from that trade may be charged to corporation tax.

718. Paragraph (b) applies where the trade was carried on in partnership. If a partner leaves a firm and a company receives a sum arising from the carrying on of the trade by that partner, the sum may be a post-cessation receipt.

Section 191: Other rules about what counts as post-cessation receipts

719. This section is new. It contains signposts to:

- the seven sections in this Act that treat other sums as post-cessation receipts; and
- the two sections in this Act that exclude certain sums from the charge on post-cessation receipts.

720. The corresponding rule for income tax is in section 247 of ITTOIA.

Section 192: Debts paid after cessation

721. This section sets out what happens when a trader is allowed a deduction for a bad or doubtful debt owed to the trade but then recovers the debt after the trade has ceased. It is based on section 103 of ICTA. The corresponding rule for income tax is in section 248 of ITTOIA.

722. If a deduction for the debt has been given during the course of the trade section 103(5) of ICTA makes it clear that the recovery has not been "brought into account" in calculating the trade profits. The result is that the recovery is within the charge in section 103 of ICTA.

723. *Subsections (1)* and *(2)* treat the recovery of the debt as a post-cessation receipt. The references to section 35 of ITTOIA and income tax cater for the possibility that a deduction for a bad debt is allowed to a person liable to income tax but the debt is paid to a person liable to corporation tax.

Section 193: Debts released after cessation

724. This section sets out the rules that apply when a debt owed by the trader is released after the trade has ceased. It is based on section 103 of ICTA. The corresponding rule for income tax is in section 249 of ITTOIA.

725. *Subsection (1)* sets out the four conditions to be met if the section is to apply. It is the equivalent of section 94 of this Act which applies in the case of a continuing trade. The reference to income tax caters for the possibility that a deduction for an expense is allowed to a person liable to income tax but a person liable to corporation tax takes over the related trade debt and is released from it.

Section 194: Transfer of rights if transferee does not carry on trade

726. This section deals with the position of the transferor if the right to a post-cessation receipt is transferred for value to a non-trading transferee. It is based on section 106 of ICTA. The corresponding rule for income tax is in section 251 of ITTOIA.

727. The transferor is charged to tax on the amount received for the transfer if the transfer is at arm's length. Otherwise the transferor is charged to tax on the arm's length value of the transfer. There is no later charge to tax on the transferee when the post-cessation receipt is received.

728. Section 95 of this Act sets out the position if the transfer is to a trading transferee.

Section 195: Transfer of trading stock

729. This section excludes from the charge on post-cessation receipts sums arising from the transfer of stock. It is based on sections 103, 104 and 110 of ICTA. The corresponding rule for income tax is in section 252 of ITTOIA.

730. *Subsection (1)* makes explicit the general rule that there is no tax charge on a post-cessation receipt arising from trading stock.

731. The policy is that stock should be valued at cessation in accordance with the rules in Chapter 11 of this Part. Once that has been done there is no need to charge tax on any sums arising from the disposal or realisation of stock.

Section 196: Allowable deductions

732. This section is the first of two that set out the rules for allowing deductions from sums charged as post-cessation receipts. It is based on section 105 of ICTA. The corresponding rule for income tax is in section 254 of ITTOIA.

733. *Subsection (3)* ensures that a deduction is not allowed for any expenses for which relief has already been allowed (for income tax) under section 96 of ITA or under any other provision.

Section 197: Further rules about allowable deductions

734. This section is the second of two that set out the rules for allowing deductions from sums charged as post-cessation receipts. It is based on section 105 of ICTA. The corresponding rule for income tax is in section 255 of ITTOIA.

735. *Subsection (2)* ensures that any loss unused at the date of cessation is set off against post-cessation receipts in the same order as it would have been set off against profits under section 393 of ICTA, that is, against an earlier accounting period before a later accounting period.

736. The references to capital allowances in section 105(1)(b) and (3) of ICTA are no longer needed because any capital allowance is allowed as a trading expense.

Section 198: *Election to carry back*

737. This section allows a company to elect to have a post-cessation receipt taxed as though it had been received in the accounting period in which the company ceased to carry on the trade. It is based on section 108 of ICTA, although that section was repealed by ITTOIA. The corresponding rule for income tax is in section 257 of ITTOIA.

738. See *Change 42* in Annex 1.

739. *Subsection (1)* requires that the post-cessation receipt is received (broadly) within six years after the company ceases to carry on the trade. This corresponds to the limit in section 108 of ICTA (which was expressed in terms of years of assessment).

740. *Subsection (3)* gives a two year time limit for the election. This was the original time limit in section 108 of ICTA before it was amended for (income tax) Self Assessment.

Section 199: *Deductions already made are not displaced*

741. This section is a rule about losses allowed against a post-cessation receipts carried back to the period of cessation under section 198. It is new.

742. The rule in this section is broadly the same as the income tax rule in paragraph 5(5) of Schedule 1B to TMA. If relief has already been given under section 196, for a period later than the period of cessation, this section makes clear that the relief is not to be re-calculated as a result of the election under section 198.

743. The section refers only to a "loss" for which a deduction has already been made. Any "expense or debit" already allowed under section 196 would in any event not be available for the accounting period in which the cessation occurred.

744. *Subsection (3)* makes clear that the rule about "displacing" a deduction for a loss does not apply to a deduction that has been made from the post-cessation receipt that is to be carried back.

745. See *Change 42* in Annex 1.

Section 200: *Election given effect in accounting period in which receipt is received*

746. This section sets out the procedure for dealing with an election under section 198. It is new.

747. The procedure for giving the relief is broadly the same as that for income tax. This is an election to which paragraph 58 of Schedule 18 to FA 1998 applies. This section makes clear that the relief is in terms of tax and corresponds to the income tax rule in paragraph 5 of Schedule 1B to TMA.

748. See *Change 42* in Annex 1.

Chapter 16: *Priority rules*

Section 201: *Provisions which must be given priority over this Part*

749. This section sets out the priority rules that apply when a receipt or other credit item might otherwise fall within more than one head of charge. It is based on section 18 of ICTA. The corresponding rules for income tax are in section 4 of ITTOIA.

750. *Subsection (2)* deals with potential overlap with ITEPA. It is based on section 18 of ICTA. In the source legislation Schedule D is the residual Schedule. So the charge in ITEPA on employment income, and other income formerly within Schedule E, has priority over the charge on profits of a trade (Schedule D in the source legislation).

Part 4: Property income

Overview

751. This Part applies to "property income". That is, income from land. The corresponding rules for income tax are in Part 3 of ITTOIA.

752. This Part covers income that is taxed under different Schedules and Cases in the source legislation. So it covers, for example, income from land both in the United Kingdom and abroad, as well as post-cessation receipts from property businesses.

753. This reflects the approach of grouping types of income which are logically part of the same "family". In this Part the unifying factor is that all the elements are amounts that are, ultimately, attributable to exploiting an interest in land.

754. As a consequence, this Part groups elements which in the source legislation are separate. But those elements do not lose their identity for all purposes. Loss relief, for example, requires them to be kept apart. For this reason the charge to corporation tax on "property income" has specific components (see section 202).

755. This Part is not an exhaustive statement of the rules for the calculation of property income. Other regimes may affect that calculation. In particular, Parts 8, 11 and 14 of this Act contain rules that may affect property business profits.

756. References to "profits or gains" in the source legislation which relate only to income are rewritten in this Part omitting the reference to "gains". This continues the tidying up of such references begun in section 46(3) of, and Schedule 7 to, FA 1998.

Chapter 1: Introduction

Section 202: Overview of Part

757. This section is introductory. It is new.

Chapter 2: Property businesses

Section 203: Overview of Chapter

758. This section introduces the Chapter and provides a "road map" to the key provisions. It is new.

759. Chapter 2 sets out the key concepts underlying the main component of income within this Part of this Act by defining "property business" and "generating income from land".

Section 204: Meaning of "property business"

760. This section defines "property business". It is new.

761. *Subsection (1)* reflects the fact that section 70A of ICTA applies the same basic rules for income from UK land to income from overseas land. So most of the provisions in this Part apply to both UK and overseas property businesses alike. Where they do not, the particular section makes that clear by, for example, referring to a UK property business only.

762. The term "property business" is not entirely straightforward. The term used in the source legislation, "Schedule A business", was introduced as part of the 1995 reform of Schedule A for income tax and was applied to corporation tax in 1998. That concept was helpful in providing a vessel to contain all the income from land previously charged under Schedule A and to which the rules for calculating trade profits could be applied. But the concept of a Schedule A business, and a UK property business, is rather more complex than that of a trade. That is reflected in this and the other sections that, together, define the range of income that is assessed as income of a property business.

Section 205: UK property business

763. This section defines "UK property business" and introduces the concept of "generating income from land". It is based on section 15(1) of ICTA. The corresponding rule for income tax is in section 264 of ITTOIA.

764. It gives a basic "one business per company" rule: that (subject to special cases such as those mentioned in section 203(3) and (4)) all the income from a company's UK land interests is treated as falling within a single UK property business.

765. Although the Chapter builds on the concept of the "business", the approach differs from the approach in the source legislation. This Act adopts the same approach as ITTOIA and uses the term "UK property business" rather than "Schedule A business".

Section 206: Overseas property business

766. This section defines "overseas property business". It is based on section 70A of ICTA. The corresponding rule for income tax is in section 265 of ITTOIA.

767. The definition is identical to that of "UK property business" except that the land from which the income arises is outside the United Kingdom..

768. For the purpose of deciding whether there is an overseas property business, overseas land law is interpreted in accordance with section 290.

Section 207: Meaning of "generating income from land"

769. This section defines "generating income from land". It is based on sections 15(1) and 24 of ICTA. The corresponding rule for income tax is in section 266 of ITTOIA.

770. The section defines what may be described as the essence of the property business. That is, exploiting rights of land ownership for profit. But it is not intended to identify everything that must be taken into account in calculating the profits of such a business. The concept of the property business is wider than that. "Property business" includes, for example, amounts specifically charged under other provisions such as certain insurance recoveries (see section 103 applied by section 210(2)).

771. *Subsection (2)* extends the meaning of "rents" and is based on section 24(6)(b) of ICTA. Including this extension in the main section (in the source legislation it is relegated to a "construction" section) keeps all the relevant definitions together.

772. *Subsection (3)* explains "other receipts" in subsection (1). This list is not exhaustive but amounts that are not listed here would have to be of a similar nature to those that are listed to come within the definition.

773. *Subsection (4*) extends the charge to particular types of receipt. The source legislation cross-refers to a definition of "caravan" in the Caravan Sites and Control of Development Act 1960. There is a Act-wide definition of "caravan" in section 1314 (and see *Change 96* in Annex 1). "Houseboat" is defined in section 1319 (other definitions).

Section 208: Activities not for generating income from land

774. This section excludes certain "land-related" income from property income and cross-refers to the trading income provisions under which that income is charged. It is based on section 15(1) of ICTA. The corresponding rule for income tax is in section 267 of ITTOIA.

Chapter 3: Profits of property businesses: basic rules

Section 209: Charge to tax on profits of a property business

775. This section applies the corporation tax charge to the profits of a property business. It is based on sections 9, 15 and 18 of ICTA.

Section 210: Profits of a property business: application of trading income rules

776. This is the main rule for calculating the profits of a property business. It is based on section 21A of ICTA. The corresponding rule for income tax is in section 272 of ITTOIA.

777. The same basic rules apply to the calculation of both UK and overseas property businesses.

778. From 1998, the profits of a Schedule A business charged to corporation tax are calculated by treating the business as similar to a trade and applying the calculation rules of Schedule D Case I.

779. In the source legislation this is achieved by section 21A of ICTA. But, at the margins, the application of certain of the Case I rules to Schedule A is not altogether clear.

780. First, the relationship of section 21A(2) of ICTA to section 21A(1) of ICTA is uncertain. Section 21A(2) of ICTA refers to provisions that apply "in accordance" with section 21A(1). It is open to debate whether section 21A(2) of ICTA merely contains examples of the Schedule D Case I provisions that apply in accordance with the general rule in section 21A(1) of ICTA or whether it contains an exhaustive list of those provisions. The former appears the better view and the one best reflecting the underlying policy.

781. Second, some Schedule D Case I provisions that are applied to Schedule A are inherently incapable of applying to income from land. The "herd basis" provisions in section 97 of, and Schedule 5 to, ICTA (rewritten in Chapter 8 of Part 3 of this Act) are an example. They are among the provisions of Chapter 5 of Part 4 of ICTA that are applied to Schedule A specifically (subject to stated exceptions) by section 21A(2) of ICTA. But they are not among the exceptions referred to in section 21A(4) of ICTA. On the other hand, some Schedule D Case I provisions outside Chapter 5 of Part 4 of ICTA that seem potentially more relevant, such as the car hire provisions in sections 578A and 578B of ICTA, are not applied specifically.

782. Section 210 clarifies these matters by listing all the trading income provisions in Part 3 of this Act that are relevant to property business profits.

783. Some of the sections in Part 3 of this Act that are applied to a property business contain rewrite changes. Those changes are carried through to property income. Details of those changes are recorded in the Annex 1 notes on the particular sections in Part 3.

784. *Subsection (2)* lists all the provisions in Part 3 that are relevant to property business income. It reflects the principle that section 21A(1) of ICTA applies all Schedule D Case I calculation provisions to Schedule A unless they are expressly disapplied elsewhere. Provisions that are expressly disapplied in the source legislation are excluded from the list.

785. Also excluded are provisions which are attracted to Schedule A in the source legislation either expressly by section 21A(2) of ICTA or under the general principle expressed in section 21A(1) of ICTA, but which are incapable of applying once carried over to the context of the property business. Exclusion is achieved simply by omitting them from the list of provisions that do apply.

786. The majority of the provisions in Part 3 that can apply to a property business are applied by subsection (2). But in some cases later sections set out the provisions specifically

(sections 261 and 262 (adjustment on change of basis) and the sections in Chapter 9 of this Part (post-cessation receipts)).

787. The following sections that are applied by subsection (2) merit specific mention. These are:

- sections 56 to 58: expenses of car hire; and
- sections 172 to 175: deduction for unremittable amounts.

788. Including these accurately reflects the effect of section 21A(1) of ICTA.

789. Although the list in subsection (2) excludes trading income provisions that are inherently incapable of applying to a property business it does not exclude those that are merely unlikely to apply. This recognises the possibility of certain provisions applying in unusual circumstances. Examples are sections 87 and 88 (scientific research). Although their relevance to a property business is unlikely, it is not inconceivable and they are needed to cater for the possibility of a landlord funding an activity that would qualify as "scientific research". An example might be research on the decontamination of brown land with a view to building an investment property on it.

Section 211: Loan relationships and derivative contracts

790. This section defines the relationship of the rules in Parts 5 and 7 to those in this Part. It is based on section 15 of ICTA.

791. *Subsection (1)* drops the words of the source "carried on by a company" in referring to a property business because in the context of corporation tax only legislation, they are redundant.

792. *Subsection (2)* is based on the premise that, in the source legislation, the second sentence of paragraph 2(3) of Schedule A is really about the relationship between that provision and section 80(5) of FA 1996 and paragraph 1(2) of Schedule 26 to FA 2002. The source makes a wide statement about the relationship between "this Schedule [A]" and Part 4 of FA 1996 and Schedule 26 to FA 2002. This Act disposes of the concept of Schedule A so the rewritten references are necessarily more focussed.

Section 212: Items treated as receipts and expenses

793. This section gives signposts to other relevant rules of calculation. It is new.

794. In particular the CAA rules override the rules against the inclusion of capital items in sections 53 and 93 of this Act (applied to this Part by section 210(2)).

Section 213: Certain amounts brought into account under Part 3

795. This section excludes from the profits of a property business certain income from land that, exceptionally, may be taxed as profits of a trade. It is based on section 15 of ICTA. See *Changes 4, 5* and *6* in Annex 1 and the commentary on sections 43, 44 and 45. The corresponding rule for income tax is in section 273 of ITTOIA .

Section 214: Relationship between rules prohibiting and allowing deductions

796. This section determines the interaction between those provisions that prohibit a deduction and those provisions that allow a deduction. It is new. The corresponding rule for income tax is in section 274 of ITTOIA.

797. This section does a similar job in Part 4 to that which section 51 does in Part 3. The general principle is that a rule allowing a deduction takes priority over a rule prohibiting a deduction. But that is subject to the exceptions the section mentions. See *Change 7* in Annex 1.

798. *Subsection (4)* makes it clear that the effect of this priority rule extends to the large number of trading income rules that apply to property income indirectly through section 210.

Chapter 4: Profits of property businesses: lease premiums etc

Overview

799. This Chapter contains rules under which a company may be treated as receiving property business receipts in relation to certain lease premiums, or certain other amounts, which would otherwise generally be amounts of a capital nature. It also contains rules whereby relief can, in certain cases, be given to companies in relation to an earlier property business receipt that another person was treated as receiving. The Chapter is based on sections 34 to 38 and 42 of ICTA. The corresponding provisions for income tax are in Chapter 4 of Part 3 of ITTOIA.

800. See sections 62 to 67 for cases in which trading expenses are treated as incurred and deductible by reference to an earlier deemed lease receipt. See section 136 for a case in which trading receipts are reduced by property business receipts that are treated as arising under sections 217 to 225.

Section 215: Overview of Chapter

801. This section provides an overview of the Chapter. It is new. The corresponding provision for income tax is in section 276 of ITTOIA.

Section 216: Meaning of "short-term lease"

802. This section defines "short-term lease" as "a lease whose effective duration is 50 years or less". It is new. The corresponding provision for income tax is in section 276 of ITTOIA.

803. The "effective duration" of a lease is its duration for the purpose of this Chapter. This may not be the same as the contractual duration of the lease. See commentary on sections 243 and 244.

Section 217: Lease premiums

804. This section treats a property business receipt as arising if a premium is payable in relation to the grant of a short-term lease. It is based on sections 34(1), (6) and (7A) and 37(2) of ICTA. The corresponding provision for income tax is in section 277 of ITTOIA.

805. *Subsection (2)* treats a company to which the premium is due as receiving an amount as a result of entering into a transaction mentioned in section 205 (UK property business) or section 206 (overseas property business), depending on the location of the land to which the lease relates. The effect is that the amount will be treated as a receipt of the company's UK or overseas property business.

806. The approach adopted in subsection (2) is also followed in sections 219 to 225.

807. *Subsection (3)* requires the company to which the premium is due to bring the amount into account in calculating the profits of the property business for the accounting period in which the lease is granted. Source legislation is not explicit about the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

Section 218: Amount treated as lease premium where work required

808. This section treats a lease premium as payable if a lease places an obligation on the tenant to carry out certain works. It is based on section 34(2) and (3) of ICTA. The corresponding provision for income tax is in section 278 of ITTOIA.

809. Such treatment could lead to a property business receipt, or a greater receipt, being treated as arising to the landlord under section 217.

Section 219: Sums payable instead of rent

810. This section treats a property business receipt as arising in certain cases where a payment is made instead of rent for some or all of the duration of a lease. It is based on sections 34(1), (4), (6) and (7A) and 37(2) of ICTA. The corresponding provision for income tax is in section 279 of ITTOIA.

811. *Subsection (1)* makes clear that, irrespective of the length of the lease, the payment of a sum instead of rent for a period of 50 years or less is within the scope of this section. Source legislation is not explicit on this point. See *Change 44* in Annex 1.

812. *Subsection (3)* requires the company to which the sum is due to bring an amount into account in calculating the profits of its property business for the accounting period in which the sum is payable. Source legislation is not explicit about the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

813. In calculating the amount to be treated as received in respect of a sum in lieu of rent within section 34(4) of ICTA, the duration of the lease for the purposes of the formula in section 34(1) of ICTA must be adjusted in accordance with section 34(4)(a) of ICTA. For this purpose, there is excluded from the duration of the lease any period other than that in respect of which the sum in lieu of rent is paid. *Subsections (4) and (6)* have the same effect as those provisions of section 34(1) and (4)(a) of ICTA.

Section 220: Sums payable for surrender of lease

814. This section treats a property business receipt as arising in certain cases where a sum is payable for the surrender of a short-term lease. It is based on sections 34(1), (4), (6) and (7A) and 37(2) of ICTA. The corresponding provision for income tax is in section 280 of ITTOIA.

815. *Subsection (3)* requires the company to which the sum is due to bring an amount into account in calculating the profits of its property business for the accounting period in which the sum is payable. Source legislation is not explicit about the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

Section 221: Sums payable for variation or waiver of terms of lease

816. This section treats a property business receipt as arising in certain cases where a payment is made for the variation or waiver of any of the terms of a lease. It is based on section 34(1), (5), (6), (7) and (7A) of ICTA. The corresponding provision for income tax is in section 281 of ITTOIA.

817. *Subsection (1)* makes clear that, irrespective of the length of the lease, the payment of a sum as consideration for the variation or waiver of the terms of a lease for a period of 50 years or less is within the scope of this section. Source legislation is not explicit on this point. See *Change 44* in Annex 1.

818. Subsection (1) also provides that this section applies only if the sum is due to the landlord or to a connected company. Source legislation does not contain this restriction. See *Change 45* in Annex 1.

819. *Subsection (3)* requires the company to which the sum is due to bring an amount into account in calculating the profits of its property business for the accounting period in which the contract providing for the variation or waiver is entered into. Source legislation is not explicit about the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

820. Section 227(1) extends relief under section 228 (the additional calculation rule) to receipts in respect of sums payable for the variation or waiver of the terms of a lease. This is reflected in *subsection (5)* of this section. See *Change 46* in Annex 1.

821. In calculating the amount to be treated as received in respect of a sum for the variation or waiver within section 34(5) of ICTA, the duration of the lease for the purposes of the formula in section 34(1) of ICTA must be adjusted in accordance with section 34(5)(a) of ICTA. For this purpose, there is excluded from the duration of the lease any period other than that in respect of which the variation or waiver has effect. *Subsections (4) and (6)* have the same effect as those provisions of section 34(1) and (5)(a) of ICTA.

Section 222: Assignments for profit of lease granted at undervalue

822. This section treats a property business receipt as arising in certain cases where a company makes a profit on the assignment of a lease that had been granted at an undervalue. It is based on sections 35(1), (2) and (2A) and 37(2) of ICTA. The corresponding provision for income tax is in section 282 of ITTOIA.

823. The formula in *subsection (4)* for calculating the deemed receipt if there is an assignment at a profit is based on section 35(2) of ICTA (which refers back to the formula in section 34(1) of ICTA).

Section 223: Provisions supplementary to section 222

824. This section supplements section 222. It is based on section 35(1) and (2) of ICTA. The corresponding provision for income tax is in section 283 of ITTOIA.

Section 224: Sales with right to reconveyance

825. This section treats a property business receipt as arising in certain cases where a property is sold on terms which provide for the property to be reconveyed to the seller, or to a connected person, at less than the sale price. It is based on section 36(1) and (4A) of ICTA. The corresponding provision for income tax is in section 284 of ITTOIA.

826. *Subsection (1)(b)* provides that this section applies only if the period between sale and reconveyance is 50 years or less. Source legislation effectively applies if the period is 51 years or less. See *Change 47* in Annex 1.

Section 225: Sale and leaseback transactions

827. This section treats a property business receipt as arising in certain cases where a company sells property on terms which provide for the grant of a lease to the vendor or to a connected person. It is based on section 36(1), (3), (4) and (4A) of ICTA. The corresponding provision for income tax is in section 285 of ITTOIA.

828. *Subsection (1)(b)* provides that this section applies only if the period between sale and leaseback is 50 years or less. Source legislation effectively applies if the period is 51 years or less. See *Change 47* in Annex 1.

Section 226: Provisions supplementary to sections 224 and 225

829. This section supplements sections 224 and 225. It is based on section 36(2), (3) and (4B) of ICTA. The corresponding provision for income tax is in section 286 of ITTOIA.

Section 227: Circumstances in which additional calculation rule applies

830. This section sets out cases where a deemed business property receipt is to be reduced, under section 228, by reference to an earlier taxed receipt. It is based on section 37(1), (2), (3) and (9) of ICTA. The corresponding provision for income tax is in section 287 of ITTOIA.

831. *Subsection (1)* provides that those cases include a deemed business property receipt arising in relation to payments for a variation or waiver of terms of a lease. See *Change 46* in Annex 1.

832. Amounts within section 218 (amount treated as lease premium where work required) are not specified separately in subsection (1), or in section 228(2), because section 218(2) treats such amounts as premiums within section 217.

833. *Subsection (3)* sets out the connection that must exist between the lease in relation to which the taxed receipt arises and the lease in relation to which the later deemed business property receipt arises.

834. *Subsection (4)'s* definitions of "taxed lease" and "taxed receipt" are based on the definitions of "head lease" and "amount chargeable on the superior interest" in section 37(1) of ICTA. The definition of a taxed lease, and taxed receipt, includes leases of land, and associated receipts, outside the UK. This restores a relief that was incorrectly removed by ITTOIA. See *Change 48* in Annex 1.

835. *Subsection (5)* stipulates that for section 228 to apply there must be at least one taxed receipt with an "unused amount". That is because section 235 (limit on reductions and deductions) prevents relief being given under section 228 by reference to a taxed receipt if that taxed receipt does not have an unused amount. Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

Section 228: The additional calculation rule

836. This section provides for the amount of a deemed business property receipt to be reduced, in cases within section 227, by reference to an earlier taxed receipt. It is based on section 37(2), (3), (7) and (9) of ICTA. The corresponding provision for income tax is in section 288 of ITTOIA.

837. The amount to be reduced is referred to in this section, and in section 229, as "the receipt under calculation".

838. Section 227 extends relief to deemed business property receipts arising in relation to the variation or waiver of the terms of a lease. *Subsection (2)* reflects this by referring to section 221. See *Change 46* in Annex 1.

839. This section introduces the label "basic relieving amount" for the amount by which the receipt under calculation is to be reduced.

840. *Subsection (3)* requires the basic relieving amount to be restricted under section 229(5) so that it does not exceed the amount of the receipt under calculation. Source legislation is not as explicit about what happens if relief is given in relation to more than one earlier taxed receipt. If there is more than one taxed receipt by reference to which the receipt under calculation may be reduced, it is for the company entitled to the relief to decide the order in which relief is to be taken by reference to those taxed receipts.

841. For subsection (3) to apply there must be at least one taxed receipt with an "unused amount". That is because section 235 (limit on reductions and deductions) prevents relief under this section being given by reference to a taxed receipt if that taxed receipt does not have an unused amount. Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

842. *Subsection (4)*'s use of the "unreduced amount" of the taxed receipt (defined in section 230(2)) in the formula makes clear that the basic relieving amount by reference to a taxed receipt is to be calculated according to the amount of that receipt *before* any reductions or deductions.

843. The definition in *subsection (6)* of "receipt period" in relation to a receipt under sections 217 and 219 to 222 is based on the definition of "the period in respect of which an amount arose" in section 37(7)(b) of ICTA.

Section 229: The additional calculation rule: special cases

844. This section:

- modifies the rule in section 228 if the receipt under calculation arises in respect of part only of the premises subject to the taxed lease; and
- sets limits on the reduction under that section in two cases.

It is based on section 37(2), (3) and (9) of ICTA. The corresponding provision for income tax is in section 289 of ITTOIA.

845. Section 227 extends relief under section 228 to business property receipts treated as arising in relation to the variation or waiver of the terms of a lease. This is reflected in the reference in *subsection (2)* to section 221. See *Change 46* in Annex 1.

846. But subsection (2) does not apply to receipts under section 222 (assignments for profit of lease granted at undervalue) because it is not possible for a lease to be assigned other than in respect of the whole of the premises subject to the lease.

847. *Subsection (3)* requires the fraction in subsection (2) to be calculated on a "just and reasonable basis", where section 37(3) of ICTA requires a "just apportionment". See *Change 12* in Annex 1.

848. *Subsection (4)* restricts the reduction calculated under section 228(4) or subsection (2) of this section to the "unused amount" of the taxed receipt by reference to which it is calculated. That is because giving greater relief would create a conflict with section 235 (limit on reductions and deductions). Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

Section 230: Meaning of "unused amount" and "unreduced amount"

849. This section is based on section 37(1), (8) and (9) of ICTA. The corresponding provision for income tax is in section 290 of ITTOIA.

850. The "unused amount" of a taxed receipt is defined in *subsections (1)* and *(5)*. That label is used by sections 228 and 229 to ensure that relief given by reference to a taxed receipt under those sections does not conflict with section 235 (limit on reductions and deductions). Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

Section 231: Deductions for expenses under section 232

851. This section provides business property deductions to a company for expenses that it is treated as incurring in respect of an earlier taxed receipt. This section is based on section 37(4) and (9) of ICTA. The corresponding provision for income tax is in section 291 of ITTOIA.

852. *Subsection (2)* provides that a deduction for an expense which the tenant is treated as incurring under section 232 is allowed for each "qualifying day" on which all or part of the premises subject to the taxed lease is either occupied for the purposes of the tenant's

property business or is sublet. A "qualifying day" is defined in section 232(3) as a day which falls within the receipt period of the taxed receipt.

853. *Subsection (3)* provides that a deduction for an expense which a tenant is treated as incurring under section 232 is subject to the application of any provision of Chapter 4 of Part 3 (rules restricting deductions). This is based on the source legislation providing that the amounts, corresponding to those in subsection (2), are treated as rent, whose deductibility is therefore subject to rules corresponding to those in Chapter 4 of Part 3.

854. *Subsection (4)* provides that the deduction allowed in respect of an expense under section 232 may be restricted to prevent the cap in section 235, on the total relief which can be given by reference to a taxed receipt, being exceeded. See *Change 49* in Annex 1.

Section 232: Tenants under taxed leases treated as incurring expenses

855. This section sets out the method of calculating the expense for which a deduction may be allowed under section 231. It is based on section 37(4) of ICTA. The corresponding provision for income tax is in section 292 of ITTOIA.

856. The formula in *subsection (4)* calculates the expense for each qualifying day by spreading the amount of the taxed receipt evenly over the receipt period of that receipt. Defining "A" in that formula as "the unreduced amount of the taxed receipt" makes clear that the amount of the expense which the tenant is treated as incurring for each qualifying day is calculated by reference to the amount of the taxed receipt *before* any reductions or deductions.

Section 233: Restrictions on section 232 expenses: the additional calculation rule

857. This section supplements section 232's application to a taxed receipt where a lease premium receipt is also reduced by reference to that taxed receipt. It is based on sections 37(5) and (7) and 37A of ICTA. The corresponding provision for income tax is in section 293 of ITTOIA.

858. *Subsections (2)* and *(3)* provide for a tenant to be treated as incurring an expense for a qualifying day under section 232 only to the extent that the "daily amount of the taxed receipt" exceeds the "daily reduction of the lease premium receipt". This prevents relief being lost in certain cases where more than one taxed receipt has been used to reduce the lease premium receipt to nil. See *Change 13* in Annex 1.

859. The daily amount of the taxed receipt and the daily reduction of the lease premium receipt are calculated according to the formulas in *subsection (6)*:

- the formula for calculating the daily amount of the taxed receipt is the same formula used in section 232(4) to calculate the amount of the expense which the tenant is treated as incurring for each qualifying day; and
- the formula for calculating the daily reduction of the lease premium receipt spreads the reduction calculated under section 228 or the corresponding section in ITTOIA evenly over the receipt period of the lease premium receipt.

860. *Subsection (5)* deals with the case where for a qualifying day a taxed receipt reduces more than one lease premium receipt. In such a case, the tenant is treated as incurring an expense for that day under section 232 only to the extent that the daily amount of the taxed receipt exceeds the *total* of the daily reductions of each of the lease premium receipts. See *Change 13* in Annex 1.

Section 234: Restrictions on section 232 expenses: lease of part of premises

861. This section adapts sections 232 and 233 for cases where the lease premium receipt arises in relation to only a part of the premises in respect of which the taxed receipt

arose. It is based on sections 37(6) and 37A of ICTA. The corresponding provision for income tax is in section 294 of ITTOIA.

862. Section 227 extends relief under section 228 to business property receipts treated as arising in relation to the variation or waiver of the terms of a lease. This is reflected in the reference in *subsection (2)* to section 221. See *Change 46* in Annex 1.

863. *Subsection (4)* applies sections 232 and 233 separately to that part of the premises in relation to which the lease premium receipt arises and to the remainder of the premises. And *subsection (5)* deals with the case where there is more than one sublease which does not extend to the whole of the landlord's premises. See *Change 13* in Annex 1.

864. *Subsection (6)* adapts sections 232 and 233 by multiplying the unreduced amount of the taxed receipt ("A") by the fraction of the premises to which the lease premium relates in the formulas for calculating:

- the expense for a qualifying day in section 232(4); and
- the daily amount of the taxed receipt in section 233(6).

865. *Subsection (7)* requires the fraction in subsection (6) to be calculated on a "just and reasonable basis", where section 37(6) of ICTA is not explicit about the necessary basis of apportionment. See *Change 12* in Annex 1.

Section 235: Limit on reductions and deductions

866. This section places a limit on the relief that can be given under this Chapter in relation to a taxed receipt. It is based on section 37(9) of ICTA. The corresponding provision for income tax is in section 295 of ITTOIA.

867. The section restricts total relief in respect of a taxed receipt by way of:

- reductions under the additional calculation rule in section 228; and
- deductions under section 232.

868. The total relief is restricted to the amount of the taxed receipt after the following (so far as given by reference to the taxed receipt):

- any reductions or deductions under sections 288 or 292 of ITTOIA (which correspond to sections 228 and 232 respectively); and
- any deductions under section 63 (trading expense), or under section 61 of ITTOIA (which corresponds to section 63).

See *Change 49* in Annex 1.

Section 236: Payment of tax by instalments

869. This section provides for corporation tax, attributable to lease premium receipts, to be paid by instalments in certain cases. It is based on section 34(8) of ICTA. The corresponding provision for income tax is in section 299 of ITTOIA.

870. *Subsection (2)* attributes the power to determine the amount and timing of instalments to an officer of Revenue and Customs where the source legislation refers to "the Board" (defined by source legislation to mean "the Commissioners of Inland Revenue"). See *Change 1* in Annex 1.

Section 237: Statement of accuracy for purposes of section 222

871. This section provides for an officer of Revenue and Customs to certify a statement, made in cases where assignment of a lease does or may give rise to a taxed receipt, if

satisfied that that the statement is accurate. It is based on section 35(3) of ICTA. The corresponding provision for income tax is in section 300 of ITTOIA.

Section 238: Claim for repayment of tax payable by virtue of section 224

872. This section provides for corporation tax, paid in respect of a receipt under section 224 (sales with right to reconveyance), to be repaid in certain cases. It is based on section 36(2) of ICTA. The corresponding provision for income tax is in section 301 of ITTOIA.

873. *Subsection (3)* refers to a period of four years where the source legislation provides for six years. Schedule 2 preserves the six year period in the source legislation until an order is made by the Treasury reducing the period to four years.

Section 239: Claim for repayment of tax payable by virtue of section 225

874. This section provides for corporation tax, paid in respect of a receipt under section 225 (sale and leaseback transactions), to be repaid in certain cases. It is based on section 36(2) and (3) of ICTA. The corresponding provision for income tax is in section 302 of ITTOIA.

875. *Subsection (3)* refers to a period of four years where the source legislation provides for six years. Schedule 2 preserves the six year period in the source legislation until an order is made by the Treasury reducing the period to four years.

Section 240: Appeals against proposed determinations

876. This section provides for determinations of amounts under this Chapter that may affect the tax liability of more than one person and for appeals against proposed determinations. It is based on section 42(1), (2) and (3) of ICTA.

Section 241: Section 240: supplementary

877. This section supplements section 240. It is based on section 42(6) and (7) of ICTA.

Section 242: Determination by tribunal

878. This section provides for objections to provisional determinations under section 240 to be determined by an independent tribunal. It is based on section 42(4) and (5) of ICTA.

Section 243: Rules for determining effective duration of lease

879. This section contains rules for determining the effective duration of a lease. It is based on section 38(1) and (6) of ICTA. The corresponding provisions for income tax are in section 303 of ITTOIA.

880. *Subsection (1)* sets out various circumstances in which a lease may be treated as ceasing other than on the date specified in the lease. Rules 1, 2 and 3 are based on paragraphs (a), (b) and (c) respectively of section 38(1) of ICTA.

881. Rule 1 provides that the lease is treated as ending on the date beyond which it is unlikely that the lease will continue. See *Change 50* in Annex 1.

882. *Subsection (3)* is new. It ensures that all amounts that may give rise to a charge to tax by reason of sections 218 to 221 are treated as premiums in applying Rule 1 in subsection (1). See *Change 50* in Annex 1.

883. Schedule 1 to this Act amends section 303 of ITTOIA (rules for determining effective duration of lease) so that the changes also apply for income tax. See *Change 50* in Annex 1.

Section 244: Applying the rules in section 243

884. This section supplements the rules in section 243. It is based on section 38(2), (3) and (4) of ICTA. The corresponding provisions for income tax are in section 304 of ITTOIA.

885. Section 38(4) of ICTA refers to benefits conferred and payments made for the purposes of securing a corporation tax advantage in the application of Part 2 of ICTA (provisions relating to the Schedule A charge) or an income tax advantage in the application of Chapter 4 of Part 3 of ITTOIA (profits of property businesses: lease premiums etc).

886. Part 2 of ICTA consists of sections 21A to 42 of ICTA. Other than the lease premiums rules in sections 34 to 39, the sections of Part 2 of ICTA which are in force are sections 21A to 21C (calculation of the profits of a Schedule A business), section 24 (construction of Part 2), section 30 (sea walls), sections 31ZA to 31ZC (energy-saving items), section 40 (receipts and outgoings on sale of land) and section 42 (appeals against determinations under sections 34 to 36 of ICTA or Chapter 4 of Part 3 of ITTOIA).

887. Sections 43A to 43G of ICTA were also in Part 2 of ICTA and could have applied to leases granted before 6 June 2006. But where those sections applied they gave rise to taxable receipts, rather than deductions from taxable income.

888. It is considered that the only tax advantage that could be secured in the context of section 38(4) of ICTA would be under sections 34 to 37 of ICTA. So *subsection (4)* refers to a corporation tax advantage under this Chapter or an income tax advantage in the application of Chapter 4 of Part 3 of ITTOIA.

Section 245: Information about effective duration of lease

889. This section provides for an officer of Revenue and Customs to require, by notice, information relevant to determining the effective duration of a lease. It is based on section 38(5) of ICTA. The corresponding provision for income tax is in section 305 of ITTOIA.

Section 246: Provisions about premiums

890. This section contains rules about sums that may be treated as premiums and the lease to which a premium may be attributed. It is based on section 24(2) to (4) of ICTA. The corresponding provision for income tax is in section 306 of ITTOIA.

Section 247: Interpretation

891. This section provides rules about the interpretation of "premium" and the application of the Chapter to Scotland. It is based on sections 24(1), (4) and (5), 37(10) and 37A(9) of ICTA. The corresponding provision for income tax is in section 307 of ITTOIA.

Chapter 5: Profits of property businesses: other rules about receipts and deductions

Overview

892. This Chapter contains provisions that supplement the basic calculation rules in Chapter 3 of this Part of this Act. The corresponding rules for income tax are in Chapter 5 of Part 3 of ITTOIA.

893. The provisions in this Chapter are about particular receipts or more unusual circumstances.

Section 248: Furnished lettings

894. This section brings the "letting" of furniture, when it is part and parcel of the letting of accommodation, within the property income charge. It is based on section 15 of ICTA. The corresponding rule for income tax is in section 308 of ITTOIA.

895. Without this provision, rent paid for use of the furniture in furnished lettings would not be included in the property income charge because the "rent" for the furniture does not derive from land.

896. The purpose of *subsection (1)(b)* is to make it clear that related revenue expenses such as the expenses of repair and insurance of the furniture are deductible in calculating the profits of the property business.

897. *Subsection (2)* excludes income and expenses where the hiring of the furniture is not simply incidental to exploiting an interest in land.

898. *Subsection (4)(a)* refers to a "caravan and a houseboat". There is a Act-wide definition of "caravan" in section 1314: see the commentary on section 1314 and *Change 96* in Annex 1. "Houseboat" is defined in section 1319 (other definitions), the corporation tax equivalent of section 878 of ITTOIA.

Section 249: Acquisition of business: receipts from transferor's UK property business

899. This section sets out what happens if a successor to a property business receives a sum that arose from the business when it was carried on by the predecessor. It is based on sections 21B and 106 of ICTA. The corresponding rule for income tax is in section 310 of ITTOIA.

900. *Subsection (2)* treats the "sum" received as a receipt of the property business. As this rule affects the calculation of the profits of a property business it appears in this Chapter rather than with the post-cessation receipt rules, where it is in the source legislation.

901. The source legislation applies "for all purposes". This section applies for corporation tax purposes. Section 310 of ITTOIA applies for income tax purposes. Section 37(1) of TCGA (as construed in accordance with section 8(4) of TCGA) ensures that any sums received as a result of the transfer are not charged to corporation tax on a company's chargeable gains.

Section 250: Reverse premiums

902. This section sets out the rules for taxing reverse premiums as receipts of a property business. It is based on Schedule 6 to FA 1999. The corresponding rule for income tax is in section 311 of ITTOIA.

903. *Subsection (1)* refers to a "reverse premium". In accordance with *subsection (6)* that expression has the same meaning as in section 96. So this section applies to reverse premiums excluding any of the "excluded cases" within section 97. The subsection also excludes any reverse premium that is charged to tax as a trade receipt by section 98.

904. *Subsections (2)* and *(3)* bring the reverse premium within the scope of the property income rules as United Kingdom or overseas property business even if the recipient is not already carrying on a property business.

905. Schedule 2 to this Act rewrites the transitional provision in section 54(2) of FA 1999. This section does not apply to pre 9 March 1999 reverse premiums.

Section 251: Deduction for expenditure on energy-saving items

906. This section provides a deduction for certain expenditure on energy-saving items where that expenditure would not otherwise be allowable because it is capital. It is based on section 31ZA of ICTA.

Section 252: Restrictions on relief

907. This section imposes certain restrictions on the relief that would otherwise be due under section 251. It is based on section 31ZB of ICTA.

Section 253: Regulations

908. This section provides for the Treasury's powers to make regulations for the purposes stated. It is based on section 31ZC of ICTA.

Section 254: Deduction for expenditure on sea walls

909. This is the first of four sections that provide relief to a landlord for making a sea wall or other embankment to protect let premises against flooding by the sea or a tidal river. The corresponding rules for income tax are in sections 315 to 318 of ITTOIA.

910. This section states the circumstances in which the relief is given. It is based on section 30(1), (4) and (5) of ICTA. The corresponding rule for income tax is in section 315 of ITTOIA.

911. *Subsection (2)* makes it clear that to obtain a deduction for sea walls expenditure, the person carrying on the property business and the person incurring the sea walls expenditure must be the same person. This may appear to be stating the obvious but section 30(1) of ICTA says merely that the person incurring the expenditure is treated as making a payment "for the purpose of computing the profits of *any* Schedule A business carried on in relation to those premises" (emphasis added). This does not mean literally any such business carried on by someone other than the person incurring the expenditure: there would be no point in deeming the payment to be made by that person if it were otherwise. And the provisions on transfer of interests in section 30(2) to (3) of ICTA reflect the notion that the deemed payment, and hence the right to relief, moves from the former owner to the transferee. There is no suggestion of involvement by any other party.

912. *Subsection (3)* defines the "deduction period" referred to in subsection (2). Qualifying expenditure is deducted over 21 years in calculating the profits of the property business. The "deduction period" is comparable to the "writing-down period" over which expenditure qualifying for capital allowances is written off. This reflects the similarity between the relief given by the sea walls provisions and certain capital allowances provisions. The relief is for expenditure which would otherwise be capital in nature. And the expenditure is not relieved all at once but over a period, even if there are changes in the person who obtains the relief.

913. *Subsection (5)* is based on section 30(4) of ICTA which deals with the unusual fact that for corporation tax purposes sea walls relief is given by reference to a year of assessment ("tax year" in ITTOIA and this Act). A year of assessment is not a term that is normally relevant to corporation tax where the relevant measures of time are financial years and accounting periods. "Tax year" is defined in a section 1319 (other definitions), the equivalent for corporation tax purposes of section 878 of ITTOIA.

Section 255: Transfer of interest in premises

914. This section deals with the case where the person who incurred the sea walls expenditure sells the premises during the 21 year period over which the deduction is due. It is based on section 30(2) and (3) of ICTA. The corresponding rule for income tax is in section 316 of ITTOIA.

915. *Subsection (1)* applies to transfers of the relevant interest "whether by operation of law or otherwise". These words derive directly from the source legislation. They ensure that the provision applies to, for example, successions to estates as well as the sort of merger of interests envisaged in section 256.

916. *Subsection (2)(b)* requires any apportionment to be "just and reasonable" whereas section 30(2)(a) of ICTA refers simply to an apportionment that is "just". This change reflects the approach that was adopted in CAA and which has been followed in similar contexts elsewhere for consistency. There is no practical difference between the two forms of words. See *Change 12* in Annex 1.

917. *Subsection (5)* makes explicit what is merely implicit in the source legislation, namely, the extent of the transferor's entitlement to a deduction in subsequent years. In particular, subsection (5)(a) makes it clear that if the transfer is of only part of the premises, the transferor continues to be entitled to a deduction in relation to the part not transferred.

Section 256: Ending of lease of premises

918. This section deals with the case where the sea walls expenditure is incurred by a lessee and the lease comes to an end before the end of the deduction period. It is based on section 30(3) of ICTA. The corresponding rule for income tax is in section 317 of ITTOIA.

919. The cases to which *subsection (3)* applies include renewals of the lease to the same person. Then the deduction passes to the immediate reversioner.

920. In the source legislation "lease" is defined for the purposes of the sea walls provisions in section 24(6)(a) of ICTA. But that definition is redundant and, since it no longer applies to any other provision, is not rewritten in this Act. It is redundant in the sea walls context for the following reasons.

921. Section 24(6)(a) of ICTA defines references to a lease as extending only to a lease conferring a right, as against the person whose interest is subject to the lease, to the possession of the premises. It originated as paragraph 16 of Schedule 4 to FA 1963. Notes on Clauses to FA 1963 explain that the reference to possession was to ensure that a "lease" in Schedule A and sections 25 to 31 of ICTA must be one of land and not of incorporeal hereditament. So a lease of sporting rights, or a right of way, would not be covered. However, Street v Mountford [1985], AC 809 established that a "lease" of land which does not confer on the tenant exclusive possession is not, in fact, a lease but a licence.

922. Section 30(2) of ICTA does not explain the meaning of the transfer of the whole of a person's interest in any premises or part of any premises. The transfer of the whole of a person's interest is significant because it can lead to the transfer of entitlement to a deduction for sea walls expenditure. But entitlement to a deduction for sea walls expenditure does not arise anyway unless a person is the owner or tenant of premises. A lease which makes a person a tenant of premises is not a lease of an incorporeal hereditament. So, although section 30 of ICTA does not expressly exclude leases of incorporeal hereditaments, to the extent that they might cover leases of incorporeal hereditaments references to "leases" in that provision are simply redundant.

Section 257: Transfer involving person within the charge to income tax

923. This section ensures that entitlement to a deduction for expenditure on sea walls continues properly when the interest in the premises is transferred between a corporation tax payer and an income tax payer. It is based on section 30(2A) of ICTA. The corresponding rule for income tax is in section 318 of ITTOIA.

924. Entitlement to a deduction for expenditure on sea walls can be transferred with ownership of the premises. That transfer can be between a corporation tax payer and

an income tax payer. Section 255 deals with transfers between corporation tax payers. But it cannot deal with a transfer from a corporation tax payer to an income tax payer or the reverse because the provisions in this Act apply only to corporation tax payers.

925. Section 257 allows the seawalls provisions in this Act to work properly in respect of the party to the transfer who is subject to corporation tax.

926. *Subsection (4)* signposts to the provisions in ITTOIA that deal with the party to the transfer who is subject to income tax.

Section 258: Relief in respect of mineral royalties

927. This section provides that only half the net profits received in respect of mineral royalties are charged to corporation tax on income. It is based on section 122 of ICTA. The other half of the profits are charged to corporation tax on chargeable gains by section 201 of TCGA. The corresponding rule for income tax is in section 319 of ITTOIA.

928. The section applies only to mineral royalties that are not taxed under Chapter 7 of this Part. That Chapter taxes rents and royalties from concerns such as mines and quarries. In practice nearly all mineral royalties will be taxed under Chapter 7 of Part 4 of this Act. For this reason this section cross-refers to the definitions in that Chapter.

Section 259: Nature of item apportioned on sale of estate or interest in land

929. This section preserves the capital or revenue nature of an amount due, or payable in arrears, that is apportioned to a seller on the sale of land. It is based on section 40(3)(b) of ICTA. The corresponding rule for income tax is in section 320 of ITTOIA.

930. Most of section 40 of ICTA is not rewritten because it has become redundant following the application of Schedule D Case I principles to Schedule A.

931. The original predecessor of section 40 of ICTA (section 20 of FA 1964) was introduced to deal with a specific problem. That was reflecting, in the calculation of income from land, any apportionments of rent (as a receipt or an expense) that took place between seller and purchaser when land was sold. That required two kinds of rule. The first were calculation rules. They were necessary because at the time section 20 of FA 1964 was introduced the charge on income from land was based on *entitlement* to incoming rent and *payment* of outgoing rent. Where there were apportionments on sale there might be neither entitlement nor payment by the "right" person. The second were timing rules to ensure that the consequential adjustments fell in the right tax year.

932. As a result of the 1995 Schedule A reforms and their application, in 1998, to corporation tax, these rules are no longer necessary. Two main factors lead to this conclusion.

933. The first relates to the object of charge under Schedule A: the profit of a Schedule A business. For there to be a Schedule A business a person has to be exploiting United Kingdom land for rent (section 15(1)1(1) of ICTA). In order to be a receipt (or outgoing) of the Schedule A business it is enough that an amount relates to a period when the person was exploiting the land.

934. The second factor relates to the time when income within the charge is brought into account. Accounting principles have been imported from Schedule D Case I into Schedule A. These principles bring an item into account in the period to which it relates. So the rules in section 40(1) to (3) of ICTA about the time of receipt and payment are unnecessary.

935. Section 40(4) of ICTA is similarly now unnecessary. It provides that any reference in section 40(1) and (2) of ICTA to a party to a contract includes a person to whom the rights and obligations of that party under the contract have passed by assignment or otherwise. Since the test of whether or not an item is to be brought into account under

Schedule A is whether it arises from a person's exploitation of land then whether the rights and obligations under the contract pass by assignment or otherwise, the person to whom they pass will be the person exploiting the land.

936. Section 40(4A) of ICTA is not rewritten. It is linked to the parts of section 40 of ICTA that are unnecessary and also gives in certain circumstances the wrong result.

937. Section 40(3)(b) of ICTA has a clear anti-avoidance purpose that is preserved in section 259. But it also contains a timing rule. The timing rule in section 40(3)(b) of ICTA is not rewritten because accounting principles again attribute the apportioned amount to the correct period.

938. This section rewrites the anti-avoidance part of section 40(3)(b) of ICTA which preserves the capital or revenue nature of any amount due or paid in arrears and apportioned by the buyer to the seller on the sale of land.

939. The time of apportionment referred to in the section is normally the time of completion of the sale.

Section 260: Mutual business

940. This section makes it clear that the concept of "mutuality" does not apply in the property income context. It is based on section 21C of ICTA. The corresponding rule for income tax is in section 321 of ITTOIA.

941. Mutuality is a concept that has been developed by the courts over a long period. It derives from the principle that one cannot make a profit by dealing with oneself. It may arise in the trading context where a class of contributors to a common fund are entitled, as a class, to share in the surpluses of that fund.

942. The approach in this section differs from that of the source and is simpler. The approach in section 21C of ICTA is to apply the normal profit calculation rules to any "mutual business" and add the result to the profits of the rest of the Schedule A business. This section on the other hand prevents, from the outset, the concept of mutuality operating on amounts within this Part of this Act.

Section 261: Adjustment on change of basis

943. This section sets out the circumstances in which an adjustment may arise. It is based on section 64 of FA 2002. The equivalent rule for trades is in section 180. The corresponding rule for income tax is in section 329 of ITTOIA.

944. In the source legislation the change of basis rules apply to a Schedule A business because they are "other rules applicable to Case I of Schedule D" (see section 21B of ICTA). On the other hand, for an overseas property business section 70A(5) of ICTA imports only "the rules applicable to the computation of the profits" (see section 21A of ICTA). So the change of basis rules do not apply to an overseas property business.

Section 262: Giving effect to positive and negative adjustments

945. This section sets out how to calculate an adjustment and how it is treated for tax purposes. It is based on paragraphs 2 and 4 to 7 of Schedule 22 to FA 2002. The corresponding rules for income tax are in sections 330, 333 and 334 of ITTOIA.

946. *Subsection (6)* is a cross-reference to the trading income rule about expenses for which a deduction has already been made.

Section 263: Expenditure on integral features

947. This section draws attention to the rule in section 33A(3) of CAA. There is a signpost to that rule in section 74(1)(da) of ICTA. That subsection is repealed. The signpost

is not formally rewritten but it is replaced in this section (and in the trading income section 60).

Chapter 6: Commercial letting of furnished holiday accommodation

Overview

948. The sections in this Chapter define the lettings that can qualify for special tax advantages: "the commercial letting of furnished holiday accommodation". They are based on section 504 of ICTA. The corresponding rules for income tax are in sections 322 to 327 of ITTOIA.

949. The sections do not, themselves, provide for the tax advantages. That is the function of the particular "relieving" provisions (such as the loss relief provisions) that are cross-referred to.

950. The primary purpose of this Chapter is to provide a central definition of this particular type of letting, income from which benefits from tax advantages provided for in other Acts.

951. This income is part of the single property business denoted in section 205 and chargeable therefore under this Part.

Section 264: Overview of Chapter

952. This section is introductory and explanatory. It is new. It makes clear that the provisions that provide for the tax advantages are to be found elsewhere. The corresponding rule for income tax is in section 322 of ITTOIA.

Section 265: Meaning of "commercial letting of furnished holiday accommodation"

953. This section defines the lettings that can benefit from the special tax treatment. It is based on section 504 of ICTA. The corresponding rule for income tax is in section 323 of ITTOIA.

954. It is not sufficient that the letting is simply of furnished holiday accommodation: it must also be "qualifying holiday accommodation". *Subsection (3)(b)* provides a signpost to the sections that define "qualifying holiday accommodation".

Section 266: Meaning of "relevant period" in sections 267 and 268

955. This section defines the period during which certain conditions need to be satisfied in order to benefit from the special tax treatment. It is based on section 504(5) of ICTA. The corresponding rule for income tax is in section 324 of ITTOIA.

956. *Subsection (4)* gives the general rule and identifies the relevant period for the case where there is established and continuing letting. It follows the source legislation (in section 504(5)(c) of ICTA) by putting the general rule covering what is likely to be the most common case, last. This is because the company still needs to read the first two rules to know whether it falls within the general rule.

Section 267: Meaning of "qualifying holiday accommodation"

957. This section sets out the additional tests the letting must satisfy to qualify for the special treatment. It is based on section 504(3) and (5) of ICTA. The corresponding rule for income tax is in section 325 of ITTOIA.

958. *Subsection (1)*, which is based on section 504(3), introduces the term "qualifying holiday accommodation" and defines it by reference to the three conditions that are set out in the subsequent subsections.

959. Subsection 504(3) of ICTA is particularly complex. The three tests it imposes in paragraphs (a) to (c) are referred to in the subsequent subsections of this section as, respectively, the "availability", "letting" and "pattern of occupation" conditions. If all three are met, the accommodation is "qualifying holiday accommodation".

960. *Subsections (4)* to *(6)* are based on section 504(3)(c) of ICTA. Section 504(3)(c) of ICTA is particularly ambiguous and this section seeks to reduce that ambiguity. The approach differs from that in the source legislation and involves a change that alters the period during which, in order to qualify for the special treatment, the accommodation must not be occupied for more than 31 days at a time. See *Change 51* in Annex 1.

Section 268: Under-used holiday accommodation: averaging elections

961. This section allows accommodation that would be "qualifying holiday accommodation", were it not simply for insufficient actual letting, nevertheless to qualify if, *on average*, the letting condition in section 267(3) is met. It is based on section 504(6) to (8) of ICTA. The corresponding rule for income tax is in section 326 of ITTOIA.

962. *Subsection (1)* introduces a new term, "under-used accommodation", to denote this accommodation.

963. *Subsection (4)* introduces a change. This changes the period over which lettings are averaged for the purpose of treating infrequently let property as qualifying holiday accommodation from the accounting period to the relevant period (as defined in section 266). See *Change 52* in Annex 1.

Section 269: Capital allowances and loss relief

964. This section provides for separate calculations in order to give effect to the tax advantages of qualifying holiday lettings. It is new. The corresponding rule for income tax is in section 327 of ITTOIA.

965. There is no explicit requirement for separate furnished holiday lettings calculations in section 503 of ICTA. But it is clearly not possible to give effect to the special corporation tax treatments available to furnished holiday lettings without separating out the relevant income and expenditure. Requiring, where appropriate, separate calculations makes explicit what is only implicit in section 503 of ICTA.

966. This section provides a mechanism to ensure that the special rules that can give tax advantages in respect of these lettings work properly and clearly in the context of a UK property business of which the furnished holiday lettings is part: the profit from such lettings must be identified separately but only when there is a practical need to do so.

Chapter 7: Rent receivable in connection with a UK section 39(4) concern

Overview

967. This Chapter charges as property income rent receivable in connection with a section 39(4) concern. It also provides for certain deductions and reliefs to be given from that income.

968. This Chapter makes the relationship between the rules derived from sections 119 (rent payable in connection with mines, quarries and similar concerns) and 122 (relief in respect of mineral royalties) of ICTA clear. So section 201(2) of TCGA (mineral leases: royalties) is omitted, see Part 2 of Schedule 1 to this Act.

Section 270: Charge to tax on rent receivable in connection with a UK section 39(4) concern

969. This section applies the charge to corporation tax to rent receivable in connection with a "UK section 39(4) concern". It is based on section 119 of ICTA. The corresponding rule for income tax is in section 335 of ITTOIA.

970. The loss regime in section 396 of ICTA applies to income charged under this Chapter and not the regime in section 392A of ICTA.

971. The charge under Schedule D Case III imposed by section 119(2) of ICTA is not rewritten. It is otiose. See *Change 53* in Annex 1. This Change reproduces Change 158 in ITTOIA in relation to section 119(2) of ICTA and so brings the income and corporation tax codes back into line.

Section 271: Meaning of "rent receivable in connection with a UK section 39(4) concern"

972. This section clarifies:

- what is meant by "UK section 39(4) concern";
- what is meant by "rent"; and
- when rent is treated as "receivable in connection with" such a concern.

973. It is based on section 119 of ICTA. The corresponding rules for income tax are in section 336 of ITTOIA.

974. *Subsection (1)* identifies when rent is receivable in connection with a "UK section 39(4) concern". It uses the language of section 207(1) (meaning of "generating income from land") to rewrite the phrase "in respect of any land or easement" in section 119(1) of ICTA. Section 207 is based on paragraph 1(1) of Schedule A (section 15(1) of ICTA). The concept in section 207 of "generating income from land" serves to determine the scope of Schedule A. The approach in this section assumes that the income taxed by section 119 of ICTA would otherwise have been taxed under Schedule A.

975. The justification for this assumption is that section 119 of ICTA can have no application to income that is already taxed under Schedule D Case VI. Neither is there any question that the rent would go untaxed if it were not for section 119 of ICTA. Rents are clearly annual profits or gains as described in Schedule D Case VI of ICTA. The effect of section 119 of ICTA is to take income that would be taxed under Schedule A and tax it under Schedule D. So in identifying the scope of the charge it is possible to use the ordinary property business definitions and avoid the need to rewrite the complicated definitions of "easement" and "rent" in section 119(3) of ICTA.

976. The section makes explicit a territorial restriction to the United Kingdom that is implicit in section 119(1) of ICTA. If a "UK section 39(4) concern" is located outside the United Kingdom it would be a foreign possession for the purposes of the charge under Schedule D Case V. Any income arising from such a possession would have been taxed under Schedule D Case V. Section 119 of ICTA could have had no application to income that was already taxed under Schedule D.

977. *Subsection (3)* provides the definition of rent. It is based on section 119(3) of ICTA. As explained in the commentary on subsection (1), this section is based on the assumption that the rents taxed by section 119 of ICTA would otherwise have been taxed under Schedule A. This means it is not necessary to reproduce the definition of "rent" in section 119(3) of ICTA.

Section 272: Deduction for management expenses of owner of mineral rights

978. This section allows a deduction for the expenses of managing mineral rights. It is based on section 121 of ICTA. The corresponding rule for income tax is in section 339 of ITTOIA.

979. *Subsection (1)* sets out the conditions for the section to apply. It does not reproduce the condition that the expenses must be incurred "necessarily". See *Change 54* in Annex 1. The "necessarily" test is impractical in this context. This change reproduces Change 78 in ITTOIA and so brings the income and corporation tax codes back into line.

980. *Subsection (2)* provides that a deduction is allowed for the qualifying expenses paid in the accounting period. This rewrites the requirement that the expenses are "disbursed" in the period.

981. The relief applies only to rents received from a "UK section 39(4) concern". If the income is taxed as income from a UK property business there is no need for special rules identifying what deductions are allowable. The normal rules apply.

Section 273: Relief in respect of mineral royalties

982. This section provides that only half of the net profit earned in respect of mineral royalties is charged to corporation tax. It is based on section 122 of ICTA. The other half of the net profit is charged to corporation tax on chargeable gains by section 201 of TCGA. The corresponding rule for income tax is in section 340 of ITTOIA.

983. *Subsection (1)* limits the relief to royalties taxed under this Chapter of this Act. If the royalty is not taxed under this Chapter the same relief is given by section 135 or section 258.

Section 274: Meaning of "mineral lease or agreement" and "mineral royalties"

984. This section defines various terms used in section 273. It is based on section 122 of ICTA. The corresponding rules for income tax are in section 341 of ITTOIA.

985. Section 291 includes a definition of "lease" that applies for the purposes of this Part. It is based on section 24 of ICTA, which applies for the purposes of Schedule A in the source legislation. Because the definition applies only for Schedule A in strictness it does not extend to the income taxed under section 273. But the definition of "mineral lease or agreement" in section 122(6) of ICTA applies to any agreement conferring a right to win and work minerals in the United Kingdom. Such an agreement would also satisfy the definition in section 24 of ICTA so there is no change in the law.

986. The legislation rewritten by *subsection (2)* does not include any rent receivable before 6 April 1970. This limitation is preserved in Schedule 2 (transitionals and savings).

Section 275: Extended meaning of "mineral royalties" etc in Northern Ireland

987. This section modifies the definition of "mineral royalties" to deal with the different rules that apply to the ownership of mineral rights in Northern Ireland. It is based on section 122 of ICTA. The corresponding rule for income tax is in section 342 of ITTOIA.

988. The right to win, and win and work, most minerals in Northern Ireland is vested in the Department of Enterprise, Trade and Investment (DETI). The DETI will grant licences to work the minerals and make compensatory payments to the former owners of the mineral rights under various Acts of the Northern Ireland Parliament. This section treats those payments as mineral royalties for the purposes of section 273.

Section 276: Power to determine what counts as "mineral royalties"

989. This section allows the Commissioners to make regulations concerning the application of the relief in section 273. It is based on section 122 of ICTA. The corresponding rule for income tax is in section 343 of ITTOIA. Any regulations made under this power would apply also to sections 135 and 258 through sections 135(3) and 258(3).

Chapter 8: Rent receivable for UK electric-line wayleaves

Overview

990. This Chapter rewrites the Schedule D Case VI charge on rent received for a wayleave granted in the United Kingdom. It is based on section 120 of ICTA.

991. If a landowner receives rent for a UK electric-line wayleave section 120 of ICTA provides that:

- the rent is charged under Schedule A if the landowner receives other rent in respect of the same land; otherwise
- the rent is charged under Schedule D.

992. In practice this meant that if the landowner carries on a trade on the land the rent can be treated as a trade receipt. Otherwise the rent was taxed under Schedule D Case VI.

993. Section 396 of ICTA gives the rules for dealing with Schedule D Case VI losses. In order to preserve that loss regime it is necessary to isolate the income that ICTA charges under Schedule D Case VI.

Section 277: Charge to tax on rent receivable for a UK electric-line wayleave

994. This section applies the charge to corporation tax to rent receivable for a UK electric-line wayleave. It is based on section 120 of ICTA. The corresponding rule for income tax is in section 344 of ITTOIA.

Section 278: Meaning of "rent receivable for a UK electric-line wayleave"

995. This section provides the definition of "rent receivable for a UK electric-line wayleave". It is based on section 120 of ICTA. The corresponding rule for income tax is in section 345 of ITTOIA.

996. Section 120(1) of ICTA identifies the right in respect of which the rent is payable as an "easement". Section 120(5) of ICTA cross-refers to the definition of "easement" in section 119(3) of ICTA. Section 119 of ICTA is rewritten in Chapter 7 of this Part. As explained in the commentary on section 45 both this Chapter and section 45 use the term "wayleave" to describe the right in respect of which the rent is received. In practice this is how most of the payments covered by this section are usually described. But the generality of the words in section 119(3) of ICTA has not been lost. The section also uses the Scottish term for "easement", "servitude".

997. *Subsection (2)* clarifies the meaning of "electric, telegraph or telephone wire or cable". It does not repeat the reference to "transformer" in the source legislation. In its context it is clear that "apparatus" would include "transformer".

Section 279: Extent of charge to tax

998. This section sets out the two exceptions under which the rent received in respect of a UK electric-line wayleave is not taxed under this Chapter. It is based on section 120 of ICTA. The corresponding rule for income tax is in section 346 of ITTOIA.

999. *Subsections (1)* and *(2)* deal with the case in which the company receives other rent in respect of the land except rent from another wayleave. The rent from the wayleave is taxed as property income.

1000. *Subsections (3)* and *(4)* deal with the case in which the company carries on a trade on the land. See *Change 6* in Annex 1 and the commentary on section 45. The rent may be taxed as a trade receipt.

Chapter 9: Post-cessation receipts

Overview

1001. This Chapter applies the rules about post-cessation receipts to UK property businesses, broadly as they apply to trades. The main rules for trades are in Chapter 15 of Part 3 of this Act. The application of the rules to property businesses is based on section 21B of ICTA, which specifically mentions sections 103 to 106 of ICTA.

1002. Although the post-cessation receipt rules apply to a Schedule A business, they do so by virtue of section 21B of ICTA. That section deals with "other rules applicable to Case I of Schedule D". On the other hand, section 21A of ICTA deals with rules about the computation of profits of a trade. So section 70A of ICTA imports only the computation rules in section 21A and the post-cessation receipt rules do not apply to an overseas property business.

1003. A property business cannot have trading stock. So section 195 (transfer of trading stock) does not have a corresponding rule in this Chapter.

1004. The following trading income rules apply to property businesses but are not in separate sections in this Chapter:

- sections 192 and 193: rules about debts (these rules are applied by section 283(2)); and
- sections 196 and 197: allowable deductions (these rules are applied by section 285).

Section 280: Charge to tax on post-cessation receipts

1005. This section applies the corporation tax charge on income to post-cessation receipts. It is based on sections 103 and 104 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 349 of ITTOIA.

Section 281: Extent of charge to tax

1006. This section restricts the charge on the post-cessation receipts. It is based on sections 103 and 104 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 350 of ITTOIA.

Section 282: Basic meaning of "post-cessation receipt"

1007. This section defines post-cessation receipts of a UK property business. It is based on sections 103, 104 and 110 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 353 of ITTOIA.

1008. *Subsection (2)* explains that a person permanently ceases to carry on a UK property business if:

- a company ceases to be within the charge to income tax in respect of the UK property business; or
- a company or any other person ceases to be a member of a firm which carries on a UK property business.

Section 283: *Other rules about what counts as a "post-cessation receipt"*

1009. This section brings together signposts to rules that operate so as to treat certain sums as post-cessation receipts and to exclude others from the charge. It is new. The corresponding rule for income tax is in section 354 of ITTOIA.

1010. *Subsection (1)* is a signpost to the section that deals with the transfer of a right to receive a post-cessation receipt to a person who does not carry on a UK property business.

1011. *Subsection (2)* lists the trading income rules that apply to create post-cessation receipts for the purpose of this Chapter.

1012. *Subsection (3)* draws attention to the rule in Chapter 5 of this Part that treats a sum received as not being a post-cessation receipt if the right to it was transferred with a property business. It also mentions the rule in Part 18 of this Act that treats profits of an overseas property business as post-cessation receipts (of a UK property business) if they become remittable after the company has ceased to carry on the business.

Section 284: *Transfer of rights if transferee does not carry on UK property business*

1013. This section sets out the positions of the transferor and transferee if the right to a post-cessation receipt is transferred for value. It is based on section 106 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 355 of ITTOIA.

Section 285: *Allowable deductions*

1014. This section applies the trading income rules about allowable deductions. It is based on section 105 of ICTA, as applied by section 21B of ICTA.

Section 286: *Election to carry back*

1015. This section allows a company to elect to have a post-cessation receipt taxed as though it had been received in the accounting period in which the company ceased to carry on the UK property business. It is based on section 108 of ICTA, as applied by section 21B of ICTA, although section 108 was repealed by ITTIOA. The corresponding rule for income tax is in section 257 of ITTOIA, as applied by section 351(2)(b) of ITTOIA.

1016. See *Change 42* in Annex 1 and the commentary on section 198.

Chapter 10: *Supplementary*

Section 287: *Provisions which must be given priority over this Part*

1017. This section provides the rules to determine which Part takes priority in the event of any overlap of the charge on the profits of a trade and the charge on the profits of an overseas property business or the charge under Chapter 7 or 8 of this Part. It is based on sections 18 and 70A of ICTA.

1018. The definitions of Schedule D Cases I and VI are in section 18 of ICTA. Those definitions deal with any overlap between a trade and the profits of a UK concern or the profits of a UK electric line wayleave. Case VI charges income that is not charged under any other case. So this section gives trading income (Case I in the source legislation) priority.

1019. The section also gives statutory effect to the Crown Option between an overseas property business and a United Kingdom trade. See *Change 55* in Annex 1. The corresponding rules for income tax are in section 261 of ITTOIA.

Section 288: Priority between Chapters within this Part

1020. This section gives an order of priority between Chapters 3, 7 and 8 of this Part. It is based on sections 119 and 120 of ICTA. The corresponding rules for income tax are in section 262 of ITTOIA.

1021. *Subsection (3)* deals with income that falls within both Chapter 7 and Chapter 8 of this Part. See *Change 6* in Annex 1 and the commentary on section 45.

Section 289: Effect of company starting or ceasing to be within charge to corporation tax

1022. This section treats a company as starting or ceasing to carry on a property business in particular circumstances. It is based on section 337 of ICTA. The corresponding rule for income tax is in section 362 of ITTOIA.

1023. This section applies when a company moves into or out of the corporation tax regime. Non-UK resident companies are within the charge to corporation tax only if they are trading, are trading in the United Kingdom, and through a permanent establishment in the United Kingdom. Then they are chargeable to corporation tax on all the profits attributable to that permanent establishment. If those profits include the profits of a property business, first meeting or ceasing to meet those conditions will result in a change of taxing regime from income tax to corporation tax or vice versa.

Section 290: Overseas property businesses and overseas land: adaptation of rules

1024. This section sets out how the rules for United Kingdom property businesses are to be adapted to apply to overseas property businesses. It is based on section 70A of ICTA. The corresponding rule for income tax is in section 363 of ITTOIA.

1025. The section explains how to apply the UK property business rules if foreign property law does not correspond exactly with United Kingdom property law.

Section 291: Meaning of "lease" and "premises"

1026. This section is interpretative. It is based on section 24(1) of ICTA. The corresponding rule for income tax is in section 364 of ITTOIA.

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 debits for impaired or released connected companies debts

1140. This section provides the basic rule that neither impairment losses nor debits arising as a result of the release of liability under a creditor relationship ("release debits") 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 debits 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 sub-paragraph, 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.

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 *debits* 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.

Part 6: Relationships treated as loan relationships etc

Overview

1342. The overview for this Part is included in the overview for Part 5.

Chapter 1: Introduction

Section 477: Overview of Part

1343. This section outlines the structure of this Part. It is new.

Chapter 2: Relevant non-lending relationships

Overview

1344. This Chapter brings within the loan relationship provisions money debts which do not fall within the definition of a loan relationship in section 302 because they do not arise from a transaction for the lending of money. The Chapter is based on section 100 of FA 1996.

Section 478: Relevant non-lending relationships: introduction

1345. This section sets out the purpose of the Chapter and provides definitions. It is new.

Section 479: Relevant non-lending relationships not involving discounts

1346. This section deals with the first type of debt which is not a loan relationship because it does not arise from a transaction for the lending of money. It is based on section 100(1) of FA 1996.

1347. The debts within this type do not involve discounts and are debts on which interest, exchange movements or impairment losses arise.

Section 480: Relevant non-lending relationships involving discounts

1348. This section deals with the second type of debt which is not a loan relationship because it does not arise from a transaction for the lending of money. It is based on section 100(1A), (1B) and (3A) of FA 1996.

1349. This type of debt involves discounts, in particular the discount that arises where a sum due in respect of the sale of an asset is payable at a later date with the discount representing compensation for the late payment.

Section 481: Application of Part 5 to relevant non-lending relationships

1350. This section explains how the provisions of Part 5 are to be applied to the preceding sections on non-lending relationships. It is based on section 100(1), (2) to (2ZB) and (3A) of FA 1996.

Section 482: Miscellaneous rules about amounts to be brought into account because of this Chapter

1351. This section provides miscellaneous rules regarding non-lending relationships. It is based on section 100(3B) and (7) of FA 1996.

Section 483: Exchange gains and losses: amounts treated as money debts

1352. This section brings exchange gains and losses on currency holdings and liabilities into the loan relationships legislation by treating them as money debts owed to or by the company. It is based on section 100(10) to (12) of FA 1996.

Section 484: Provision not at arm's length: meaning of "interest" and "money debt"

1353. This section requires references to interest on money debts within this Chapter to include amounts treated as such under Schedule 28AA of ICTA (transfer pricing). It is based on section 100(3) of FA 1996.

Section 485: Exclusion of debts where profits or losses within Part 7 or 8

1354. This section excludes amounts from being brought into account under this Chapter if they are brought into account under the regimes for derivative contracts or intangible fixed assets. It is based on section 100(14) of FA 1996.

Section 486: Exclusion of exchange gains and losses in respect of tax debts etc

1355. This section precludes exchange gains and losses from being taken into account under this Chapter where they arise on certain tax payments or are on sums which are not deductible against trading profits or as management expenses. It is based on section 100(9) of FA 1996.

Chapter 3: OEICs, unit trusts and offshore funds

Overview

1356. This Chapter provides the rules for calculating debits and credits under Part 5 where a company holds an interest in an open-ended investment company (OEIC), unit trust scheme or offshore fund and the assets held by those entities are at least 60% "qualifying investments" by value. Qualifying investments are broadly assets that are or represent loan relationships. Such holdings are treated as rights under a creditor relationship.

Section 487: Overview of Chapter

1357. This section explains what the Chapter does. It is new.

Section 488: Meaning of "open-ended investment company" etc

1358. This section gives the definition of "open-ended investment company". It is based on paragraph 8(7A), (7B) and (7D) of Schedule 10 to FA 1996 and regulation 95(2) of the Authorised Investment Funds (Tax) Regulations 2006.

1359. The definition is by reference to sections 468A(2) to (4) of ICTA because the definition in section 468A(2), read with section 468A(3) and (4), is in substance the same as that in paragraph 8(7A)(b), read with paragraph 8(7B) and (7D) of Schedule 10 to FA 1996 and any differences are negligible.

Section 489: Meaning of "offshore fund" etc

1360. This section gives a definition of "offshore fund" and also for "a material interest in such a fund" for this Chapter. It is based on paragraphs 7(1) and (2) and 8(7F) of Schedule 10 to FA 1996.

1361. The definition of "offshore fund" in paragraph 7 of Schedule 10 to FA 1996 has been applied throughout the Chapter. See *Change 60* in Annex 1.

Section 490: Holdings in OEICs, unit trusts and offshore funds treated as creditor relationship rights

1362. This section provides the basic rule: if at any time in an accounting period an OEIC, unit trust scheme or offshore fund fails the qualifying investments test, a company's holdings in such entities are treated as rights under a creditor relationship and the credits and debits are to be brought into account on the basis of fair value. It is based on paragraphs 4(1) to (4) and 7(1) of Schedule 10 to FA 1996, section 48B(5) of FA 2005 and regulation 95(2) of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).

1363. *Subsection (1)(a)(i)* refers to ownership of "shares" in an open-ended investment company. Paragraph 4(1) of Schedule 10 to FA 1996, as modified by regulation 95 of the above regulations, refers to a company holding "rights" in an open-ended investment company. The term "shares" has been used in this section because regulation 93 of those Regulations provides that the modification made by regulation 95 is in relation to "shareholders" in authorised investment funds. Referring to shares in an open-ended investment company also aligns this section with section 587.

1364. In *subsection (5)*, the meaning of "interest distributions" is provided by regulation 18(3) of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).

Section 491: Holding coming within section 490: opening valuations

1365. This section provides the opening valuation for holdings of a company in an OEIC, unit trust scheme or offshore fund when section 490 first applies. It is based on paragraphs 5(1) and 6 of Schedule 10 to FA 1996.

1366. The words "the value of that asset" in paragraph 6 of Schedule 10 to FA 1996 have been rewritten as the "value of the holding" since the words in paragraph 6 refer directly back to "valuation of the holding" in sub-paragraph (b) of that paragraph.

Section 492: Disregard of investments made and liabilities incurred with avoidance intention etc

1367. This section provides that in determining credits and debits to be brought into account by any company in respect of its holding ("the relevant holding") under the deemed creditor relationship, there shall be left out of account amounts relating to any investment or liability of the collective investment scheme or fund where the investment was made or the liability was incurred, or any transaction (or series of transactions) relating to the investment or liability was entered into, with a "relevant avoidance intention". It is based on paragraph 4(5) and (6) of Schedule 10 to FA 1996 and regulation 95(2) of the Authorised Investment Funds (Tax) Regulations 2006.

Section 493: The qualifying investments test

1368. This section explains what is meant by the qualifying investment test and how "qualifying investment" is to be interpreted when applied to OEICs, unit trust schemes or offshore funds. It is based on paragraph 8(1), (5), (5A), (7A), and (7C) of Schedule 10 to FA 1996 and regulation 95(3) of the Authorised Investment Funds (Tax) Regulations 2006.

1369. *Subsection (2)(b)* explains the meaning of references to investments of OEICs for cases where under section 468A(3) of ICTA parts of umbrella companies are themselves regarded as separate OEICs. This involves rewriting the reference in paragraph 8(5A) of Schedule 10 to FA 1996 to "investments comprised in the scheme property of that company" with the changes made by paragraph 8(7B) to (7D) for such parts. Paragraph 8(7C)(a) converts these words to a reference to such of the investments of the umbrella company as form part of the separate pool in question. But for paragraph 8(7C)(a), paragraph 8(7C)(b) would operate on the reference in paragraph 8(5A) to scheme property in the case of such parts, but once paragraph 8(7C)(a) has applied, there are no references to scheme property on which paragraph 8(7C)(b) can operate and so it is otiose and has not been rewritten.

Section 494: Meaning of "qualifying investments"

1370. This section lists the investments which constitute "qualifying investments". It is based on paragraph 8(2), (7) and (7E) of Schedule 10 to FA 1996, paragraph 1 of Schedule 2 to FA 2005 and regulation 95(3) of the Authorised Investment Funds (Tax) Regulations 2006.

1371. Paragraphs 1 and 9 of Schedule 2 to FA 2005 require the reference to "money placed at interest" in paragraph 8(2)(a) of Schedule 10 to FA 1996 to include a reference to arrangements falling within section 47, 48A, 49 or 49A of FA 2005 (rewritten in Chapter 6 of this Part). It does not include diminishing shared ownership arrangements under section 47A of FA 2005.

1372. The Unit Trust Schemes and Offshore Funds (Non-qualifying Investments Test) Order, SI 2006/981 also added a new paragraph 8(2)(h) to the list of qualifying investments in Schedule 10 to FA 1996 to cover "alternative finance arrangements". They are defined in paragraph 8(7I) of that Schedule by reference to section 46(1) of FA 2005 as arrangements within section 47, 47A, 48A, 49 or 49A of FA 2005.

1373. Therefore, diminishing shared ownership arrangements (section 47A of FA 2005) are included as qualifying investments. However, paragraph 8(2)(e) of Schedule 10 to FA 1996 provides that derivative contracts are only included where the underlying subject matter consists of investments within paragraph 8(2)(a) to (d) of that Schedule. Therefore derivative contracts that consist mainly of diminishing shared ownership arrangements (section 47A) are not included, and hence the exclusion of these arrangements under *subsection (1)(f)(i).*

1374. The definition of "derivative contract" in paragraph 8(7E) of Schedule 10 to FA 1996 has not been rewritten. If a contract is treated as a derivative contract in Part 7 then it is also treated as a derivative contract for the purposes of this section because the definition of "derivative contract" in section 834(1) of ICTA (which refers to Schedule 26 to FA 2002 and is consequentially amended to refer to Part 7) applies for the purposes of the Corporation Tax Acts.

Section 495: Qualifying holdings

1375. This section explains what is meant by "qualifying holdings" in an OEIC, unit trust scheme or offshore fund within the qualifying investments list in the preceding section. It is based on paragraph 8(3), (3A), (4), (6) and (7C) of Schedule 10 to FA 1996.

1376. Paragraph 8(3)(b) of Schedule 10 to FA 1996 has been rewritten to make it clear that "the same accounting period" refers to the accounting period of the company holding the investment in the unit trust scheme etc and not the accounting period of the unit trust scheme etc.

1377. Paragraphs 8(6A) and (6B) of that Schedule have not been rewritten because they are considered unnecessary and add nothing to the operation of paragraph 8(6)(c). It does

not matter for the purposes of paragraph 8(6)(c) whether the shares are of different denominations; all that matters is their value.

Section 496: Meaning of "hedging relationship"

1378. This section provides the meaning of "hedging relationship". It is based on paragraph 8(7G) and (7H) of Schedule 10 to FA 1996.

Section 497: Power to change investments that are qualifying investments

1379. This section gives the Treasury power to amend this Chapter. It is based on paragraphs 8(8) and 9 of Schedule 10 to FA 1996.

1380. *Subsection (1)* includes a change that allows the Treasury to amend the descriptions of qualifying investments of an open-ended investment company. See *Change 61* in Annex 1.

1381. *Subsection (2)* allows orders to be made for such "incidental, supplemental, consequential and transitional provision and savings". This is a standard formulation for this Act for the extra things that can be done under an order and regulation-making powers. It is not considered a change in the law.

Chapter 4: Building societies

Overview

1382. This Chapter brings payments in respect of shares in building societies into the loan relationship regime. It provides that dividends and interest payable in respect of shares in, or deposits with, or loans to, a building society should be treated as a liability arising under a loan relationship of the building society.

Section 498: Building society dividends and interest

1383. This section brings dividends and interest payable by building societies into the loan relationship regime so far as they would not otherwise be within it. It is based on section 477A(3), (4), (9) and (10) of ICTA. The corresponding provision for income tax is section 372 of ITTOIA.

Chapter 5: Industrial and provident societies

Overview

1384. This Chapter brings payments in respect of shares in industrial and provident societies and agricultural or fishing co-operatives into the loan relationship regime. It does not treat the shares themselves as a loan relationship other than to allow dividends etc on shares held for the purposes of a trade to be treated as trading income.

Section 499: Industrial and provident society payments treated as interest under loan relationship

1385. This section treats certain payments by an industrial and provident society and agricultural or fishing co-operatives as payments of interest on a loan relationship. It is based on section 486(1), (4), (9) and (12) of ICTA. The corresponding provision for income tax is section 379 of ITTOIA.

1386. *Subsection (2)* treats dividends, bonuses and other sums payable on shareholdings held for the purposes of a trade or for other purposes as if that shareholding were a loan relationship so held. See *Change 62* in Annex 1.

Section 500: Exclusion of interest where failure to make return

1387. This section disallows a debit for interest paid by industrial and provident societies where returns under section 887 of ITA are not made within the specified period. Section 887 requires such companies to make returns of interest paid without deduction of tax. It is based on section 486(1), (7) and (12) of ICTA.

Chapter 6: Alternative finance arrangements

Overview

1388. This Chapter treats arrangements that comply with Shari'a law as falling within the loan relationships regime. Shari'a law prohibits transactions that involve interest, and arrangements for the borrowing or lending of money will usually involve some form of risk sharing instead. The rules are not limited to Shari'a compliant products but also apply to any finance arrangement that falls within their terms. In this Chapter these arrangements are known as "alternative finance arrangements".

1389. The rules covering alternative finance arrangements do not change the nature of the finance arrangements, nor do they in any way impute interest, or deem interest to arise where there is none. What they do is bring certain types of finance arrangements and the returns from those arrangements, into the same tax rules as those that apply to interest, providing a level playing field for tax between certain types of economically equivalent, but differently structured, finance arrangements.

1390. The Chapter sets out the nature of the five types of alternative finance arrangements in sections 503 to 507. Sections 509 to 513 explain which elements of the arrangements are treated as if they were loan relationships.

1391. Sections 48(1), 48B(4), 51, 51A and 56(3) of FA 2005 are not relevant for corporation tax purposes and therefore have not been rewritten in this Act. They remain in FA 2005 for non-corporation tax purposes.

Section 501: Introduction to Chapter

1392. This section provides an introduction to the Chapter by explaining what it does and provides definitions for the Chapter. It is based on paragraph 8(7I) of Schedule 10 to FA 1996 and section 46(1) of FA 2005 and is new in part.

Section 502: Meaning of "financial institution"

1393. This section gives the meaning of "financial institution". It is based on section 46(2) and (3) of FA 2005.

Section 503: Purchase and resale arrangements

1394. This section deals with the first type of alternative finance arrangement, whereby an asset is purchased by a financial institution and then sold to another person with the payment by that second person left on credit. It is based on section 47(1) to (3) of FA 2005. The price paid by that second person exceeds the price paid by the financial institution. The difference between the two prices equates to the return from an investment at interest and is treated as an alternative finance return (see section 511).

Section 504: Diminishing shared ownership arrangements

1395. This section deals with a second type of alternative finance arrangement. It is based on section 47A(1) to (4) of FA 2005. Two persons, at least one of them a financial institution, acquire an interest in an asset. The financial institution receives payments from the other party for that party's use of the financial institution's share as well as (usually leasing) payments, with the ownership of the asset passing by degrees to the other party. The other party in the arrangement has full use of the asset being acquired

and may grant rights in the asset. Payments made by the other party in excess of the payments for the beneficial interest being acquired are treated as an alternative finance return.

Section 505: Deposit arrangements

1396. This section deals with a third type of alternative finance arrangement whereby deposits are made with a financial institution and payments are made to the depositor out of profits earned by the use of the money. It is based on section 49(1) of FA 2005. The payments must equate to a return from an investment at interest. The return is treated as an alternative finance return.

Section 506: Profit share agency arrangements

1397. This section deals with a fourth type of alternative finance arrangement. It is based on section 49A(1) of FA 2005. Here the investor appoints an agent to whom a sum of money is given to be invested at a specified return. Any additional sum above that specified return is retained by the agent as an incentive fee.

Section 507: Investment bond arrangements

1398. This section deals with a fifth type of alternative finance arrangement and sets out the conditions that must be present for arrangements to be treated as an investment bond arrangement. It is based on section 48A(1) and (2) of FA 2005. Investment bond arrangements are a new variety of alternative finance arrangement that share some characteristics of a bond.

1399. An investment bond arrangement exists where the "bond-issuer" uses the subscription proceeds to acquire assets, which are specified in the arrangement, and are held for the benefit of the "bond-holder". Income generated from the assets is distributed to the bond-holder and, on maturity of the bond, the assets are sold under pre-existing arrangements and the proceeds returned to the bond-holder.

Section 508: Provision not at arm's length: exclusion of arrangements from sections 503 to 507

1400. This section excludes arrangements from sections 503 to 507 where the parties are connected persons within the transfer pricing legislation in Schedule 28AA of ICTA, the arrangements are not at arm's length and the recipient of the alternative finance return is not subject to income or corporation tax or a similar non-United Kingdom tax. It is based on section 52(1) to (3) of FA 2005.

1401. In *subsection (2)(c)(ii)* "an amount representing relevant return" covers back to back arrangements where there is an intermediary between the two parties to the arrangements.

Section 509: Application of Part 5: general

1402. This section applies Part 5 to the five kinds of alternative finance arrangements. It is based on section 50(1) to (3) of FA 2005.

Section 510: Application of Part 5 to particular alternative finance arrangements

1403. This section provides, for each of the five alternative finance arrangements, the rules for what is to be treated as interest under that deemed loan relationship. It also provides some definitions for terms used in this section. It is based on section 50(1) to (2A) and (4) of FA 2005 and paragraph 7 of Schedule 2 to that Act.

Section 511: Purchase and resale arrangements

1404. This section explains the meaning of "alternative finance return" in relation to the purchase and resale arrangements in section 503. It is based on section 47(4), (6), (7) and (8) of FA 2005. It provides for where the second purchase price is paid either immediately or in instalments.

Section 512: Diminishing shared ownership arrangements

1405. This section explains the meaning of "alternative finance return" in relation to the diminishing shared ownership arrangements in section 504. It is based on section 47A(5) of FA 2005.

1406. "Costs and expenses" in section 47A(5) has been reduced to "expenses" in *subsection (3)* to avoid tautology.

Section 513: Other arrangements

1407. This section explains the meaning of "alternative finance return" in relation to deposit arrangements, profit share agency arrangements and investment bond arrangements. It is based on sections 48B(1), 49(2) and 49A(2) of FA 2005.

1408. In FA 2005 the return on some alternative investment arrangements is called "alternative finance return", but the return on deposit arrangements and profit share agency arrangements is called "profit share return". However, there is no material difference in the returns on these arrangements to justify different terminology. So "profit share return" has been replaced with "alternative finance return" in relation to deposit arrangements (section 505) and profit share agency arrangements (section 506). These are then consistent with purchase and resale arrangements, diminishing shared ownership arrangements and investment bond arrangements.

1409. Chapter 5 of Part 2 of FA 2005 is being amended to remove the term "profit share return" for income tax purposes.

Section 514: Exclusion of alternative finance return from consideration for sale of assets

1410. This section excludes the profits dealt with as interest under a loan relationship in relation to the arrangements under sections 503, 504 and 507 from determining the sale or purchase price for other tax purposes (eg trading or capital gains). It is based on section 53(1) to (3) of FA 2005. It does not prevent other tax provisions applying which substitute a different sum for a sale or purchase amount.

Section 515: Diminishing shared ownership arrangements not partnerships

1411. This section provides that diminishing shared ownership arrangements are not treated as a partnership for the purposes of the Corporation Tax Acts. It is based on section 47A(6) of FA 2005.

Section 516: Treatment of principal under profit sharing agency arrangements

1412. This section ensures that in the case of profit sharing arrangements the deposit-taker is taxable in respect of all of the profit resulting from the use of the money – both the depositor's share of profit made under the arrangements and also the amount that the deposit-taker can retain. It is based on section 49A(3) of FA 2005. The deposit-taker is entitled to relief for the depositor's share of profit.

Section 517: Treatment of bond-holder under investment bond arrangements

1413. This section provides that whatever the documentation accompanying investment bond arrangements may say, for tax purposes the bond-holder is not treated as having a legal

or beneficial interest in the assets, and so is not entitled to capital allowances, nor is the bond-issuer treated as a trustee, or as making payments in a fiduciary or representative capacity. It is based on section 48B(2) of FA 2005.

Section 518: Investment bond arrangements: treatment as securities

1414. This section provides that alternative finance investment bonds are securities for the purposes of the Corporation Tax Acts. It is based on section 48B(3) of FA 2005.

Section 519: Investment bond arrangements: other provisions

1415. This section provides the rules about how investment bond arrangements impact on the regimes for securitisation companies, close companies and group relief. It is based on section 48B(6) to (8) of FA 2005.

Section 520: Provision not at arm's length: non-deductibility of relevant return

1416. This section prevents any deduction in calculating profits for corporation tax purposes as a result of alternative finance arrangements where the arm's length rule in section 508 applies. It is based on section 52(4) and (5) of FA 2005.

Section 521: Power to extend this Chapter to other arrangements

1417. This section provides the Treasury with powers to introduce further arrangements into this Chapter and make consequential amendments to the Tax Acts as necessary. It is based on section 98 of FA 2006.

Chapter 7: Shares with guaranteed returns etc

Overview

1418. The rules in this Chapter counter avoidance through the use of shares which function in a similar way to loan relationships but which fall outside the definition. The schemes making use of these shares exploit the fact that increases in value and gains from the disposal of shares are subject only to the rules for corporation tax on chargeable gains, if at all. The schemes use derivatives in conjunction with shares, or deferred subscription agreements to create what is in form a share but in economic substance a deposit or loan. In most of them the risks associated with equity investments, as well as the rewards, are removed or significantly reduced, leaving the share giving a return, either by the payment of "dividends" or by a wholly predictable increase in value, which is the type of return expected from debt.

Section 522: Introduction to Chapter

1419. This section sets out what the Chapter does, how it is arranged and some useful cross-references. It is based on sections 91A(1), (10) and (11), 91B(1), (7) and (8), 91C(7), 91D(13) and 91E(4) of FA 1996.

1420. *Subsection (6)* provides that the full definition of "share" in section 476 does not apply for the purposes of this Chapter. The part of the definition that does apply to this Chapter is that the meaning of "share" does not include a share in a building society.

Section 523: Application of Part 5 to certain shares as rights under creditor relationship

1421. This section treats rights in shares as loan relationships and distributions from such shares as debits or credits under this Part where either section 524 or 526 applies. It is based on sections 91A(1), (2) and (2A) and 91B(1), (2), (2A) and (6A) of FA 1996.

Section 524: Shares subject to outstanding third party obligations

1422. This section deals with the first type of shares to fall within section 523: shares which increase in value in a similar way to an investment return as a result of an obligation by a third party. It is based on section 91A(1) and (5) to (6) of FA 1996.

Section 525: Meaning of "interest-like investment"

1423. This section explains a term used in the previous section. It is based on section 91A(7) to (9) of FA 1996.

Section 526: Non-qualifying shares

1424. This section deals with the second type of shares to fall within section 523: shares ("non-qualifying shares") which produce predictable gains because of the nature of the assets underlying them. It is based on section 91B(1) and (6) of FA 1996. One of three conditions, dealt with in sections 527 and 529 to 532, must be met for shares to fall within this category.

Section 527: The increasing value condition

1425. This section gives the first of the conditions necessary for a share to be a non-qualifying share within section 526. It is based on section 91C(1) to (3) and (6) of FA 1996. This is where the assets of the company in which the shares are held increase at a rate similar to commercial interest but which are not income-producing.

Section 528: Regulations about income-producing assets

1426. This section gives powers to the Treasury to add to the list of income-producing assets in section 527. It is based on section 91C(4) and (5) of FA 1996.

Section 529: The redemption return condition

1427. This section gives the second of the conditions necessary for a share to be a non-qualifying share within section 526. It is based on section 91D(1) to (2A) of FA 1996. This is where a redeemable share (with certain exceptions) produces a return similar to commercial interest.

Section 530: The redemption return condition: excepted shares

1428. This section explains which redeemable shares are excluded from being shares which may meet the condition dealt with by section 529. It is based on section 91D(3) to (8) and (11) of FA 1996.

1429. "Independent person" in section 91D has been rewritten in this section as "persons not connected with the company" which is the definition in section 91D(11). Given that the definition in section 839 of ICTA applies, "persons" here refers to both companies and individuals. Section 839 is not separately referred to in this Part as the definition of "connected persons" in section 1316 applies for the purposes of the Act. The use of "independent person" appears twice in Chapter 2 of Part 4 of FA 1996 with two quite different definitions. The other definition is in section 103 of FA 1996. The use of both terms has been replaced by their definitions.

Section 531: The redemption return condition: unallowable purposes

1430. This section explains what is meant by an unallowable purpose to ascertain whether a share is a qualifying publicly issued share for the purposes of section 530 and thus excluded from the redemption return condition as an excepted share. It is based on section 91D(9) to (11) of FA 1996.

Section 532: The associated transactions condition

1431. This section gives the third and final condition necessary for a share to be a non-qualifying share within section 526. It is based on section 91E(1) to (3) of FA 1996. This is where neither of the other conditions is met but there is a scheme or arrangement under which the combined effect of the shares and another transaction produce a return similar to a commercial rate of interest.

Section 533: Power to change conditions for non-qualifying shares

1432. This section gives the Treasury the power to vary the conditions to be met under which shares may be "non-qualifying shares" for the purposes of section 526. It is based on section 91F of FA 1996.

Section 534: Amounts to be brought into account where section 523 applies

1433. This section sets out rules concerning the amounts to be brought into account for the purposes of this Part by the company holding the shares. It is based on section 91A(3), (4) and (9) and section 91B(3), (4) and (6A) of FA 1996.

1434. *Subsection (7)* overrides the requirement for amortised cost basis where both this section and section 349 apply. See *Change 57* in Annex 1.

Section 535: Shares ceasing to be shares to which section 523 applies

1435. This section treats shares which cease to fall within section 523 as having been disposed of and reacquired. It is based on section 91G(2) of FA 1996.

Chapter 8: Returns from partnerships

Overview

1436. This Chapter deals with arrangements involving firms that are intended to give rise to interest-like returns. It brings into the loan relationship provisions those arrangements that function in a similar way to loan relationships but which fall outside the definition. It is based on sections 91H and 91I of FA 1996 (inserted by paragraph 17 of Schedule 22 to FA 2008).

Section 536: Introduction to Chapter

1437. This section sets out what the Chapter does and how it is arranged. It is based on sections 91H(1), (2) and (6), and 91I(1), (2) and (7) of FA 1996.

Section 537: Payments in return for capital contribution to partnership

1438. This section deals with arrangements under which a company obtains a return by acquiring an interest in a firm for an amount which will increase in value in a similar way to interest. It is based on section 91H(1) to (4) of FA 1996.

1439. In accordance with the Partnership Act 1890, in this Act reference to the relationship between the partners is a "partnership", but the collection of partners is a "firm".

Section 538: Change of partnership shares

1440. This section deals with arrangements under which a company invests money in a firm in the form of capital contributions, initially receiving a share of the firm's profits that is smaller than would be received by reference to that contribution but with a compensating greater entitlement to capital of the firm later on. It is based on section 91I(1) to (5) of FA 1996.

Chapter 9: Manufactured interest etc

Overview

1441. This Chapter treats "manufactured interest" (payments representing interest under a stock-lending arrangement) as interest under a loan relationship.

Section 539: Introduction to Chapter

1442. This section explains when a company has a "manufactured interest relationship". It is based on section 97(1) and (4) of FA 1996.

Section 540: Manufactured interest treated as interest under loan relationship

1443. This section provides the main rule that the manufactured interest is treated as if it were interest under a loan relationship and the manufactured interest relationship is treated as if it were a loan relationship. It is based on section 97(2), (2A) and (4B) of FA 1996. It also ensures that debits and credits in respect of related transactions can still be taken into account after the company no longer has the right to receive manufactured interest (to prevent the sale of rights to receive such interest to third parties).

Section 541: Debits for deemed interest under stock lending arrangements disallowed

1444. This section disallows a debit under the loan relationship provisions for representative payments under section 736B(2) of ICTA. It is based on section 97(4A) of FA 1996.

Chapter 10: Repos

Overview

1445. The rules in this Chapter provide for the tax treatment of repo transactions to follow their accounting treatment under generally accepted accounting practice (GAAP). These rules have been rewritten from Schedule 13 to FA 2007.

Section 542: Introduction to Chapter

1446. This section sets out the purpose of the Chapter and how it is arranged. It is based on paragraph 1(1) of Schedule 13 to FA 2007.

1447. The purpose of the Chapter is that arrangements involving the sale and subsequent purchase of securities that equate in substance to the lending of money by or to a company (with the securities in substance acting as collateral) are to be taxed in accordance with their economic substance and accounting treatment.

Section 543: Meaning of creditor repo

1448. This section provides the definition of creditor repo - that is, a repo from the point of view of the lender, the company that purchases the securities as collateral. It is based on paragraph 7 of Schedule 13 to FA 2007.

1449. The securities are purchased with cash that, although legally a purchase price, equates in substance to a loan. Commercially this is known as a "reverse repo". It is intended to cover normal repos executed under standard market documentation (although since it does not require the lender to sell the securities back to "the borrower" it goes wider than this).

Section 544: Meaning of creditor quasi-repo

1450. This section provides the definition of creditor quasi-repo. It is based on paragraph 8 of Schedule 13 to FA 2007. A creditor quasi-repo is intended to cover arrangements that are economically equivalent to standard creditor repos but are on non-standard terms.

Section 545: Ignoring effect on lender etc of sale of securities

1451. This section contains the first of two operative rules that apply when a company ("the lender") has a creditor repo or creditor quasi-repo. It is based on paragraph 9 of Schedule 13 to FA 2007.

1452. The rule is intended to secure that the lender is not taxed on any income that arises on the securities during the period of the repo and does not obtain tax relief for any manufactured payments made, so long as neither is recognised in determining the lender's profit or loss. This rule reflects the fact that for accounts purposes neither the income nor the payment will generally be recognised.

Section 546: Charge on lender for finance return in respect of the advance

1453. This section contains the second operative rule for creditor repos and creditor quasi-repos. It is based on paragraph 10 of Schedule 13 to FA 2007. It treats the financial asset as a loan relationship and the finance charge reflected in the accounts as deemed interest on that loan.

Section 547: Repo under arrangement designed to produce quasi-interest: tax avoidance

1454. This section is an anti-avoidance provision. It is based on paragraph 12 of Schedule 13 to FA 2007.

Section 548: Meaning of debtor repo

1455. This section introduces the concept of "debtor repo" – that is, a repo from the point of view of the borrower, the company that sells securities as collateral. It is based on paragraph 2 of Schedule 13 to FA 2007. It is intended to cover normal repos executed under standard market documentation (although since it does not require the borrower to buy the securities back from "the lender" it goes slightly wider than this).

Section 549: Meaning of debtor quasi-repo

1456. This section is the counterpart of section 544 and introduces the concept of "debtor quasi-repo" which is intended to cover arrangements that are economically equivalent to standard debtor repos but are on non-standard terms. It is based on paragraph 3 of Schedule 13 to FA 2007.

Section 550: Ignoring effect on borrower of sale of securities

1457. This section contains the first of two operative rules that apply when a company ("the borrower") has a debtor repo or debtor quasi-repo. It is based on paragraph 4 of Schedule 13 to FA 2007. It also contains a special rule that applies where a person has entered into a "relevant arrangement".

1458. It provides for the sale of securities by a company and the manufactured payment made by the other company in respect of the securities to be ignored. The borrower is taxed on the interest (or dividends) from the securities the borrower is selling and any manufactured interest the borrower receives representing that income is ignored.

Section 551: Relief for borrower for finance charges in respect of the advance

1459. This section sets out the second operative rule for debtor repos and debtor quasi-repos which is that the borrower obtains relief for any finance charge shown in its accounts that represents its cost of borrowing. It is based on paragraph 5 of Schedule 13 to FA 2007.

Section 552: General provisions about arrangements

1460. This section provides a number of rules for the purpose of applying other sections in this Chapter. It is based on paragraph 14(5) to (7) of Schedule 13 to FA 2007.

Section 553: Persons buying or selling for others

1461. This section ensures that where the sale or purchase of securities is made by a person for the benefit of another, the rules operate by reference to beneficial ownership. It is based on paragraph 14(3) of Schedule 13 to FA 2007.

Section 554: Power to modify this Chapter

1462. This section contains a power to modify some of the provisions of the Chapter to deal with non-standard repos or cases involving redemption arrangements. It is based on paragraph 15(1), (6), (7) and (9) of Schedule 13 to FA 2007.

Section 555: Cases where section 554 applies: non-standard repos

1463. This section sets out the situations when the powers under section 554 may be used. It is based on paragraph 15(2) to (5) of Schedule 13 to FA 2007.

Section 556: Meaning of securities and similar securities

1464. This section explains the meaning of "securities" for the other sections. It is based on paragraph 14 of Schedule 13 to FA 2007.

Section 557: Meaning of person receiving an asset

1465. This section provides that receiving an asset or payments in respect of an asset includes obtaining the value of, or a benefit from, an asset, whether directly or indirectly. It is based on paragraph 14(2) of Schedule 13 to FA 2007.

Section 558: Interpretation of accounting expressions

1466. This section explains accounting expressions used in the Chapter. It is based on paragraph 14(9) and (11) of Schedule 13 to FA 2007.

Section 559: Minor definitions

1467. This section provides further definitions for expressions used in this Chapter. It is based on paragraph 14(1) of Schedule 13 to FA 2007.

Chapter 11: Investment life insurance contracts

Overview

1468. This Chapter contains provisions that treat investment life insurance contracts as falling within the loan relationship rules. It is based on Schedule 13 to FA 2008.

Section 560: Introduction to Chapter

1469. This section sets out the purpose of the Chapter, how it is arranged and provides definitions for the Chapter. It is based on paragraph 1(1) and (2) of Schedule 13 to FA 2008.

Section 561: Meaning of "investment life insurance contract"

1470. This section defines "investment life insurance contract", and also states the types of policies that are excluded from that definition. It is based on paragraph 1(1) to (3) of Schedule 13 to FA 2008.

Section 562: Contract to be loan relationship

1471. This section treats the investment life insurance contract as a creditor relationship of the company for the loan relationship provisions. It is based on paragraph 2(1) and (2) of Schedule 13 to FA 2008.

1472. *Subsections (3) and (4)* provide that credits representing the excess of any lump sum payout on death, or the onset of critical illness, over the policy's surrender value at that time are exempt from tax under the loan relationship rules.

Section 563: Increased non-trading credits for BLAGAB and EEA taxed contracts

1473. This section provides a special rule within the loan relationships legislation for company-held investment policies. It is based on paragraphs 3(1) to (3) and 4(1) of Schedule 13 to FA 2008.

1474. The rule applies where the contract is a BLAGAB contract or is subject to a comparable "EEA tax charge". In general, such policies will simply follow the normal rules, but this section recognises that in many cases the insurance company will have borne tax on the income and gains which are building up within the company in order to provide the benefits under the policy.

1475. This section provides that where a company has to bring in a non-trading credit representing a profit from a related transaction, then that credit is increased and the amount of the increase is set off against corporation tax assessable on the company for the accounting period.

Section 564: Section 563: interpretation

1476. This section provides the meaning of "BLAGAB contract" and provides the conditions for when a relevant comparable EEA tax charge has applied. It is based on paragraph 3(4) to (6) of Schedule 13 to FA 2008.

Section 565: Relevant amount where the relevant company uses fair value accounting

1477. This section provides a special rule where the policy is accounted for on the basis of fair value accounting. It is based on paragraphs 3(3) and 4(1) to (4) of Schedule 13 to FA 2008.

1478. The rule ensures that the whole profit, and not just the credit calculated by reference to the opening fair value at the start of the accounting period of sale etc, is used in calculating the additional credit and giving relief for the whole of the relevant I minus E tax.

Section 566: Introduction

1479. This section introduces the following three sections that deal with the charges on future gains of investment life insurance contracts that existed immediately before the

beginning of the first accounting period of the company beginning on or after 1 April 2008. It is based on paragraphs 6(1), 7(1) and 8(1) of Schedule 13 to FA 2008.

1480. Although these sections are transitional, they have been placed in the body of this Part, rather than in the Schedules, because those contracts will be the majority for some time.

1481. The part of paragraph 6(1) providing that there was a deemed surrender of the rights under the contract immediately before 1 April 2008 is spent and has not been rewritten.

Section 567: Gains on deemed surrenders to be brought into account on related transactions

1482. This section provides that gains that accrued as a result of that deemed surrender are brought into account in the accounting period in which there is a related transaction. It is based on paragraphs 6(2) to (4) of Schedule 13 to FA 2008.

1483. The deemed gain that is brought into account is apportioned where the company is still party to the contract after the related transaction.

Section 568: Restriction on credits on old contracts: fair value accounting cases

1484. This section applies where the company uses fair value accounting and the cost of the contract at the start of the first accounting period beginning on or after 1 April 2008 is greater than the fair value of that contract at that time. It is based on paragraph 7(1) to (3) of Schedule 13 to FA 2008.

1485. Subsequent credits are not brought into account until they exceed the amount by which cost exceeded fair value at the start of that period.

Section 569: Restriction on debits on old contracts: non-fair value accounting cases

1486. This section applies where the company does not use fair value accounting and the carrying value of the contract at the start of the first accounting period beginning on or after 1 April 2008 is greater than the fair value of that contract at that time. It is based on paragraph 8(1) and (2) of Schedule 13 to FA 2008.

1487. Subsequent debits are not brought into account until they exceed the amount by which that carrying value exceeded that fair value.

1488. This rule prevents amounts being brought into account where the drop in value of the policy occurred before the start of the initial period.

Part 7: Derivative contracts

Overview

1489. This Part deals with profits and losses arising to a company from its derivative contracts. It is based on Schedule 26 to FA 2002.

1490. In most cases, the company's accounts treatment of its derivatives is followed in identifying and quantifying the credits and debits which make up profits and losses in respect of its derivative contracts for tax purposes.

1491. If the contract is held for the purposes of a company's trade, credits and debits arising from it are treated as receipts and expenses in calculating the profits of the trade under Part 3 of this Act. If it is not so held, the credits and debits are brought into account under Part 5 of this Act (loan relationships) in determining whether the company has non-trading profits or a non-trading deficit from its loan relationships. But, in a number of cases (primarily if the underlying subject matter of the derivative contract is land or shares), credits and debits are instead treated as giving rise to chargeable gains or allowable losses for the purposes of TCGA.

1492. There are similarities between many of the core rules for derivative contracts and those for loan relationships. The arrangement and drafting of the provisions for such common rules in Parts 5 and 6 and this Part is matched so far as appropriate. There are also rules for the interaction of the two regimes if a loan relationship includes a derivative contract (see section 700).

1493. Secondary legislation modifies the effect of these sections. See in particular the Exchange Gains and Losses (Bringing into Account Gains or Losses) Regulations 2002 (SI 2002/1970), as amended, the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256), as amended, and the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (SI 2004/3271), as amended. The modifications in secondary legislation have not been rewritten in these sections.

1494. The Part uses a number of defined terms. The more important are those in sections 576 to 583 (meaning of "derivative contract" and other basic definitions) in Chapter 2, section 596 (meaning of "related transaction") in Chapter 3 and sections 702 to 710 (other general definitions) in Chapter 13.

1495. Part 10 of Schedule 2 contains a number of transitional rules affecting the application of this Part. The commentary draws attention where relevant to particular paragraphs. But see particularly the paragraphs headed "contracts which became derivative contracts on 16 March 2005", "contracts which became derivative contracts on 28 July 2005" and "plain vanilla contracts which became derivative contracts before 30 December 2006" which have more general effect.

Chapter 1: Introduction

Section 570: Overview of Part

1496. This section contains a brief description of the Part and includes a signpost to the key definition for the Part, that of "derivative contract". It is new.

Section 571: General rule: profits chargeable as income

1497. This section provides that profits arising to a company from its derivative contracts are chargeable to corporation tax as income. It is based on paragraph 1(1) of Schedule 26 to FA 2002.

1498. Profits arising to a company from its derivative contracts are generally chargeable to corporation tax as income, even if they would otherwise be regarded as capital profits under accounting rules. But some such profits are charged instead to corporation tax as chargeable gains. *Subsection (2)* signposts this exception to the general rule.

1499. Profits are so chargeable "in accordance with this Part". That is, this Part contains all the necessary rules for identifying and quantifying the amount to be charged to tax. These rules take priority over any rule that might otherwise apply. See in particular section 699 (priority of this Part for corporation tax purposes).

Section 572: Profits and losses to be calculated using credits and debits given by this Part

1500. This section sets out how profits and losses from derivative contracts are calculated. It is based on paragraph 14(1) of Schedule 26 to FA 2002.

1501. The terms "credit" and "debit" are used in accounting practice. The Part operates by reference to accounts drawn up in accordance with generally accepted accounting practice (see section 595 (general principles about the bringing into account of credits and debits)).

1502. Chapter 3 contains the main rules for finding the relevant credits and debits. *Subsection (2)* indicates that in some cases profits and losses are calculated using other factors (the sections in question all give rise to amounts to be charged to corporation tax as chargeable gains).

Section 573: Trading credits and debits to be brought into account under Part 3

1503. This section provides for the treatment of credits and debits if the company is a party to the derivative contract for the purposes of a trade it carries on. It is based on paragraph 14(2) and (4) of Schedule 26 to FA 2002.

1504. Credits and debits are treated respectively as receipts and expenses of the company's trade. Profits and losses in respect of the derivative contract are therefore charged under Part 3 (trading income).

1505. The provisions referred to in *subsection (4)* are those that would otherwise prevent a debit being taken into account as an expense of the trade.

1506. The provisions referred to in *subsection (5)* disapply this section, either because the contract in question is taken outside the scope of this Part or because credits and debits are taken into account instead in computing chargeable gains.

Section 574: Non-trading credits and debits to be brought into account under Part 5

1507. This section provides for credits and debits to be brought into account under Part 5 (loan relationships) if section 573 does not apply to them. It is based on paragraph 14(3) of Schedule 26 to FA 2002.

1508. Credits and debits are treated as non-trading credits and non-trading debits for the purposes of Part 5 and lumped in with any non-trading credits and non-trading debits arising on the company's loan relationships to determine whether there is an amount to charge (or to relieve as a deficit) under that Part. Profits and losses in respect of such credits and debits arising from the derivative contract are therefore charged under Part 5.

1509. *Subsection (3)* has the same function for non-trading credits and debits as does section 573(5) for trading credits and debits. The paragraphs in Part 10 of Schedule 2 headed "existing assets representing creditor relationships: options", "existing assets representing creditor relationships: contracts for differences" and "disapplication of section 658" also disapply this section.

Chapter 2: Contracts to which this Part applies

Section 575: Overview of Chapter

1510. This section describes the purpose and content of the Chapter. It is new.

Section 576: "Derivative contract"

1511. This section sets out the conditions under which a contract of a company is a derivative contract. It is based on paragraph 2(1) of Schedule 26 to FA 2002.

1512. The first condition, that it is a "relevant contract" (defined in section 577), limits the application of the term "derivative contract" to contracts that derive their value from underlying subject matter (defined in section 583) which is subject to changes in market prices or other factors.

1513. The second condition, that it meets the "accounting conditions" in section 579, means that the contract either:

- is treated by the relevant accounting standards as a derivative or as a financial asset or liability; or

- has underlying subject matter within certain categories.

1514. The third condition, that section 589 (contracts excluded because of underlying subject matter: general) or "any other provision of the Corporation Tax Acts" does not prevent it being a derivative contract, cuts down the scope of this Part, particularly in relation to contracts whose underlying subject matter is land or shares. Section 226(3) of FA 1994 (Lloyd's underwriters: relevant contract forming part of a premium trust fund not to be a derivative contract) is an example of such another provision.

Section 577: "Relevant contract"

1515. This section defines the term "relevant contract". It is based on paragraph 2(2) of Schedule 26 to FA 2002.

1516. In this Part, the term is used to refer generically to a contract within one of the three categories of contract listed here. In many contexts it is immaterial whether the relevant contract is an option, a future or a contract for differences.

1517. See also sections 584 to 586, under which some of the rights and liabilities under a contract are themselves *treated* as a relevant contract. The deemed relevant contract is a derivative contract if it meets the other conditions in section 576(1).

Section 578: Relevant contracts of a company and being party to such contracts

1518. This section explains what references in this Part to a company's relevant contracts, or to a company being a party to such a contract, mean. It is based on paragraphs 2(2A) and 53(1) and (2) of Schedule 26 to FA 2002.

1519. A relevant contract is "of" a company if that company has entered into or acquired the contract. A reference to a company being a party to a contract means the company has entered into or acquired the contract.

1520. *Subsection (2)* explains what "acquires" means in relation to a contract for the purposes of this Part. The words "whether by assignment or otherwise" in the source legislation have not been reproduced as they add nothing.

Section 579: The accounting conditions

1521. This section sets out the conditions mentioned in section 576(1)(b). It is based on paragraph 3 of Schedule 26 to FA 2002.

1522. Most derivative contracts meet the first of the conditions in *subsection (1)*, that the relevant contract is treated for accounting purposes as a derivative. *Subsections (3)* and *(5)* explain when a relevant contract is treated for accounting purposes as a derivative. Financial Reporting Standard 25 ("FRS 25") deals with the presentation of financial instruments in accounts.

1523. The second condition has two legs. The first covers a contract that does not meet a particular requirement of Financial Reporting Standard 26 (measurement in accounts of financial instruments) ("FRS 26") that must be satisfied if the contract in question is to be treated as a derivative under FRS 25. Paragraph 9(b) of FRS 26 prescribes that the "financial instrument or other contract within the scope of this Standard… requires no initial net investment or an initial net investment that is smaller than would be required for other types of contract that would be expected to have a similar response to changes in market factors".

1524. The second leg of the second condition is that the contract is nevertheless treated for accounting purposes as a financial asset or financial liability. *Subsections (4)* and *(5)* have the same function in relation to the second condition as have subsections (3) and (5) in relation to the first condition.

1525. The third condition brings in contracts that fail the first or second condition but have underlying subject matter within one of the categories prescribed in *subsection (2)*. If the underlying subject matter is commodities, it does not matter what category of relevant contract the contract is. But only a contract for differences can meet the condition by reference to the other prescribed categories of underlying subject matter. So an option or future whose underlying subject matter is one or more of the categories in subsection (2)(b) is only a derivative contract if it meets one of the other accounting conditions.

Section 580: "Option"

1526. This section defines the term "option". It is based on paragraph 12(1), (8) and (10) of Schedule 26 to FA 2002.

1527. Subject to the non-exhaustive definition in *subsection (1)* and the limitation in *subsection (2)* (itself limited by *subsection (3)*), the word takes its ordinary meaning. "Warrant", in subsection (1), is defined in section 710 (other definitions).

1528. The limitation in subsection (2) excludes cash-settled options from the meaning of "option". Contracts so excluded fall within the definition of contracts for differences and are therefore subject to the rules applying to relevant contracts generally and those applying specifically to contracts for differences.

1529. *Subsection (4)* lists a number of provisions that dispense with this limitation and so do not exclude cash-settled options from the meaning of "option" in that context.

Section 581: "Future"

1530. This section defines the term "future". It is based on paragraph 12(1), (6), (7) and (10) of Schedule 26 to FA 2002.

1531. *Subsections (3)* and *(4)* exclude cash-settled futures from the scope of the definition in the same way that section 580(2) and (3) does for cash-settled options in relation to the definition of "option". Contracts so excluded also fall within the definition of contracts for differences.

Section 582: "Contract for differences"

1532. This section defines the term "contract for differences". It is based on paragraph 12(1), (3), (4) and (5) of Schedule 26 to FA 2002.

1533. This is the broadest category of relevant contract and the definition is expressed initially in wide-ranging terms. *Subsection (2)* therefore excludes a number of categories of contract from the scope of the definition, in particular an option and a future, but also a loan relationship and a number of other types of financial instrument. Section 710 has definitions of "contract of insurance" and "capital redemption policy". For the meaning of "loan relationship", see section 302.

1534. *Subsection (3)* emphasises the wide-ranging nature of the indices or factors that may be designated in a contract for differences. The words in the source legislation "and, for those purposes, a numerical value may be attributed to any variation in a matter", have not been rewritten as they add nothing. It is of the essence of any index or factor used in a contract for differences that it has such a numerical value.

Section 583: "Underlying subject matter"

1535. This section defines the term "underlying subject matter" for each category of relevant contract. It is based on paragraph 11 of Schedule 26 to FA 2002.

1536. *Subsection (5)* echoes section 579(2)(b) in explaining that certain factors may be the underlying subject matter of a contract for differences. One of those factors is interest rates. *Subsection (6)* provides that interest rates are not regarded as the underlying

subject matter of a contract for differences if such rates are only used incidentally in determining the variable amount of a payment due under the contract at a variable date. That is, in such a case an interest rate or rates are a factor in the operation of the contract but are not themselves what its outcome depends on.

1537. *Subsection (7)* applies to all categories of relevant contract. It stops certain types of property from being regarded as the underlying subject matter of the contract just because *income* from that property is included in that underlying subject matter. Contracts to which this provision applies are therefore, as regards this aspect of their underlying subject matter, not excluded as derivative contracts under section 589.

Sections 584 to 586: Cases where companies treated as parties to relevant contracts

Overview

1538. These three sections treat certain rights and liabilities under a contract (an "embedded derivative") as themselves constituting a relevant contract independent of the remaining rights and liabilities under the main contract. The deemed relevant contract is a derivative contract if it meets the conditions in section 576(1)(b) and (c).

1539. All three cases cater for the provision in accounting standards for a financial or other instrument to be treated as divided between:

- the rights and liabilities that constitute one or more derivatives or one or more derivative financial instruments or equity instruments; and
- the remaining rights and liabilities under the instrument.

1540. All three cases provide for the deemed relevant contract to be treated as an option, future or contract for differences if that is what a contract having only the rights and liabilities of the deemed relevant contract would be. So references in this Part to an option, future or contract for differences include a reference to the deemed relevant contract unless the context requires otherwise. And provisions dealing with a "relevant contract" or "derivative contract" apply to an embedded derivative that is treated as a relevant contract or qualifies as a derivative contract unless the context requires otherwise.

1541. A number of provisions in this Part make special provision for one or other category of embedded derivative (see in particular Chapters 7 and 8 (chargeable gains arising in relation to derivative contracts)).

Section 584: Hybrid derivatives with embedded derivatives

1542. This section treats a relevant contract divided in accordance with generally accepted accounting practice between one or more embedded derivatives and a host contract as a number of relevant contracts for the purposes of this Part. It is based on paragraph 2B of Schedule 26 to FA 2002.

1543. It applies if a relevant contract that is not itself a derivative for accounting purposes is so divided into one or more embedded derivatives and the remaining rights and liabilities ("the host contract") which by themselves amount to a relevant contract.

1544. The host contract is also treated as a relevant contract with the same consequences as for the embedded derivative (in this respect, this section differs from its two successors).

1545. A relevant contract which may be treated as containing such deemed relevant contracts is called a "hybrid derivative" (*subsection (4)*). *Subsection (5)* lists the provisions which apply in relation to a hybrid derivative.

Section 585: Loan relationships with embedded derivatives

1546. This section treats the embedded derivative or embedded derivatives in a company's loan relationship as relevant contracts. It is based on section 94A of FA 1996.

1547. It applies if a loan relationship is treated under generally accepted accounting practice as divided between rights and liabilities under one or more derivative financial instruments or equity instruments (the embedded derivative(s)) and the remaining rights and liabilities which by themselves constitute a loan relationship.

1548. For the meaning of "equity instrument", see section 710 (that is, it has the meaning it has for accounting purposes). It is defined in paragraph 11 of International Accounting Standard 32 as follows: "an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities".

1549. *Subsection (4)* is a signpost to section 415 in Part 5 (loan relationships) which deals with the remaining rights and liabilities which by themselves constitute a loan relationship.

1550. *Subsection (5)* includes a signpost to section 416 which provides for a company to elect that certain of its loan relationships shall be split as mentioned in section 415 and this section, if they would not be so split under the accounting practice the company uses.

Section 586: Other contracts with embedded derivatives

1551. This section provides for the embedded derivative or embedded derivatives in a contract that is neither a hybrid derivative nor a loan relationship to be treated as relevant contracts. It is based on paragraph 2A of Schedule 26 to FA 2002.

1552. It applies if such a contract is divided under generally accepted accounting practice between one or more embedded derivatives and the remaining rights and liabilities under the contract.

1553. *Subsection (2)(a)* is written in terms of the rights and liabilities of the embedded derivative rather than, as in the source legislation, simply referring to the embedded derivative. This aligns the rule here with the expression of the similar rule in the preceding two sections.

1554. The source legislation for subsection (2)(b) refers at the equivalent point to a contract "whose rights and liabilities consist only of one of the *non-financial* embedded derivatives". "Non-financial" is part of the label "non-financial embedded derivative" in paragraph 2A of Schedule 26 to FA 2002, which applies to the relevant contract to which the company is deemed to be a party under this provision. It is not appropriate to the embedded derivative itself by virtue of which the company is treated as a party to a relevant contract. That is, the embedded derivative has first to be identified before there is a deemed relevant contract to which such a label can be applied. "Non-financial" has therefore not been rewritten in subsection (2)(b).

Section 587: Contract relating to holding in OEIC, unit trust or offshore fund

1555. This section treats as a derivative contract a relevant contract that is not otherwise such a contract if its underlying subject matter consists wholly or partly of a holding in a collective investment scheme and that scheme fails to meet a "qualifying investments test". It is based on paragraph 36(1), (2), (3) and (4) of Schedule 26 to FA 2002.

1556. A number of the contracts to which this section would appear to apply are in fact already derivative contracts because their underlying subject matter does not qualify as "excluded property" under section 589. This section therefore sweeps up any relevant contract that fails to meet the conditions for a derivative contract despite its underlying subject matter consisting wholly or partly of a "relevant holding".

1557. The words "but for this section", at the end of paragraph (a) in *subsection (1)*, avoid conflict between the effect of the section (the contract is a derivative contract) and the condition for the section to apply (the contract is not a derivative contract).

1558. If *subsection (2)* applies to treat the relevant contract as a derivative contract in a particular accounting period, that treatment persists for so long as the contract is a

relevant contract of the company (even if the circumstances that first led to it being treated as a derivative contract no longer apply).

1559. *Subsection (3)* describes what a "relevant holding" is for the purposes of the section. It is drafted in terms of the underlying subject matter of the contract rather than, as in the source legislation, referring to a relevant holding of a "person". This corrects a misfiring of the provision that arose from adapting a similar provision for loan relationships (see paragraph 4(1) of Schedule 10 to FA 1996, rewritten in section 490 of this Act). See *Change 63* in Annex 1. (This Change also applies to section 601; see the signpost to that section in *subsection (6)*.)

1560. The meaning of "material interest in an offshore fund" in subsection (3)(a)(iii) is provided by reference to Chapter 3 of Part 6 of this Act, where the definition is based on paragraph 7 of Schedule 10 to FA 1996, to which the source legislation for this section refers. But that definition pleads into the meaning given to "offshore fund" in section 489(1), which is slightly wider in scope than that given in section 756A of ICTA. See *Change 60* in Annex 1.

1561. *Subsection (5)* refers to the power to amend the definition of "relevant holding", by regulations under section 17 of F(No 2)A 2005, in relation to the source legislation for both this section and its loan relationships equivalent (section 490 in Part 5). The power has not yet been exercised.

1562. The provisions mentioned in *subsections (6)* and *(7)* are those that deal specifically with contracts to which this section applies. But a contract treated as a derivative contract by this section is subject to other provisions that operate on derivative contracts so far as the context permits.

Section 588: Associated transaction treated as derivative contract

1563. This section treats an "associated transaction" in respect of shares held by an "investing company" as either a derivative contract or a transaction in respect of a derivative contract, if it would not already be such a contract or transaction. It is based on section 91B(5) of FA 1996.

1564. If the section does so, credits and debits arising from the associated transaction are then brought into account under this Part under section 603.

1565. Chapter 7 of Part 6 (shares with guaranteed returns etc) deals with certain shares which in substance are equivalent to loan relationships. It provides that the same consequences follow for tax purposes as if the company's holding of shares were a loan relationship.

1566. Section 523 (which is also based on section 91B of FA 1996) applies to "non-qualifying shares". A share is "non-qualifying" if one of various conditions is met. One of those conditions (see section 532) is that there is a scheme or arrangement under which the share and "one or more associated transactions" are designed to equate to an investment yielding a commercial rate of interest. An "associated transaction" is one of entering into, or acquiring rights and liabilities under, a derivative contract or contracts having some similarity to a derivative contract or a contract of insurance or indemnity.

1567. *Subsection (4)* applies if there is such an associated transaction (the "associated transactions condition").

Section 589: Contracts excluded because of underlying subject matter: general

1568. This section, supplemented by the next four, provides that a relevant contract is not a derivative contract if its underlying subject matter falls wholly into certain categories (or is treated as doing so) and one or more conditions applies. It is based on paragraph 4(1), (2), (2ZA) and (4) of Schedule 26 to FA 2002.

1569. Profits and losses arising in relation to such contracts are therefore not brought into account under this Part but are taxed as appropriate under other provisions, primarily as chargeable gains.

1570. *Subsection (1)* introduces the term "excluded property" to describe underlying subject matter that causes the relevant contract not to be a derivative contract. *Subsection (2)*, supplemented by *subsections (3)* to *(6)* defines the term, with further detail appearing in sections 590 to 592.

1571. Intangible fixed assets are excluded property, but only in the case of an option or future. Profits and losses in respect of such a contract are dealt with primarily under Part 8.

1572. The major categories of excluded property, in relation to any type of relevant contract, are (a) shares in a company and (b) rights of a unit holder under a unit trust scheme. But in such cases the relevant contract must both satisfy one of the conditions in section 591 and not have the characteristics of a commercial investment.

1573. Subsection (3) takes certain types of share out of the excluded category. These are:

- shares dealt with by Chapter 7 of Part 6 (shares with guaranteed returns etc); and
- shares in an open-ended investment company if that company fails to meet the qualifying investments test for the purposes of the loan relationships provisions.

1574. For more on the qualifying investments test, see the commentary on section 587.

Section 590: Disregard of subordinate or small value underlying subject matter

1575. This section provides that the parts of a relevant contract's underlying subject matter that are subordinate or of small value are ignored in determining for the purposes of section 589 whether its underlying subject matter consists wholly of excluded property. It is based on paragraph 9 of Schedule 26 to FA 2002.

1576. A relevant contract may contain a number of minor elements in addition to its main purpose. For example, there may also be an option to settle the contract in one or more currencies by reference to a particular exchange rate or there may be some minor leeway as to the settlement date.

1577. *Subsection (3)* provides that any question of whether part of the underlying subject matter is "subordinate" or of "small value" is determined by reference to the time the company enters into or acquires the contract. But the section does not otherwise provide any definition of "subordinate" or "small value". Paragraph CFM13120 of HMRC's Corporate Finance Manual (and the examples in CFM13120a) provides guidance.

1578. See also section 593 which deals with the case of an option or future where the part of the underlying subject matter that is not excluded property is neither subordinate nor of small value.

Section 591: Conditions A to E mentioned in section 589(5)

1579. This section provides the conditions mentioned in section 589(5)(a) which govern whether shares in a company or rights of a unit holder under a unit trust scheme are excluded property under that section. It is based on paragraphs 4(2A) to (2D) and 12(1) and (11A) of Schedule 26 to FA 2002.

1580. Condition A applies to certain relevant contracts entered into or acquired by life insurers that are an "approved derivative" within the meaning of Rule 3.2.5 of the Insurance Prudential Sourcebook issued by the Financial Services Authority on 25 October 2006 or, in the case of an overseas life insurance company which is a European Economic Area firm or a "treaty firm", are derivative instruments falling within article 23.3 of the EC Consolidated Life Directive (EC/2002/83).

1581. Rule 3.2.5 of the Insurance Prudential Sourcebook sets out a number of conditions to do with the purposes for which the derivative is held, how the risk under the derivative is managed and the circumstances in which it is entered into or acquired. See the definition of "Insurance Prudential Sourcebook" in section 431(2) of ICTA.

1582. Condition A does not apply to a relevant contract that meets the condition in section 579(1)(b) (one that is treated by accounting standards as a financial asset or liability, but is not treated as a derivative by accounting standards because of the size of the initial outlay).

1583. The source legislation for condition A applies only to cases where the contract is "entered into" by the company. But the source legislation for conditions B to D in this section applies if the company enters into *or acquires* the contract. This condition has been brought into line with those conditions. See *Change 64* in Annex 1.

1584. See also section 592 which extends the application of condition A to certain rights and liabilities that are treated as a relevant contract by section 584.

1585. Condition B applies if the company is not a party to the relevant contract for the purposes of its trade and there is a "hedging relationship" (defined in section 707) between the relevant contract and either (a) shares or rights of a unit holder in a unit trust scheme or (b) the company's share capital or related liability.

1586. Condition B does not apply if the relevant contract is one treated as such by section 585 (that is, it is an embedded derivative in a loan relationship).

1587. Condition C applies if the company is not a party to the relevant contract for the purposes of its trade and the contract is a quoted option to subscribe for shares.

1588. Condition D deals with a relevant contract that relates to the acquisition by company A of a major investment in the share capital of company B other than for the purposes of core activities of company A's trade. The reference to "activities forming an integral part of a trade" ensures that the condition is not disapplied in the case of, say, a financial trader. For a financial trader, the particular contract may be relevant to its structural assets, which might be regarded as held in the course of its trade, but may not actually be relevant to its core trading activities. The contract must be an option or future for the acquisition or delivery of shares. As with condition B, condition D does not apply if the relevant contract is one treated as such by section 585.

1589. Condition E applies if there is a hedging relationship between the relevant contract and an asset or liability representing a loan relationship to which section 585 applies. The second leg of condition E is that each of the relevant contracts to which the company is treated as a party under that section is a derivative contract to which one of the provisions specified in paragraph (b) of *subsection (6)* applies. Under the provisions listed in *subsection (7)*, credits and debits are brought into account in calculating chargeable gains rather than as income. Part 10 of Schedule 2 extends that list in respect of certain rules in that Part.

1590. The section does not rewrite those parts of paragraph 4(2B)(a), (2C)(a) and (2CA)(a) of Schedule 26 to FA 2002 that refer to the trading activities of an insurance company or mutual trading company. They are redundant following changes in the source legislation for sections 633 and 634.

Section 592: Embedded derivatives treated as meeting condition in section 591 etc

1591. This section extends the ability to satisfy one of the conditions in section 591 to certain embedded derivatives within the meaning of section 584. It is based on paragraphs 2B(3), 45M and 54(1) of Schedule 26 to FA 2002.

1592. If this section applies, the underlying subject matter of the embedded derivative may satisfy the definition of "excluded property" in section 589(2). The embedded derivative may thereby not be a derivative contract for the purposes of this Part.

1593. The section applies only if the "hybrid derivative" (within the meaning of section 584) is a relevant contract within section 579(1)(b). That is one that is not treated as a derivative by accounting standards because of the size of the initial outlay (for example, a prepaid equity forward) but is treated as a financial asset or liability. Also, the "host contract" (*subsection (5)*) must be treated for accounting purposes as (or as part of) a financial asset.

1594. The embedded derivative must itself satisfy section 579(1)(a) (a relevant contract that is treated for accounting purposes as a derivative). And its underlying subject matter must be wholly shares in a company or rights of a unit holder in a unit trust scheme. *Subsection (4)* indicates that section 590 applies if appropriate to determine whether the "wholly" test in paragraph (c) of *subsection (1)* is met.

1595. If the section applies, the embedded derivative is treated as satisfying one of the conditions in section 591, and therefore meets one element of the meaning of "excluded property" in section 589(2). In the source legislation the embedded derivative is treated as meeting condition A in section 591 because this rule is expected to be relevant primarily (although not exclusively) to insurance companies (and condition A specifically applies to such companies). But it is sufficient to deem the embedded derivative to meet any one of the conditions in section 591 for the purposes of section 589(2).

1596. The section does two more things. First, it treats the embedded derivative (which in all likelihood is not now a derivative contract, because of section 589) as a "chargeable asset" for the purposes of this Part and TCGA. See the definition of that term in section 703.

1597. Second, the host contract is treated as a "creditor relationship" of the company for the purposes of the Corporation Tax Acts. That primarily affects the operation of Parts 5 and 6 (loan relationships). But it also affects those sections in this Part that operate by reference to a creditor relationship (for example, section 631(4)). See the definition of "creditor relationship" in section 704.

Section 593: Contracts where part of underlying subject matter is excluded property

1598. This section provides for an option or future to be treated in certain cases as divided between a relevant contract whose underlying subject matter consists wholly of excluded property within the meaning of section 589 and one whose underlying subject matter consists wholly of other underlying subject matter. It is based on paragraph 46 of Schedule 26 to FA 2002.

1599. See the commentary on section 589 for the significance of the underlying subject matter of a contract being or not being "excluded property".

Chapter 3: Credits and debits to be brought into account: general

Section 594: Overview of Chapter

1600. This section describes the purpose and content of the Chapter. It is new.

1601. The Chapter provides in particular for the application of generally accepted accounting practice in determining the profits and losses to be brought into account under this Part. In some cases, it provides for departure from generally accepted accounting practice for that purpose. Chapter 4 contains provisions about credits and debits for a number of special situations.

Section 595: General principles about the bringing into account of credits and debits

1602. This section specifies for the identification of the credits and debits to be brought into account under this Part. It is based on paragraphs 15(1), (4) and (9) and 17A(1) of Schedule 26 to FA 2002.

1603. *Subsections (1)* and *(2)* make general statements on the part played by accounts prepared in accordance with generally accepted accounting practice in identifying credits and debits for the purposes of this Part. "Generally accepted accounting practice" is defined by section 832(1) of ICTA by reference to section 50(1) of FA 2004. If a company prepares accounts in accordance with international accounting standards, those standards constitute generally accepted accounting practice. Otherwise UK generally accepted accounting practice applies.

1604. The general statement in subsection (2) refers to credits and debits which are amounts "recognised in determining the company's profit or loss" for the period. For the meaning of "recognised" in this context, see section 597.

1605. But that statement is qualified by the more specific rule in *subsection (3)* that those credits and debits must "fairly represent" profits, losses and expenses that arise in respect of the derivative contract or arise from certain transactions in respect of the contract (labelled "related transactions").

1606. There is a further significant rule in *subsection (7)* that makes both the general statement in subsection (2) and the rule in subsection (3) subject to the qualifying effect of "the following provisions of this Part".

Section 596: Meaning of "related transaction"

1607. This section provides the meaning of "related transaction" for the purposes of this Part. It is based on paragraph 15(7) and (8) of Schedule 26 to FA 2002.

1608. The term is used extensively in this Part in provisions which may apply to or involve consideration of the acquisition or disposal of a derivative contract.

Section 597: Amounts recognised in determining a company's profit or loss

1609. This section explains what "an amount recognised in determining a company's profit and loss" means. It is based on paragraph 17B of Schedule 26 to FA 2002.

1610. The various statements listed in paragraphs (a) and (b) of *subsection (1)* are those mentioned in UK generally accepted accounting practice or international accounting standards. But subsection (1)(c) caters for amounts recognised in any accounting statement not among those listed.

1611. The statements listed in paragraphs (a) and (b) of subsection (1) include a "statement of comprehensive income", "statement of recognised income and expense" and "statement of income and retained earnings". These statements are not mentioned in the source legislation but are the equivalents in more recently applying accounting standards of the statements listed there.

1612. So far as the terms in those paragraphs derive from accounting standards, they are defined in section 710 as having the meaning they have for accounting purposes.

1613. *Subsection (2)* brings in prior period adjustments for this purpose but *subsection (3)* excludes amounts recognised "by way of correction of a fundamental error". Such amounts are brought into account in the prior period affected by the error (so that the amounts so brought into account "fairly represent" profits and losses etc in respect of the contract in that period).

1614. See also sections 613 to 615 for the treatment of adjustments shown in accounts on a change of accounting policy.

Section 598: Regulations about recognised amounts

1615. This section provides powers for regulations that amend the amounts regarded as "recognised" in one or other of the various statements mentioned in section 597(1). It is based on paragraph 17C of Schedule 26 to FA 2002 and paragraph 52 of Schedule 4 to FA 2005.

1616. For regulations made under this power, see the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256), as amended, and the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (SI 2004/3271), as amended.

Section 599: Meaning of "amounts recognised for accounting purposes"

1617. This section defines "amounts recognised for accounting purposes" by reference to the case of a company that has not prepared accounts in accordance with generally accepted accounting practice. It is based on paragraph 17A(2), (3) and (4) of Schedule 26 to FA 2002.

1618. This section is particularly relevant to the application of section 595 and the interpretative provision in section 597.

1619. See the commentary on section 595(2) for the relevance of "generally accepted accounting practice". Unless a company uses international accounting standards for a period, the default meaning of "generally accepted accounting practice" is UK generally accepted accounting practice (see section 50(1) of FA 2004). When this section applies, it therefore uses UK generally accepted accounting practice (as defined in section 50(4) of FA 2004).

Section 600: Contract which is or forms part of financial asset or liability

1620. This section provides that fair value accounting is used in the case of certain contracts for the purposes of the general rule in section 595(2). It is based on paragraph 17A(1A) of Schedule 26 to FA 2002.

1621. The contracts to which this section applies are those that are not treated as a derivative for accounting purposes because they fail the requirement of the relevant accounting standard as regards the initial net investment required by the contract but are nevertheless treated as a financial asset or liability. See the commentary for section 579.

Section 601: Contract relating to holding in OEIC, unit trust or offshore fund

1622. This section applies fair value accounting in determining the credits and debits to be brought into account in respect of a contract that is treated as a derivative contract because of section 587. It is based on paragraph 36(1) and (2A) of Schedule 26 to FA 2002.

1623. Section 587 applies if the underlying subject matter of a contract includes a holding in a collective investment scheme that fails to meet a "qualifying investments" test. Because this section operates by reference to section 587, *Change 63* in Annex 1 (reference to a "relevant holding" is to a holding which is the underlying subject matter of the contract rather than a holding of the company which is a party to the contract) applies here as well.

Section 602: Contract becoming one relating to holding in OEIC, unit trust or offshore fund

1624. This section determines the opening valuation of a derivative contract for the purposes of section 601. It is based on paragraph 37(1), (2), (3), and (4) of Schedule 26 to FA 2002.

1625. The accounting period to which this section applies is that in which a relevant contract is treated as a derivative contract because of section 587 if that period immediately follows another in which it was not so treated. The section applies only if the relevant contract was a "chargeable asset" (defined in section 703) at the end of the earlier period.

1626. For the meaning of "market value" for the purposes of corporation tax on chargeable gains, see in particular section 272 of TCGA.

Section 603: Associated transaction treated as derivative contract

1627. This section applies fair value accounting in determining the credits and debits to be brought into account by virtue of section 588 in respect of an "associated transaction" that is treated as a derivative contract because of that section. It is based on section 91B(5) of FA 1996.

1628. For the circumstances in which section 588 applies and for the meaning of "associated transaction", see the commentary on that section.

1629. *Subsection (1)* provides that this section must be construed as if it were part of Chapter 7 in Part 6 (shares with guaranteed returns etc). That Chapter rewrites sections 91A to 91G of FA 1996.

Section 604: Credits and debits treated as relating to capital expenditure

1630. This section brings a credit or debit that is treated in the accounts as part of a fixed capital asset or project into account under this Part in the same way as a credit or debit that is brought into account in determining the company's profit or loss. It is based on paragraph 25 of Schedule 26 to FA 2002.

1631. Generally accepted accounting practice may permit a credit or debit of an income nature to be included in the value of a fixed capital asset or project. If this happens, the credit or debit bypasses the statements mentioned in section 597. This section overrides that treatment, except in the cases mentioned in *subsections (3)* and *(5)*.

1632. Subsection (5) prevents any debit being taken into account under this Part that writes down the value of the asset or project in question, or creates a reserve for amortisation or depreciation of that asset or project, so far as the write down etc is attributable to a debit brought into account under this section. As this section overrides the accounts treatment of the capitalised debit, this rule in this subsection prevents a double deduction should the asset or project be written down, or a reserve created for its amortisation or depreciation, whether in the same or a later period, if the amount taken to profit and loss is attributable to the amount brought into account under this section.

1633. The source legislation for subsection (5) refers to "so much of any amortisation or depreciation as represents *a writing off of the interest component of the asset*". The rule is identical to that in the equivalent rule for loan relationships (section 320(6)). But the "interest component" of the asset refers to something that is dealt with by the loan relationships provisions and has no relevance to the derivative contracts provisions. The emphasised words have therefore not been reproduced in this section. See *Change 65* in Annex 1.

Section 605: Credits and debits recognised in equity

1634. This section brings a credit or debit that is recognised in equity or shareholders' funds, rather than in one of the statements mentioned in section 597(1), into account for the purposes of this Part in the same way as a credit or debit that is brought into account in determining the company's profit or loss. It is based on paragraph 25A of Schedule 26 to FA 2002.

1635. As in the case of section 604, this section overrides the accounts treatment.

Section 606: Exchange gains and losses

1636. This section provides that exchange gains and losses arising from a derivative contract are included in the profits and losses mentioned in section 595(3). It is based on paragraph 16 of Schedule 26 to FA 2002.

1637. *Subsection (1)* does not rewrite the words "and related transactions" in paragraph 16(1) of Schedule 26 to FA 2002. They are not considered to add to the effect of this provision.

1638. *Subsection (3)* excludes exchange gains and losses arising in two circumstances from the basic rule in subsection (1) if those gains and losses are recognised in the company's "statement of total recognised gains and losses", "statement of recognised income and expense", "statement of changes in equity" or "statement of income and retained earnings". Those terms are defined in section 710 as having the meaning they have for accounting purposes. Some are taken from UK generally accepted accounting practice and the others from international accounting standards, but are otherwise equivalent terms. This subsection is subject to the effect of any regulations made under the power in *subsection (5)*.

1639. The section contains two regulatory powers. The first is in *subsection (4)*. It concerns exchange gains and losses from a derivative contract whose underlying subject matter is wholly or partly currency. Regulations may exclude such gains from the scope of subsection (1). For regulations made under this power, see the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256), as amended.

1640. The second is in subsection (5). Regulations may countermand the effect of the rule in subsection (3) or of regulations made under subsection (4). Where the regulations apply, the affected amounts are brought into account under this Part as credits or debits arising from a company's derivative contracts or for the purposes of corporation tax on chargeable gains. (The Exchange Gains and Losses (Bringing into Account Gains or Losses) Regulations 2002 (SI 2002/1970), as amended, are made partly under the power rewritten in subsection (5). But, as amended by regulation 5 of SI 2005/2013, SI 2002/1970 now has no direct impact on the source legislation for this section.)

1641. The source legislation for this section was repealed by paragraph 9 of Schedule 6 to F(No 2)A 2005, subject to the making of an order for the repeal to have effect. That prospective repeal is preserved by the paragraph "repeal of provisions concerning exchange gains and losses from derivative contracts" in Part 10 of Schedule 2.

Section 607: Pre-contract or abortive expenses

1642. This section adds pre-contract and abortive expenses to the expenses that are taken into account under section 595(3) in determining a company's profits and losses under this Part. It is based on paragraph 15(5) of Schedule 26 to FA 2002.

Section 608: Company ceasing to be party to derivative contract

1643. This section brings into account amounts recognised in accounts in respect of a derivative contract after the accounting period in which the company ceases to be a

party to that contract. It is based on paragraph 53(3), (4), (5) and (6) of Schedule 26 to FA 2002.

1644. The accounting policies of a company may treat part of the profit or loss in respect of a contract as deferred income or loss to be brought into account in accounting periods later than that in which the company ceased to be a party to the contract. This section identifies amounts to be treated as credits and debits in subsequent periods until all the deferred income or loss has been brought into account under this Part.

1645. *Subsections (3)* to *(6)* set out how certain conditions in this Part may be treated as satisfied in respect of the former derivative contract. Those are conditions that may need to be satisfied for a particular provision to apply in respect of post-cessation credits or debits. For examples of the conditions to which subsection (3) or (5) may apply, see sections 573 and 690.

1646. *Subsection (7)* makes clear that the deeming effect of subsections (3) to (6) carries through for any question of what a company's derivative contracts are or whether a company is a party to a derivative contract (see section 578).

Section 609: Company ceasing to be UK resident

1647. This section and the next apply if a derivative contract moves out of the scope of corporation tax because the company holding it is no longer within the charge to tax in respect of it. This section treats a company as making a deemed disposal and reacquisition of the contract at its fair value immediately before the company ceases to be UK resident. It is based on paragraph 22A(1), (2) and (3) of Schedule 26 to FA 2002.

1648. "Fair value" is defined in section 710.

1649. *Subsection (1)* provides that the company is treated for the purposes of this Part as reacquiring the derivative contract for the same amount. This deemed value will be taken into account should the derivative contract re-enter the scope of corporation tax because of a further change in the residence status of the company or otherwise.

1650. *Subsection (2)* has an exception to the general rule. This applies if a company moves abroad but leaves behind such a business operation as amounts to a permanent establishment and that operation includes at least some of the rights and liabilities under the derivative contract. In effect, the contract has not left the scope of corporation tax. ("Permanent establishment" is defined in section 832(1) of ICTA by reference to the meaning provided by section 148 of FA 2003.)

1651. *Subsection (3)* provides an order of priority if this section would apply in relation to the same circumstances as trigger section 631 or 632. There is an equivalent order of priority in section 333 in Part 5. There is no reason for the two sets of provisions to differ in this respect. This subsection brings the provisions for loan relationships and derivative contracts into line. See *Change 66* in Annex 1.

Section 610: Non-UK resident company ceasing to hold derivative contract for UK permanent establishment

1652. This section treats a non-UK resident company as making a deemed disposal and reacquisition of a derivative contract at its fair value if and to the extent that some or all of the rights or liabilities under a contract held or owed for the purposes of a permanent establishment of that company cease to be so held or owed. The section is based on paragraph 22A(1) and (4) of Schedule 26 to FA 2002.

1653. The circumstances in which this section applies include where the contract is now held for the purposes of another part of the company's business (which is not a permanent establishment) or where the permanent establishment ceases to be such. In those cases the derivative contract has left the scope of corporation tax.

1654. A significant difference between the conditions for the application of this section and those for the preceding section is that this section does not apply if the rights and liabilities under the contract cease to be held or owed for the purposes of the permanent establishment because of a "related transaction" (defined in section 596). That is, it does not apply when the contract ceases to be held because it is disposed of. That disposal is itself an occasion leading to amounts being brought into account under this Part.

1655. *Subsection (3)* introduces the same priority rule as is introduced in the preceding section. See again *Change 66* in Annex 1.

Section 611: Release under statutory insolvency arrangement of liability under derivative contract

1656. This section exempts from the scope of this Part any credit arising on the release of a company's liability to pay an amount under a derivative contract, if the release is part of a statutory insolvency arrangement. It is based on paragraph 22(5) of Schedule 26 to FA 2002.

1657. A "statutory insolvency arrangement" is defined in section 834(1) of ICTA by reference to the Insolvency Act 1986 and other provisions having a similar effect.

Chapter 4: Further provision about credits and debits to be brought into account

Section 612: Overview of Chapter

1658. This section describes the purpose and content of the Chapter. It is new.

Section 613: Introduction to sections 614 and 615

1659. This section sets out when sections 614 and 615 apply. It is based on paragraph 50A(1) and (1A) of Schedule 26 to FA 2002 and paragraph 7(6) of Schedule 6 to F(No 2)A 2005.

1660. A company may decide to apply a different set of standards to the presentation of the company's results. Regulatory rules may also require that a company switches to a different set of standards. If there is such a change of accounting policy, the value of the company's assets and liabilities at the start of the first period of account to which the change applies are restated in accordance with the standards adopted.

1661. This section applies only if the change is from an accounting policy that "accords with the law and practice applicable" in relation to the earlier period to another such policy in relation to the next. The law and practice in question is that provided in particular by the Companies Acts and the Accounting Standards Board (or their equivalents in its country of residence if the company is non-UK resident but within the charge to corporation tax in respect of a derivative contract).

1662. Sections 614 and 615 prescribe the credit or debit to be brought into account on a change of accounting policy, according to whether the value of the company's assets and liabilities increases or decreases on the change.

1663. *Subsection (4)* treats a particular situation as a change of accounting policy although there is no change in the actual accounting policy used by the company from one period to the next. International accounting standards and new UK generally accepted accounting practice require a company, in certain circumstances, to divide a loan relationship between rights and liabilities under a loan relationship and rights and liabilities under one or more derivative financial instruments or equity instruments (see section 585(1)).

1664. Section 416 allows a company subject to old UK generally accepted accounting practice (which does not permit it to divide a loan relationship in that way) to elect that a loan relationship is treated as divided as mentioned in section 415(1) (the equivalent for loan

relationships of section 585(1)), if division would be permitted under new UK generally accepted accounting practice or international accounting standards. Section 416 applies an election made under it for the purposes of this Part as well as for Part 5.

1665. The result of such an election is a change in accounting policy for the purposes of sections 614 and 615, but only in relation to all the derivative financial instruments or equity instruments in the company's affected loan relationships. This rule applies from the date the election has effect. Broadly, the election has effect from the beginning of the period of account in which the first loan relationship is acquired to which an election can apply.

Section 614: Change of accounting policy involving change of value

1666. This section treats the increase or decrease in the carrying value of a derivative contract on a change of accounting policy as a credit or debit to be brought into account in the later period. It is based on paragraph 50A(2), (3) and (5) of Schedule 26 to FA 2002.

1667. "Carrying value" is defined in section 702.

1668. *Subsection (3)* makes an exception to the general rule in so far as a credit or debit arising from the change of accounting policy is brought into account for the purposes of this Part under another provision. For example, a prior period adjustment brought into account under section 597(2) would be excepted from the general rule in this section.

Section 615: Change of accounting policy after ceasing to be party to derivative contract

1669. This section requires a credit or debit to be brought into account, similarly to section 614, in a case where section 608(2) applies. It is based on paragraph 50A(3C), (3D) and (5) of Schedule 26 to FA 2002.

1670. Section 608 applies if profits and losses arising to a company from a derivative contract for the accounting period in which the company ceases to be a party to the contract are not wholly reflected in credits and debits brought into account under this Part for that period. In effect, it is a "post-cessation receipts" provision.

1671. Because the derivative contract from which the income or loss derived is either no longer in existence or no longer held by the company, section 613 cannot apply in this case. Section 615 deals with the amount by which the value of the residual deferred income or loss in respect of the former contract alters as a result of the change of accounting policy affecting a subsequent period.

1672. *Subsection (4)* corresponds to the rule in section 614(3).

1673. *Subsection (6)* corrects a minor error in the source legislation. Paragraph 50A(3D) of Schedule 26 to FA 2002, in defining the "amount outstanding", refers to an amount recognised "in respect of the profits, gains or losses that arose from that *relationship* or a related transaction in the cessation period (within the meaning of *section 103(6)*)". The words with emphasis are of course appropriate to the loan relationships provisions and not to those for derivative contracts. They reflect the wording of paragraph 19A(4C) and (4D) of Schedule 9 to FA 1996 (rewritten as section 318 in Part 5), on which paragraph 50A(3C) and (3D) of Schedule 26 to FA 2002 was modelled. More appropriate wording has been substituted.

Section 616: Disapplication of fair value accounting

1674. This section reverses the effect of sections 584 and 586 if certain conditions are met by reference to an embedded derivative identified by either of those sections. It is based on paragraphs 45L(1), (1A), (1B), (1C), (2) and (3) of Schedule 26 to FA 2002.

1675. Because the contract out of which the embedded derivative arose is treated as one that is not split in accordance with section 584 or 586, the section disapplies sections 573 and 574 to that derivative.

1676. It also sets aside fair value accounting as an accounting basis in calculating profits and losses on the contract in question. For contracts to which this section applies, splitting of the contract under section 584 or 586, or the use of fair value accounting, may produce unacceptably volatile results for tax purposes.

1677. The section does not apply to an embedded derivative within section 584 that comes within section 592 (so that it may meet the "excluded property" conditions in section 589). Nor does it apply if regulation 9 of the Disregard Regulations applies (SI 2004/3256, as amended). That regulation prescribes credits and debits, in the case of derivative contracts that are interest rate contracts, for the purposes of paragraph 17B of Schedule 26 to FA 2002 (rewritten in section 597).

1678. Nor does the section apply if an election is made under section 617 for this section not to apply. A company may choose to make such an election if it prefers to retain fair value accounting for contracts within section 584 or 586.

1679. *Subsection (3)* treats the relevant contract that was divided under section 584 as not so divided. It is therefore treated as a single derivative contract for the purposes of this Part. But again the contract is treated as one to which fair value accounting does not apply.

1680. *Subsections (4)* and *(5)* treat the contract that was divided under section 586 as not so divided. The contract is therefore outside the scope of this Part. It is dealt with for tax purposes according to what sort of contract it is. Subsection (5) also provides that section 46 in Part 3 of this Act (calculation of trade profits in accordance with generally accepted accounting practice) applies as if fair value accounting was not generally accepted accounting practice for that company.

1681. Subsections (3) and (4) apply to the "original contract" (defined in *subsection (7)*) rather than (as in the source legislation) the "contract" to avoid confusion with the relevant contract referred to in subsection (1)(a).

Section 617: Election for section 616 not to apply

1682. This section allows a company to elect that section 616 does not apply to its contracts. It is based on paragraph 45L(2A), (2B) and (2C) of Schedule 26 to FA 2002.

1683. For some companies the benefit afforded by section 616 may be disproportionate to the administrative and accounting burden of distinguishing and tracking affected contracts. Or the degree of volatility in the tax consequences of splitting the contract or using fair value accounting may be acceptable to the company holding the contract.

1684. An election under this section applies to all of a company's contracts. Section 618 contains further provisions modifying or extending the effect of an election made by a member of a group of companies.

1685. *Subsection (2)* excludes two types of contract from an election. They are, first, a "contract of long-term insurance" (defined in section 431(2) of ICTA) and, second, a contract where the embedded derivative identified by section 584 or 586 has commodities as its underlying subject matter.

1686. Subsection (2)(b) says "embedded derivative" rather than "embedded derivative contract". The Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006, SI 2006/3269 omitted the definition of "embedded derivative contract" from the source legislation. But the use of the term in paragraph 45L(2A) of Schedule 26 to FA 2002 was missed. "Embedded derivative" matches the amendments introduced in this respect by that Order. See in particular sections 584 and 586.

1687. Unlike the source legislation, the section does not specify how the election must be made. See *Change 1* in Annex 1.

Section 618: Elections under section 617: groups of companies

1688. This section applies or disapplies the effect of an election under section 617 in a number of cases where a party to a contract is a member of a group of companies. It is based on paragraph 45LA of Schedule 26 to FA 2002.

1689. In the first case, *subsection (1)* treats the group member who is a counterparty to a contract to which a fellow group member is a party as having made an election in relation to that contract if that fellow group member has made an election. This rule ensures parity of treatment of the contract within the group.

1690. In the second case, *subsection (2)* provides that a group member to whom a fellow group member has transferred a contract is treated as having made an election in relation to that contract if the fellow group member makes an election. This rule applies even if that fellow group member makes the election at a time after the transfer has been made or at a time when the companies are no longer members of the same group. This rule ensures that a company cannot exclude some of its contracts from the effect of an election by first transferring them to another group member.

1691. The reference in subsection (2) to a contract "to which section 584… or section 586… applies" corrects a missed consequential amendment to paragraph 45LA(3)(b) of Schedule 26 to FA 2002. The reference there to "paragraph 2(3)" is otiose following the replacement of that provision by paragraph 2(2A) of Schedule 26 to FA 2002 (by article 3 of the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006, SI 2006/3269) and the insertion of paragraphs 2A and 2B of Schedule 26 to FA 2002 (by article 4 of that Order). Sections 584 and 586 apply to the types of contract to which paragraph 2(3) of Schedule 26 to FA 2002 applied.

1692. The third case is if:

- B becomes a party in place of A to a relevant contract treated as such by section 584 or 586, at a time when they are members of the same group;
- that contract was within section 616 in A's hands (that is, A had not made an election); and
- B's other contracts are outside section 616 by virtue of an election B has made (whether an election made before B has succeeded A as a party to the contract or one made later).

1693. *Subsection (4)* ring-fences the contract in question, so that any existing or later election by B is ineffective in relation to that contract. This rule ensures that a contract cannot be selected for preferential treatment under another group member's election if the member who is the original party to the contract does not otherwise wish to make an election. This rule is however disapplied if A makes an election in respect of its contracts subsequent to B becoming a party to the contract in place of A.

Section 619: Partnerships involving companies

1694. This section and the next two set out how a company partner brings into account credits and debits in respect of its share of a firm's derivative contracts. This section provides that each company partner, not the firm, brings credits and debits into account in calculating its profits chargeable to tax. It is based on paragraph 49(1) and (2) of Schedule 26 to FA 2002.

1695. Paragraph (c) in *subsection (1)* requires that the firm is a party to a contract that "is a derivative contract or would be a derivative contract if the firm were a company". A

firm is not a company. So a contract held by a firm would not meet any test under which a contract is or is treated as a derivative contract because it is held by a company.

1696. *Subsection (2)* switches off the normal rule in section 1259 (which rewrites section 114(1) of ICTA) under which the profits of the firm's trade etc are calculated, in accordance with the partners' interests in the firm, as if the firm were a company.

Section 620: Determination of credits and debits by company partners

1697. This section determines the credits and debits to be brought into account under section 619(3) by each company partner in a firm. It is based on paragraph 49(3), (4), (5) and (6) of Schedule 26 to FA 2002.

1698. *Subsections (2)* to *(4)* attribute the actions of the firm to the partner for the purposes of applying the rules that determine the credits and debits to be brought into account in accordance with this Part.

1699. "Profit-sharing arrangements", in relation to a partnership, is defined in section 710. A firm's "profit-sharing arrangements" are described in section 1262, in the sections rewriting section 114 of ICTA, as "the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade".

Section 621: Company partners using fair value accounting

1700. This section applies fair value accounting, in determining under section 620 the company partner's share of the credits and debits arising in respect of the firm's derivative contracts, if that company partner uses fair value accounting in relation to its interest in the firm. It is based on paragraph 50 of Schedule 26 to FA 2002.

Section 622: Contracts ceasing to be derivative contracts

1701. This section provides that, if a relevant contract to which the company continues to be a party ceases to be a derivative contract, there is a deemed disposal of the contract at the time of that cessation. It is based on paragraphs 43A(5) and 43B of Schedule 26 to FA 2002.

1702. *Subsection (2)* deems the company to have disposed of the contract in a "related transaction" (defined in section 596) for consideration equal to the "notional carrying value" of the contract at the time it ceases to be a derivative contract. Depending on the amount of the consideration attributed to that disposal under this subsection, a credit or debit arises to be brought into account under this Part. That credit or debit is additional to any other credit or debit that arises in relation to the contract, while it was a derivative contract, for the accounting period in which the deemed disposal occurs. "Carrying value" is defined in section 702.

1703. The source legislation for *subsection (4)* refers to the amount that would have been the carrying value of the contract in the accounts of the company "if an accounting period had ended immediately before that time". The source legislation for the equivalent definition in section 625(6), paragraph 28(3) of Schedule 26 to FA 2002, refers to the value found "if a period of account had ended immediately before" the requisite time. But, if a period of account comes to an end, that is the end of an accounting period under section 10. The two definitions have been brought into line using "period of account".

1704. After the contract ceases to be a derivative contract, it is likely to be a chargeable asset for the purposes of corporation tax on chargeable gains. *Subsection (5)* therefore signposts section 662 which prescribes the acquisition cost of the contract for that purpose.

Section 623: Index-linked gilt-edged securities with embedded contracts for differences

1705. This section provides that credits and debits arising in respect of an embedded derivative in an index-linked gilt-edged security are not brought into account under this Part if conditions are met. It is based on paragraphs 12(1), (11A) and (11B) and 45I of Schedule 26 to FA 2002.

1706. If the embedded derivative is closely related to the host contract, generally accepted accounting practice does not in fact require the company to divide the security as mentioned in section 585. In that case, sections 399 and 400 in Part 5 (loan relationships) apply. But, for example, a company whose functional currency is not sterling may be required to divide its index-linked securities between an embedded derivative and a host contract, in which case this section may apply.

Chapter 5: Continuity of treatment on transfers within groups

Section 624: Introduction to Chapter

1707. This section describes the purpose of the Chapter. *Subsection (3)* is based on paragraph 28(6) of Schedule 26 to FA 2002 but otherwise the section is new.

Section 625: Group member replacing another as party to derivative contract

1708. This section and the next three deal with the case where one member of a group of companies replaces another as a party to a derivative contract as the result of a related transaction or similar transactions. This section determines the credits and debits to be brought into account by the transferor company and the transferee company. It is based on paragraph 28(1), (3), (3ZA), (3A) and (7) of Schedule 26 to FA 2002.

1709. "Notional carrying value" is defined in *subsection (6)* on the model of the similar definition in section 622(4). "Carrying value" is defined in section 702.

1710. Should any "discount" arise in respect of the related transaction or the equivalent series of transactions, it is added to the amount treated as consideration by the transferor under *subsection (3)* (but not to the amount treated as consideration given by the transferee under *subsection (4)*).

1711. "Discount" is defined in subsection (6) by reference to section 480 in Part 5 (loan relationships). A discount arises if payment of part of the consideration for a disposal is deferred and the consideration is accordingly increased to recognise the delay.

1712. *Subsection (7)* disapplies Schedule 28AA to ICTA in a case where credits and debits are determined under *subsection (2)*. Schedule 28AA to ICTA might otherwise substitute market value for the amounts agreed between the parties, which amounts would give rise to credits and debits for the purposes of this Part. Such a substitution is unnecessary given that this section requires both parties to use the notional carrying value of the contract rather than amounts shown in the accounts (the amounts "recognised for accounting purposes").

Section 626: Transactions to which section 625 applies

1713. This section defines the related transaction or series of transactions which acts or act as a trigger for the application of section 625. It is based on paragraph 28(2) of Schedule 26 to FA 2002.

Section 627: Meaning of company replacing another as party to derivative contract

1714. This section gives a particular example of what the reference in section 625(1) to one company replacing another as a party to a derivative contract means. It is based on paragraph 28(4) of Schedule 26 to FA 2002.

1715. The commonest way in which one company may replace another as a party to a derivative contract is by the assignment of the rights and liabilities under the contract. But there may be other types of transaction that have the same effect.

1716. This section ensures that, if the company referred to as the transferee in section 625 becomes a party to a contract whose rights and liabilities are equivalent to those of the contract to which the company referred to as the transferor in that section has ceased to be a party, the transferee is treated as having replaced the transferor in respect of the derivative contract. A novation is an example of this.

1717. This section still applies in the event of the transferor again becoming a party to the original contract (that is, a contract to which it had previously ceased to be a party).

Section 628: Transferor using fair value accounting

1718. This section substitutes rules based on fair value accounting for those in section 625, in a case to which that section applies, if the transferor uses fair value accounting in respect of the derivative contract in question. It is based on paragraph 30 of Schedule 26 to FA 2002.

1719. As regards the transferee, this section treats it as having acquired the derivative contract at the fair value of the contract as at the time of the transfer for the purposes of determining the credits and debits brought into account under this Part, regardless of whether it itself uses fair value accounting as respects the contract. This treatment continues to apply for any accounting period in which the transferee is a party to the contract.

1720. As in section 625, any "discount" is added to the amount treated as consideration by the transferor (only).

Section 629: Tax avoidance

1721. This section disapplies section 625 in two cases where avoidance of tax is involved. It is based on paragraph 28(3ZB), (3ZC) and (3ZD) of Schedule 26 to FA 2002.

1722. The first case (*subsection (1)*) is if the transferor is a party to arrangements for tax avoidance purposes under which the derivative contract will be transferred on by the transferee. The second case (*subsection (4)*) is if another provision countering tax avoidance (section 698) applies to a disposal which would otherwise be within section 625.

Section 630: Introduction to sections 631 and 632

1723. This section and the next two provide for a deemed assignment of the derivative contract in question if a transferee within section 625 ceases to be a member of the group of companies mentioned in section 626(2) or (3). This section sets out when sections 631 and 632 apply and defines terms used in this and those sections. It is based on paragraph 30A(1), (5A) and (8) of Schedule 26 to FA 2002.

1724. If section 625 applies because of a series of transactions within section 626(3), the relevant time limit in respect of the transferee leaving the relevant group of companies before the end of a six year period begins with the *last* of the transactions in the series of transactions. This contrasts with the rule in section 625(3) which determines the consideration to be brought into account by the transferor by reference to the *first* transaction in the series.

1725. The rules in these sections take priority if the rules in section 609 or 610 would apply in the same circumstances (see the commentary on those sections).

Section 631: Transferee leaving group otherwise than because of exempt distribution

1726. This section deems the transferee within section 625 to have assigned (and immediately reacquired) the rights and liabilities under the derivative contract, immediately before it left the group, for a consideration equal to their fair value at that time. It is based on paragraph 30A(2), (3), (4), (5) and (8) of Schedule 26 to FA 2002.

1727. One of the conditions for this section to apply is that the company ceases to be a member of the group of companies in question for reasons which are not just that it does so because of an "exempt distribution" under section 213(2) of ICTA. That section provides for a distribution arising from the demerger of the trading activities of a single company or group of companies to a number of companies or groups to be disregarded for certain purposes.

1728. The second condition is that a credit would be brought into account under either this Part (condition A in *subsection (3)*) or Part 5 (loan relationships) (condition B in *subsection (4)*). The credit in question, as regards this Part, is the credit that would be brought into account under this Part on the deemed assignment under this section of the rights and liabilities under the derivative contract.

1729. As regards Part 5, the credit in question is the credit brought into account under that Part because of section 345(2)(a) and (b) in a case where the transferee has a "hedging relationship" between the derivative contract and a creditor relationship That section makes matching provision for loan relationships to that made by this section for derivative contracts.

1730. In either case, the second condition is not satisfied if the assignment would give rise to a debit. So the section cannot give rise to a reduction of the transferee's liability to corporation tax.

1731. "Hedging relationship" is described in section 707 in a number of ways. Broadly, these relate to cases where the derivative contract is entered into to shelter the company from risks associated with holding or owing the hedged asset or liability (such as a fluctuation in values because of movement in a relevant market, such as a stock or commodities exchange).

Section 632: Transferee leaving group because of exempt distribution

1732. This section deems the transferee within section 625 to have assigned (and immediately reacquired) the rights and liabilities under the derivative contract at the time a "chargeable payment" is made, for a consideration equal to the fair value of the rights and liabilities at the time of that payment, if it left the group solely because of an exempt distribution. It is based on paragraph 30A(3), (4), (5), (6), (7) and (8) of Schedule 26 to FA 2002.

1733. A "chargeable payment" is broadly a payment made in connection with tax avoidance or otherwise than for genuine commercial reasons.

1734. Conditions A and B, in *subsections (3)* and *(4)*, are the same as the conditions in section 631(3) and (4). See the commentary on that section.

Chapter 6: Special kinds of company

Overview

1735. This Chapter contains rules that modify the application of this Part to mutual trading companies or insurance companies. The Chapter does not rewrite paragraph 41 of Schedule 26 to FA 2002 as it is merely introductory.

Section 633: Mutual trading companies

1736. This section treats the activities of a mutual trading company as not being those of a trade. It is based on paragraph 43 of Schedule 26 to FA 2002.

1737. Because of this section, any credits and debits arising to a mutual trading company do not fall within section 573 (trading credits and debits to be brought into account under Part 3). And any provision that operates in part by reference to whether the company is a party to a contract for the purposes of a trade (or a type of business which constitutes a trade) does not apply to a mutual trading company in that respect.

Section 634: Insurance companies

1738. This section treats certain activities of an insurance company as not being those of a trade. It is based on paragraphs 41A and 43 of Schedule 26 to FA 2002.

1739. This section has the same effect, in relation to the activities specified in paragraphs (a) and (b), as the preceding section has for mutual trading companies.

1740. For the meaning of "life assurance business" and "basic life assurance and general annuity business", see section 431(2) of ICTA.

Section 635: Creditor relationships: embedded derivatives which are options

1741. This section requires a life assurance company to treat a creditor relationship as mentioned in section 585(1) despite the fact that it accounts for that relationship at fair value through profit and loss. It is based on paragraph 45D(3A) of Schedule 26 to FA 2002.

1742. Under generally accepted accounting practice, a company that accounts for a creditor relationship at fair value through profit and loss would not divide the relationship between embedded derivatives and the remaining rights that are a loan relationship. This section overrules that accounting rule for the purposes of both this Part and Part 5 (loan relationships).

Section 636: Modifications of Chapter 5

1743. This section makes modifications of Chapter 5 (continuity of treatment on transfers within groups) in respect of insurance companies. It is based on paragraphs 28(1) and (2) and 29 of Schedule 26 to FA 2002.

1744. Section 625 deals with the case where one member of a group of companies replaces another as a party to a derivative contract as the result of a related transaction or similar transactions. It determines the credits and debits to be brought into account by the transferor company and the transferee company by treating both as using the same consideration in relation to that transaction or transactions.

1745. This section first adds two further cases to the list in section 626 of transactions that trigger the operation of section 625. They are cases involving the transfer of classes of insurance business between two companies where the transfer does not already fall within section 625.

1746. *Subsection (4)* then disapplies section 625, in respect of a triggering transaction falling within the original categories listed in section 626, in relation to the transfer of derivative contracts moving into or out of a company's long-term insurance fund.

1747. *Subsection (5)* disapplies section 625 in respect of a triggering transaction falling within the categories treated as added to section 626 by subsection (3), if derivative contracts are in one of the categories set out in section 440(4) of ICTA before the transfer and in a different category after the transfer.

1748. For the meaning of "contract of long-term insurance", "insurance business transfer scheme", "qualifying overseas transfer" and "overseas life insurance company", see section 431(2) of ICTA (as modified, in relation to the meaning of "qualifying overseas transfer", by regulation 6(5) of the Overseas Life Insurance Companies Regulations 2006 (SI 2006/3271)). Because the meaning of "overseas life insurance company" is provided by that section "for the interpretation of the life assurance provisions of the Corporation Tax Acts" (and this section is such a provision), it is unnecessary to rewrite paragraph 29(4) of Schedule 26 to FA 2002.

Section 637: Investment trusts: profits or losses of a capital nature

1749. This section and the next except certain capital profits and losses of an investment trust or venture capital trust from the scope of this Part so that credits and debits in respect of such profits or losses do not fall within section 595. This section deals with investment trusts. It is based on paragraph 38 of Schedule 26 to FA 2002 and articles 2 and 3 of The Investment Trusts and Venture Capital Trusts (Definition of Capital Profits, Gains or Losses) Order 2006 (SI 2006/1182).

1750. *Subsection (1)* refers to "profits or losses" rather than "profits, gains and losses" as in the source legislation. But there is no difference in the meaning of the two phrases in the context of an investment trust's transactions of a capital nature.

1751. *Subsection (2)* uses the meaning of profits or losses of a capital nature given by SI 2006/1182 for both trusts using UK generally accepted accounting practice and those using international accounting standards. It does not rewrite the meaning given in paragraph 38(3) of Schedule 26 to FA 2002 as the relevant Statement of Recommended Practice uses terms from international accounting standards (and accordingly does not rewrite the part of paragraph 38(2)(a) of that Schedule which refers to that meaning).

1752. *Subsection (4)* contains powers for the amendment by Treasury order of the meaning of "profits or losses of a capital nature" in this section. This rewrites the powers in paragraph 38(2) of Schedule 26 to FA 2002 used to make the order in SI 2006/1182 applying to investment trusts and venture capital trusts that use international accounting standards.

1753. There were similar rules in relation to "capital profits, gains and losses" of authorised unit trusts and open-ended investment companies in paragraphs 32 and 33 of Schedule 26 to FA 2002 with regulatory powers in paragraph 34 of that Schedule. The first two of those paragraphs were omitted by F(No 2)A 2005. Paragraph 34 of that Schedule is now omitted and not rewritten as it is redundant.

1754. Schedule 1 to this Act inserts section 842(2D) and (2E) of ICTA (investment trusts: net excess of relevant credits over relevant credits under this Part treated as income derived from shares or securities for the purposes of approval of a company under that section, so far as the credits and debits are brought into account under section 574). This insertion is based on paragraph 39 of Schedule 26 to FA 2002.

Section 638: Venture capital trusts: profits or losses of a capital nature

1755. This section excepts certain capital profits and losses of a venture capital trust from the scope of this Part. It is based on paragraph 38A of Schedule 26 to FA 2002 and articles 2 and 3 of the Investment Trusts and Venture Capital Trusts (Definition of Capital Profits, Gains or Losses) Order 2006 (SI 2006/1182).

1756. This section has the same effect for venture capital trusts as section 637 has for investment trusts. See the commentary on that section.

1757. This section does not rewrite paragraph 38A(2)(a)(part) and (3) of Schedule 26 to FA 2002 for the same reasons as those mentioned in the commentary on section 637 in relation to not rewriting paragraph 38(3) of Schedule 26 to FA 2002.

Chapter 7: Chargeable gains arising in relation to derivative contracts

Overview

1758. This Chapter sets out when profits and losses in relation to derivative contracts are dealt with as chargeable gains or allowable losses for the purposes of the charge to corporation tax on chargeable gains rather than being taken into account as income under Part 3 (trading income) or Part 5 (loan relationships).

Section 639: Overview of Chapter

1759. This section gives an overview of the contents of the Chapter. It is new.

1760. Sections 640 and 651 switch off respectively section 574 and both that section and section 573, under which credits and debits are brought into account as income, so that the credits and debits in question may be used instead to give rise to chargeable gains or allowable losses.

1761. Section 641 (to which there are exceptions in section 642) brings credits and debits on four types of derivative contract into account as chargeable gains or allowable losses. The four types are:

- derivative contracts relating to land and certain tangible movable property (section 643, with a supplementary rule in section 644);
- embedded derivatives in a creditor relationship that are options (section 645, to which there are exceptions in section 646);
- embedded derivatives in a creditor relationship that are exactly tracking contracts for differences (section 648); and
- property based total return swaps (section 650).

1762. The remaining provisions of the Chapter (other than various interpretative sections) provide bespoke chargeable gains rules for a number of cases:

- embedded derivatives in a debtor relationship that are options (the affected derivative contract is defined in section 652 and the rules that apply are set out in sections 653 to 655); and
- embedded derivatives in a debtor relationship that are contracts for differences (the affected derivative contract is defined in section 656 and the rules that apply are set out in section 658).

1763. Chapter 8 contains further rules for a miscellany of situations in which chargeable gains rules are applied or modified.

Section 640: Credits and debits not to be brought into account under Part 5

1764. This section disapplies section 574 to "relevant credits and debits" in respect of a derivative contract to which one of the provisions listed in *subsection (2)* applies. It is based on paragraph 45A(1) and (2) of Schedule 26 to FA 2002.

Section 641: Derivative contracts to be taxed on a chargeable gains basis

1765. This section treats a chargeable gain or allowable loss as arising in respect of a contract to which one of the provisions listed in *subsection (2)* applies. It is based on paragraph 45A(1), (4) and (5) of Schedule 26 to FA 2002.

1766. Whether there is such a gain or loss depends on whether the relevant credits arising in respect of the contract exceed such relevant debits or those debits exceed those credits.

Section 642: Exception from section 641

1767. This section provides an exception to the general rule in section 641 for a contract to which section 645 (embedded derivatives in a creditor relationship that are options) applies if a condition is met. It is based on paragraph 45A(4) and (6) of Schedule 26 to FA 2002.

1768. The condition is that paragraph 2 of Schedule 7AC to TCGA would apply to a gain arising on the disposal of the option represented by the rights and liabilities under the embedded derivative. Schedule 7AC to TCGA provides exemptions from the charge to corporation tax on chargeable gains for disposals of a company's substantial shareholdings in another company. Paragraph 2 of that Schedule extends the exemption to most disposals of assets relating to shares if a disposal of the shares themselves would qualify for exemption.

1769. The condition applies on the assumptions given in *subsection (2)*, which deem the embedded derivative to be a separate contract that is an option which is disposed of at the end of the accounting period in question and the disposal results in a gain.

Section 643: Contracts relating to land or certain tangible movable property

1770. This section sets out the type of derivative contract it applies to (so that section 641 may then apply to credits and debits in respect of the contract). It is based on paragraph 45C(1) and (4) of Schedule 26 to FA 2002.

1771. As with a number of similar sections in this Chapter which define the derivative contracts to which they apply, condition B in *subsection (3)* is that the company does not hold the derivative contract for the purposes of a trade it carries on. This subsection does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45C(2) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in sections 633 and 634.

1772. Condition C, in *subsection (4)*, an equally common element in such sections, is that the company in question is not an "excluded body". That term is defined in section 706 for the purposes of this Part and refers to various types of collective investment scheme.

1773. Condition A, in *subsection (2)*, is the distinguishing characteristic of this type of derivative contract. The underlying subject matter of the contract is either or both of land and certain tangible movable property. *Subsection (5)* contains a signpost to an additional rule in section 644 that modifies what the underlying subject matter of the contract is taken to consist of.

Section 644: Income to be left out of account in determining whether section 643 applies

1774. This section provides for underlying subject matter that is income from property of the type or types mentioned in condition A in section 643 to be disregarded in determining whether that condition is met. It is based on paragraph 45C(5) and (6) of Schedule 26 to FA 2002.

1775. This section is substantially similar to section 590, which performs the same function in relation to the definition of "excluded property" in section 589.

Section 645: Creditor relationships: embedded derivatives which are options

1776. This section sets out the type of derivative contract it applies to (so that section 641 may then apply to credits and debits in respect of the contract). It also disapplies a chargeable gains provision in TCGA. It is based on paragraphs 12(1) and (11A) and 45D(1), (2), (3), (8) and (9) of Schedule 26 to FA 2002.

1777. Condition C in *subsection (4)* sets out the main distinguishing characteristic of the type of derivative contract to which this section applies. It is that the underlying subject matter of the contract is "qualifying ordinary shares" (broadly, fully participating shares in a listed company, holding company or trading company) or "mandatorily convertible preference shares" (shares that have to be converted into qualifying ordinary shares within 24 hours of acquisition).

1778. *Subsection (7)* provides that the creditor relationship, by virtue of which there is a deemed derivative contract to which this section applies, is itself not treated as a "qualifying corporate bond" although section 117(A1) of TCGA would otherwise treat it as such. That section defines a qualifying corporate bond as "any asset representing a loan relationship of a company". This subsection effectively switches off for the creditor relationship those provisions in TCGA or elsewhere that apply to qualifying corporate bonds.

1779. Condition D, in *subsection (5)*, does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45D(3) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in sections 633 and 634.

1780. See also Part 10 of Schedule 2 which disapplies this section and applies other rules if the asset representing the creditor relationship is an asset in relation to which paragraph 9(2) of Schedule 10 to FA 2004 has effect.

Section 646: Exclusions from section 645

1781. This section makes two exclusions from the scope of section 645. It is based on paragraph 45E(1), (3) and (4) and 12(11C) of Schedule 26 to FA 2002.

1782. The exclusions apply in circumstances where the holder is not sharing in the equity risk that is a part of the creditor relationship in which the derivative contract is an embedded derivative. The circumstances are where the holder of the deemed derivative contract may get a predetermined cash amount (condition A) or where cash payable instead of the shares differs significantly from the value of the shares (condition B).

Section 647: Meaning of certain expressions in section 645

1783. This section provides definitions of "mandatorily convertible preference shares" and "qualifying ordinary shares" for the purposes of section 645 and contains signposts to other relevant definitions. It is based on paragraph 45D(4), (5), (6) and (7) of Schedule 26 to FA 2002.

1784. "Shares" is defined in section 710. "Recognised stock exchange", in condition B of the definition of "qualifying ordinary shares", has the meaning given by section 841 of ICTA.

Section 648: Creditor relationships: embedded derivatives which are exactly tracking contracts for differences

1785. This section sets out the type of derivative contract it applies to (so that section 641 may then apply to credits and debits in respect of the contract). It also disapplies a chargeable gains provision in TCGA. It is based on paragraphs 12(1) and (11A) and 45F(1), (2), and (8) of Schedule 26 to FA 2002.

1786. Condition C, in *subsection (4)*, and condition D, in *subsection (5)*, set out the distinguishing characteristics of this type of derivative contract. They are that the underlying subject matter of the contract is qualifying ordinary shares listed on a recognised stock exchange and that the derivative contract is an "exactly tracking contract".

1787. "Exactly tracking contract" is defined in section 649(2) by reference to a formula. Such a contract is one under which the amount to be paid to discharge the rights and liabilities under the contract varies according to a percentage figure applied to the cost of the asset representing the creditor relationship when that asset comes into existence. The percentage figure is equal to the movement in the value of the assets (that is, the listed shares) which are the underlying subject matter of the contract (or an index of that value). The period over which the movement in the value of the assets is tracked is the period from when the asset representing the creditor relationship came into existence to the date the corresponding debtor relationship comes to an end. (Paragraph (b) of section 649(3) provides a minor amount of leeway in measuring that period for the case where a valuation date in respect of the assets in question is not exactly coterminous with either the beginning or end of the period.) In such a case, the discharge amount tracks the value of those assets exactly.

1788. Condition E, in *subsection (6)*, does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45F(3) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in sections 633 and 634.

1789. *Subsection (8)* provides that that creditor relationship is itself not treated as a "qualifying corporate bond" although section 117(A1) of TCGA would otherwise treat it as such. See the commentary on the similar provision in section 645(7).

1790. *Subsection (9)* contains a signpost to section 672, which modifies the rules for acquisition costs in section 38 of TCGA if the asset representing the creditor relationship mentioned in this section is disposed of.

1791. See also Part 10 of Schedule 2 which disapplies this section and applies other rules if the asset representing the creditor relationship is an asset in relation to which paragraph 11(2) of Schedule 10 to FA 2004 has effect.

Section 649: Meaning of certain expressions in section 648

1792. This section provides definitions for the interpretation of section 648. It is based on paragraph 45F(4), (5), (6) and (7) and 12(11C) of Schedule 26 to FA 2002.

1793. See the commentary on section 648 in relation to the meaning of "exactly tracking contract".

1794. "Shares" is defined in section 710.

Section 650: Property based total return swaps

1795. This section sets out the type of derivative contract it applies to (so that section 641 may then apply to credits and debits in respect of the contract). It is based on paragraph 45G(1) and (1A) of Schedule 26 to FA 2002.

1796. Conditions A to D, in *subsections (2)* to *(5)*, set out the distinguishing characteristics of this type of derivative contract. It is, first, a contract for differences whose underlying subject matter includes interest rates (in addition to other underlying subject matter). Second, one or more indices are specified in the contract including an index of changes in the value of land (a "capital value index").

1797. Condition E, in *subsection (6)*, does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45G(1B) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in sections 633 and 634.

1798. By virtue of the special meaning of "relevant debits and credits" in this section, provided by section 659(3), only part of the credits and debits found under section 595 is brought into account under section 641 as a chargeable gain or allowable loss.

Section 651: Credits and debits not to be brought into account under Part 3 or Part 5

1799. This section disapplies section 573 to "relevant credits and debits" from a derivative contract to which one of the provisions listed in *subsection (2)* applies. It is based on paragraphs 45J(3) and 45K(3) of Schedule 26 to FA 2002.

Section 652: Introduction to sections 653 to 655

1800. This section sets out the type of derivative contract it applies to (so that section 653, 654 or 655 may then apply in respect of the contract). It is based on paragraphs 12(1) and (11A) and 45J(1), (2), and (10) of Schedule 26 to FA 2002.

1801. It applies to a derivative contract that comprises the rights and liabilities treated by section 585 as a relevant contract, because of a debtor relationship of the company, if that relevant contract is also treated as an option by that section. For the purposes of this section, the definition of "option" in section 580 is shorn of its usual limiting conditions (that a cash-settled option is not an option).

1802. The paragraph "issuers of securities with embedded derivatives: deemed options" in Part 10 of Schedule 2 disapplies the rules in sections 653 and 655, and modifies the application of the rule in section 654 if the company was a party to the debtor relationship before its first accounting period to begin on or after 1 January 2005.

1803. For other rules that apply if a company is a party to an embedded derivative because of a debtor relationship of the company and the embedded derivative is treated as an option, see sections 665 and 666 in Chapter 8. They apply if the embedded derivative is an equity instrument and the company pays an amount to the creditor in the loan relationship in discharge of obligations under the relationship.

Section 653: Shares issued or transferred as a result of exercise of deemed option

1804. This section determines for the purposes of section 144(2) of TCGA the value of the consideration given for the option represented by the derivative contract within section 652 if shares are issued or transferred as a result of the exercise of the option. It is based on paragraph 45J(3), (4A) and (5) of Schedule 26 to FA 2002.

1805. Section 144(2) of TCGA treats the grant of an option and the transaction under which the grantor fulfils the obligation under the option as a single transaction. The consideration for the option is regarded as part of the consideration for the sale. This section determines the amount of the consideration for the grant of the option for the purposes of that section. It does so by reference to the carrying value of the option at the time the company became a party to the relevant debtor relationship. "Carrying value" is defined in section 702.

1806. The source legislation for this rule, paragraph 45J(5)(a) of Schedule 26 to FA 2002, refers to "the amount treated in accordance with section 94A(2) of the Finance Act 1996 as the carrying value of the option". That section makes no direct reference to the carrying value of any item. But paragraph 50A(3B) of Schedule 26 to FA 2002 refers to that section in the course of setting out what the carrying value of a contract is. That reference is rewritten in section 702, but in terms of section 585. It would be superfluous to add any such reference to the present section, so the words "in accordance with section 94A(2) of the Finance Act 1996" have not been rewritten here.

Section 654: Payment instead of disposal on exercise of deemed option

1807. This section provides for a chargeable gain or allowable loss in the same circumstances as those applying in section 653, except that an amount is paid in fulfilment of the company's obligations under the debtor relationship (and there is no issue or transfer of shares). It is based on paragraphs 12(1) and (11B) and 45J(3), (6), (7), (8) and (9B) of Schedule 26 to FA 2002.

1808. In a number of circumstances it may suit one or other or both parties to a debtor relationship containing an option for the issue or transfer of shares not to go ahead when the option is exercised. Instead the matter is settled by a monetary payment. Such a cash settlement would fall foul of the limiting conditions in the definition of an "option" in section 580, so those conditions are disapplied for the purposes of the present section by section 652.

1809. There is a chargeable gain if the carrying value of the derivative contract at the time the company became a party to the debtor relationship exceeds the amount paid in fulfilment of the company's obligations under the debtor relationship. For this purpose that amount is first reduced, but not below nil, by the fair value of the host contract at the time the option is exercised. But if that amount (as so reduced) exceeds that carrying value, an allowable loss arises. The gain or loss, as the case may be, is the amount of the excess.

Section 655: Ceasing to be party to debtor relationship when deemed option not exercised

1810. This section deems there to be an acquisition and disposal of an asset for the purposes of corporation tax on chargeable gains if a company ceases to be a party to a debtor relationship within section 652 at a time when the option has not been exercised. It is based on paragraphs 12(1) and (11B) and 45J(3), (8), (9), (9A) and (9B) of Schedule 26 to FA 2002.

1811. A company may cease to be a party to a debtor relationship by redeeming or repaying the liability in question or by some other means (such as assigning the rights and liabilities under the relationship).

1812. *Subsection (2)* treats the company as having acquired an asset for consideration equal to the amount paid to cease to be a party to the relationship. It also treats the company as having disposed of that asset for consideration equal to the carrying value of the relationship when acquired. But the carrying value is first reduced, as in respect of section 654, by the fair value of the host contract at the time the option was acquired. The deemed disposal may give rise to a chargeable gain or allowable loss.

Section 656: Introduction to section 658

1813. This section sets out the type of derivative contract it applies to (so that section 658 may then apply in respect of the contract). It is based on paragraphs 12(1) and (11A) and 45K(1) and (2) of Schedule 26 to FA 2002.

1814. *Subsection (3)(b)* provides that this section does not apply to a derivative contract that falls within section 652. The definition of "option" in section 580 is shorn for the purposes of that section of its usual limiting conditions (by virtue of which a cash-settled option is not an option). A contract which is an option under the modified definition is a contract for differences and would otherwise fall also within this section.

1815. The distinguishing characteristic of this section, condition C in *subsection (4)*, is that the derivative contract is an "exactly tracking contract", as defined in section 657. That term has a similar meaning to that in section 648, as defined in section 649. But what is being tracked here is the amount regarded in accordance with generally accepted accounting practice as the proceeds of issue of the liability which represents the debtor relationship in this case. And, as this section deals with a debtor relationship (while section 648 deals with a creditor relationship), the period over which the tracking takes place is measured from the date the liability representing the debtor relationship begins to the date the corresponding creditor relationship ends.

Section 657: Meaning of "exactly tracking contract" in section 656

1816. This section defines "exactly tracking contract" for the purposes of section 656. It is based on paragraph 45K(2A), (2B) and (2C) of Schedule 26 to FA 2002.

Section 658: Chargeable gain or allowable loss treated as accruing

1817. This section provides for a chargeable gain or allowable loss to arise when a debtor relationship within section 656 comes to an end if an amount is paid to discharge a company's obligations under that relationship. It is based on paragraphs 12(1) and (11B) and 45K(3), (3A) and (3B) of Schedule 26 to FA 2002.

1818. The gain or loss is calculated on the assumptions that:

- there is a disposal of an asset which is the contract for differences in section 656;
- the cost of that asset is the amount paid to discharge the company's obligations; and
- the consideration for the disposal is the amount of the proceeds of the issue of the security representing the debtor relationship (or, if the company became a party to that relationship at a time after it was created, the carrying value of the host contract at that time).

1819. See the paragraph headed "disapplication of section 658" in Part 10 of Schedule 2 which applies if the liability representing the debtor relationship was owed by the company immediately before its first accounting period to begin on or after 1 January 2005.

Section 659: Meaning of "relevant credits" and "relevant debits"

1820. This section provides the meaning of "relevant credits" and "relevant debits" for the purposes of this Chapter. It is based on paragraphs 45A(3), 45G(2), (3) and (4), 45J(3) and 45K(3) of Schedule 26 to FA 2002.

1821. For all but one case the meaning is the same as that of credits and debits within section 595(3) and (4).

1822. The exception is the meaning of the terms in the case of a derivative contract to which section 650 (property based total return swaps) applies. For the purposes of section 641, as it applies to derivative contracts within section 650, the credits and debits found by section 595(3) and (4) are relevant credits and debits only to the extent they are also amounts found by applying the calculation formula in *subsection (4)*.

1823. Section 650 applies to contracts for differences in which there is a specified "capital value index" (see the commentary on that section). Subsection (4) finds an amount of credits and debits by calculating the percentage change ("R%") in the value of that index over the relevant accounting period (or part of that period, if the company is not a party to the contract throughout) and applying R% to the "notional principal amount". That term is not defined but is used in relation to derivative contracts to describe the notional amount of capital by reference to which payments are due between the parties to the contract (see the reference to interest rates in condition D in section 650).

1824. The R% x N rule may give a credit but the accounts show a debit, or may give a larger credit (or debit) than the accounts credit (or debit). See the example in paragraph CFM13540a of HMRC's Corporate Finance Manual.

Chapter 8: Further provision about chargeable gains and derivative contracts

Section 660: Contract relating to holding in OEIC, unit trust or offshore fund

1825. This section provides for a chargeable gain or allowable loss to arise when a company ceases to be a party to a relevant contract that is treated as a derivative contract because of section 587. It is based on paragraph 37(1), (2), (3) and (5) of Schedule 26 to FA 2002.

1826. Section 587 applies if the underlying subject matter of a relevant contract is an interest in a collective investment scheme and that scheme fails to meet a "qualifying investments test" in the relevant accounting period. The relevant contract is treated as a derivative contract for that accounting period and later periods.

1827. Section 602 provides for value to be attributed to the deemed derivative contract by reference to its market value when it is so deemed. Section 601 sets out the credits and debits to be brought into account for the purposes of this Part.

1828. This section deals with the profit and loss latent in the contract immediately before it is deemed to be a derivative contract. It applies if the contract was then a "chargeable asset". That term is defined in section 703 as an asset on whose disposal any gain would be a chargeable gain for the purposes of corporation tax on chargeable gains. The charge on that accrued gain or loss is in effect deferred until the company ceases to be a party to the contract.

1829. The consideration for the disposal equals any value given to the relevant contract in the company's accounts for the period immediately preceding that in which it is deemed to be a derivative contract. This value may be the same as or different from that found under section 602.

Section 661: Contract which becomes derivative contract

1830. This section provides for a chargeable gain or allowable loss to arise when a company ceases to be a party to a relevant contract that, not having been a derivative contract, became a derivative contract. It is based on paragraph 43A(1), (2), (4) and (5) of Schedule 26 to FA 2002.

1831. There are a number of ways in which a relevant contract that was not a derivative contract may become one. For example, if the terms of the contract change (without creating a new contract) in such a way that the accounting conditions in section 579 are now met, the contract may become a derivative contract. Or it may be that the contract no longer meets the "excluded property" rule in section 589 by virtue of which it was not a derivative contract. See for example the circumstances described in the paragraph "contracts which became derivative contracts on 16 March 2005" in Part 10 of Schedule 2.

1832. If this section applies, it operates similarly to section 660. Again, bringing into account the gain or loss latent in the relevant contract (which is also a chargeable asset) is deferred until the company ceases to be a party to the relevant contract.

1833. "Notional carrying value" has the same meaning as in section 622(4), that is, the carrying value the contract would have had in the books of the company had a period of account ended immediately before the deemed disposal. See the commentary on that section as regards the use of "period of account" rather than "accounting period" in that definition.

1834. See also the paragraph headed "disapplication of section 661" in Part 10 of Schedule 2 which applies if the relevant contract became a derivative contract before 30 December 2006.

Section 662: Contracts ceasing to be derivative contracts

1835. This section provides that, if a relevant contract to which the company continues to be a party ceases to be a derivative contract, the company is treated as acquiring the contract for an amount equal to its notional carrying value at the time it ceases to be a derivative contract. It is based on paragraph 43B of Schedule 26 to FA 2002.

1836. This section is the companion to section 622 which deals with the deemed disposal of the relevant contract for the purposes of this Part at the time it ceases to be a derivative contract. See the commentary on that section.

Section 663: Contracts to which section 641 applies

1837. This section provides that, if a company makes a claim, allowable losses deemed to arise for an accounting period may be carried back and set against chargeable gains deemed to arise in accounting periods in the previous 24 months. It is based on paragraph 45B(1), (2) and (3) of Schedule 26 to FA 2002.

1838. The gains and losses deemed to arise are those given by section 641 (chargeable gains basis substituted for income basis in charging credits and debits from certain types of derivative contract).

1839. The gains eligible for relief in an earlier period are the total section 641 gains for that period less the total of allowable losses under that section for that period. Those gains are further reduced by any other allowable losses for that period so far as those other allowable losses could not be deducted, within the meaning of section 8(1) of TCGA, from other chargeable gains. That is, any allowable losses for the purposes of corporation tax on chargeable gains, other than losses under section 641, are notionally deducted from the section 641 gains if they cannot be set against any chargeable gains, other than gains under section 641, to find the amount of gains against which the losses carried back under this section can be set. The amount found under this rule is called "net section 641 gains".

1840. *Subsection (3)* provides that, to the extent the losses for a period are carried back and relieved under this section, they are used up and cannot otherwise be relieved under the provisions for corporation tax on chargeable gains by set off or carry forward.

Section 664: Meaning of certain expressions in section 663

1841. This section provides the meaning of some terms used in section 663. It is based on paragraph 45B(4), (5), (6), (7) and (8) of Schedule 26 to FA 2002.

Section 665: Introduction to section 666

1842. This section sets out the type of contract it applies to for the purposes of the relief provided by section 666. It is based on paragraphs 12(1) and (11A) and 45JA(1), (2) and (5) of Schedule 26 to FA 2002.

1843. For the purposes of this section, the definition of "option" in section 580 is shorn of its usual limiting conditions (that a cash-settled option is not an option).

1844. "Equity instrument" is defined in section 710 as having the meaning it does for accounting purposes. (See the commentary on section 585 for further detail.)

1845. For other rules that apply if a company is a party to an embedded derivative because of a debtor relationship of the company and the embedded derivative is treated as an option, see sections 652 to 655 in Chapter 7. They apply if the underlying subject matter of the embedded derivative is shares.

Section 666: Allowable loss treated as accruing

1846. This section deems there to be an allowable loss for the purposes of corporation tax on chargeable gains if a company pays an amount to discharge obligations under the debtor relationship to which section 665(2) refers. It is based on paragraphs 12(1) and (11B) and 45JA(3) and (4) of Schedule 26 to FA 2002.

1847. The allowable loss equals any excess of that payment (as first reduced by the fair value of the host contract at that time) over the carrying value of the equity instrument that is treated as a derivative contract under section 585 as at the time the company became a party to the debtor relationship.

1848. "Fair value" is defined in section 710.

1849. The definition of "B" in *subsection (2)* does not rewrite the words "in accordance with section 94A(2) of the Finance Act 1996" for the same reasons as given in the commentary on section 653.

1850. See also the paragraph headed "disapplication of section 666" in Part 10 of Schedule 2 which applies if the liability representing the debtor relationship was owed by the company immediately before its first accounting period to begin on or after 1 January 2005.

Section 667: Shares acquired on exercise of non-embedded option

1851. This section and the next modify the amounts otherwise allowable as acquisition costs under section 38 of TCGA on the disposal of shares acquired under an option or future. This section deals with shares acquired as the result of the exercise of rights under an option. It is based on paragraph 45HA(1), (2) and (3) of Schedule 26 to FA 2002.

1852. This section applies only if the derivative contract is a "plain vanilla contract" (defined in section 708). That is, it does not apply to the exercise of rights within rights and liabilities treated as a derivative contract under section 584, 585 or 586. Although the provision normally operates on the terminal exercise of the option, it is theoretically possible for it to apply to each instalment of a staged exercise of the option. Paragraph (e) of *subsection (1)* is therefore in terms of the exercise of "any of" the rights under the option.

1853. *Subsection (2)* provides for allowable acquisition costs under section 38(1)(a) of TCGA to be increased (or reduced) when there is a disposal of the shares acquired as a result of the exercise of rights under the option. The increase or reduction in effect reverses the earlier treatment of credits and debits in respect of the option, so far as referable to the shares which were the subject of the option, as non-trading credits and debits for the purposes of Part 5 (loan relationships).

1854. Subsection (2) also provides that, if there is only a part disposal of those shares, section 42(2) of TCGA applies. That provision deals with the calculation of costs allowable under section 38 of TCGA if there is a part disposal of an asset. It uses an A divided by A+B formula which takes into account the consideration for the part disposal ("A") and the value of the remainder of the asset ("B").

1855. Section 669 sets out the amount of the credits and debits to be used in calculating the amount of the adjustment to expenditure allowable under section 38 of TCGA.

1856. In a case where the adjustment reduces allowable expenditure and exceeds the amount that can be so reduced, the excess reduction is instead treated under *subsection (3)* as additional consideration for the disposal of the shares.

Section 668: Shares acquired on running of future to delivery

1857. This section makes provision equivalent to that in section 667 if shares are disposed of following their acquisition as the result of the delivery of those shares under the terms of a future. It is based on paragraph 45HA(1A), (2) and (3) of Schedule 26 to FA 2002.

1858. See the commentary on section 667.

Section 669: Meaning of G and L in sections 667 and 668

1859. This section determines the amounts used under section 667 or 668 to modify the amounts allowable as acquisition costs under section 38 of TCGA on the disposal of shares acquired as mentioned in either section. It is based on paragraph 45HA(4) and (5) of Schedule 26 to FA 2002.

1860. The credits and debits relevant to the calculation under section 667(2) or 668(2) are those brought into account under section 574. That is, they are amounts which are

treated as non-trading credits and debits for the purposes of Part 5 (loan relationships). It is unnecessary to take account for this purpose of credits and debits within section 573, as profits and losses on derivative contracts to which that section applies are brought into account as trading profits rather than as chargeable gains.

1861. The credits and debits in question are those referable to the shares acquired or delivered. That is, they are credits and debits arising in respect of the derivative contract before the exercise of the option or the running to delivery of the future, as appropriate, as a result of which the shares were acquired. And they are referable to the shares which are the subject of the contract. *Subsection (2)* also provides that any necessary apportionment of credits and debits may be made on a just and reasonable basis.

1862. *Subsection (4)* indicates that the credits and debits in question are those arising in respect of any accounting period of the company during which it is a party to the derivative contract up to and including that in which the shares are disposed of. It is a question of fact whether in any of those accounting periods there are relevant credits or debits.

Section 670: Treatment of net gains and losses on exercise of option

1863. This section modifies the amounts allowable under section 38 of TCGA in respect of a disposal of (a) shares acquired as a result of the exercise of rights under an option, if those rights were held under a derivative contract which is an embedded derivative in a creditor relationship within section 645 or (b) the asset representing the creditor relationship in such a case. It is based on paragraph 45H(1), (2), (3), (4), (5), (5A) and (6) and 12(11C) of Schedule 26 to FA 2002.

1864. "Creditor relationship" is defined in section 704.

1865. As in section 667, it is theoretically possible for the section to apply to each instalment of a staged exercise of the option as well as the terminal exercise of the option. Paragraph (c) of *subsection (1)* is therefore in terms of the exercise or disposal of "any of" those rights.

1866. Credits and debits arising in a case to which section 645 applies are brought into account as chargeable gains or allowable losses under section 641. The effect of this section is to reverse that treatment when the asset representing the creditor relationship or the shares acquired under the option are disposed of. It avoids double charging of so much of the value in that asset or shares as represents the credits or debits already brought into charge as a chargeable gain or allowable loss.

1867. The adjustment under *subsection (5)* applies only if the circumstances in which the shares were acquired involved a disposal treated as not occurring because of section 127 of TCGA. That provision disregards as a disposal the replacement of a holding of shares by another such holding in the course of a reorganisation of share capital. That is, the disposal of the rights under the option, as a result of exercising those rights, was not treated as a disposal.

1868. Similarly to section 667, if the adjustment to be made under *subsection (3)* or (5) is a reduction that exceeds the amounts otherwise allowable under section 38 of TCGA, the excess is added to the consideration for the disposal.

1869. *Subsection (7)* disapplies sections 37 and 39 of TCGA in relation to a disposal covered by this section. Those sections remove from the chargeable gains calculation any consideration and expenditure that is taken into account in an income calculation.

Section 671: Meaning of G, L and CV in section 670

1870. This section provides the meaning of labels used in the calculations made under section 670(3) and (5). It is based on paragraphs 12(1) and (11B) and 45H(6) and (7) of Schedule 26 to FA 2002.

1871. The chargeable gains ("G") and allowable losses ("L") relevant to those calculations are those referable to the shares acquired as a result of the exercise of the option. That is, they are credits and debits arising in respect of the derivative contract before the exercise of the option as a result of which the shares were acquired. And they are referable to the shares which are the subject of the contract.

1872. *Subsection (5)* indicates that the credits and debits in question are those arising in respect of any accounting period of the company during which it is a party to the derivative contract up to and including that in which the shares are disposed of.

Section 672: Treatment of net gains and losses on disposal of certain embedded derivatives

1873. This section modifies the amounts allowable under section 38 of TCGA on a disposal of the asset representing the creditor relationship mentioned in section 648 in a case where that section applies. It is based on paragraph 45HZA(1), (2), (3), (4) and (5) of Schedule 26 to FA 2002.

1874. For the circumstances in which section 648 applies, and for the meaning of an "exactly tracking contract for differences", see the commentary on that section.

1875. As with section 670, this section in effect reverses the treatment of credits and debits in respect of the embedded derivative under section 641 so that double counting is avoided when the asset representing the creditor relationship is disposed of.

1876. And similarly again to that section and others, if the adjustment to be made under *subsection (2)* is a reduction that exceeds the amounts otherwise allowable under section 38 of TCGA, the excess is added to the consideration for the disposal.

Section 673: Meaning of G, L and CV in section 672

1877. This section provides the meaning of labels used in the calculations made under section 672(2). It is based on paragraphs 12(1) and (11B) and 45HZA(5) and (6) of Schedule 26 to FA 2002.

1878. The definitions of "G", "L" and "CV" are similar to those in section 671 but modified for the purposes of section 672. See the commentary on section 671.

Chapter 9: European cross-border transfers of business

Overview

1879. This Chapter gives the rules that apply for derivative contracts in the case of cross-border transfers within the European Community of the whole or part of a business carried on in the United Kingdom.

Section 674: Introduction to Chapter

1880. This section sets out the two conditions required for the Chapter to apply together with the claim requirement. It is based on paragraphs 30D(1), (2), (3) and (4), 30G(1) and 30I(1) of Schedule 26 to FA 2002.

1881. The source legislation for *subsection (2)(c)* requires that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA. The subsection says "within the charge to corporation tax" as the result is the same.

1882. See also the paragraph headed "references to Companies Act 2006" in Part 10 of Schedule 2 which provides for the interpretation of references to section 658 of that Act before that section comes into force.

Section 675: Transfer of derivative contract at notional carrying value

1883. This section provides the rule that if either of the conditions in section 674 applies, debits and credits in respect of derivative contracts which are transferred as part of the business transfer are brought into account by both transferor and transferee as if the contracts had been transferred at the carrying value in the accounts of the transferor. It is based on paragraph 30D(1), (2) and (6) of Schedule 26 to FA 2002.

1884. The definition of "notional carrying value" is the same as that used in section 625(6).

Section 676: Transferor using fair value accounting

1885. This section provides the rule to apply in place of section 675 if the transferor company uses fair value accounting. It is based on paragraph 30D(7) of Schedule 26 to FA 2002.

Section 677: Tax avoidance etc

1886. 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 this Chapter should apply. It is based on paragraph 30F(1) and (2) of Schedule 26 to FA 2002.

Section 678: Procedure on application for clearance

1887. This section sets out the procedure to be followed for an application that section 677 should not apply. It is based on paragraph 30F(3) of Schedule 26 to FA 2002.

1888. This section follows the procedure set out in the equivalent provision in Part 5 (loan relationships) (see section 427).

Section 679: Decision on application for clearance

1889. This section sets out how the outcome of an application that section 677 should not apply is notified. It is based on paragraph 30F(3) of Schedule 26 to FA 2002.

1890. This section follows the procedure set out in the equivalent provision in Part 5 (loan relationships) (see section 428).

Section 680: Disapplication of Chapter where transparent entities involved

1891. This section disapplies the Chapter under certain circumstances if transparent entities are involved in the transfer of business. It is based on paragraphs 30G(1) and (2) and 30I(1) of Schedule 26 to FA 2002.

Section 681: Interpretation

1892. This section defines "company" and explains what company residence in a member State means for the purposes of the Chapter. It is based on paragraph 30I of Schedule 26 to FA 2002.

Chapter 10: European cross-border mergers

Overview

1893. This Chapter gives the rules that apply for derivative contracts in the case of European cross-border mergers if the merging companies are resident in different member States of the European Community.

Section 682: Introduction to Chapter

1894. This section sets out the conditions (which include the different categories of merger) under which the Chapter applies. It is based on paragraphs 30B(1) and (2) and 30H(1) of Schedule 26 to FA 2002.

1895. The source legislation for *subsection (5)* requires that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA. The subsection says "within the charge to corporation tax" as the result is the same.

1896. See also the paragraph headed "references to Companies Act 2006" in Part 10 of Schedule 2 which provides for the interpretation of references to section 658 of that Act before that section comes into force.

Section 683: Meaning of "the transferee" and "transferor"

1897. This section gives the meaning of the two terms for the different categories of merger set out in section 682(2). It is based on paragraph 30B(9) of Schedule 26 to FA 2002.

Section 684: Transfer of derivative contract at notional carrying value

1898. This section provides that debits and credits in respect of derivative contracts transferred under a merger are brought into account as if the transfer had been for a consideration of an amount equal to the carrying value of the contract in the transferor company's or companies' accounts. It is based on paragraph 30B(3) of Schedule 26 to FA 2002.

Section 685: Transferor using fair value accounting

1899. This section provides the rule to apply in place of section 684 if the transferor company uses fair value accounting. It is based on paragraph 30B(4) of Schedule 26 to FA 2002.

Section 686: Tax avoidance etc

1900. This section disapplies the Chapter if the merger is not effected for genuine commercial purposes unless the Commissioners for HMRC are satisfied, following an application, that this Chapter should apply. It is based on paragraph 30B(6), (7) and (8) of Schedule 26 to FA 2002.

1901. *Subsections (2)* and *(3)* provide a clearance procedure equivalent to that in the previous Chapter.

Section 687: Disapplication of Chapter where transparent entities involved

1902. This section disapplies the Chapter under certain circumstances if transparent entities are involved in the merger. It is based on paragraphs 30H(1) and (2) and 30I(1) of Schedule 26 to FA 2002.

Section 688: Interpretation

1903. This section defines some terms used in the Chapter. It is based on paragraphs 30B(9) and 30I of Schedule 26 to FA 2002.

Chapter 11: Tax avoidance

Section 689: Overview of Chapter

1904. This section describes the content of the Chapter. It is new.

Section 690: Derivative contracts for unallowable purposes

1905. This section prevents certain credits and debits being brought into account for corporation tax purposes, whether under this Part or otherwise, if the derivative contract

in question has an "unallowable purpose". It is based on paragraph 23(1), (2), (3), (8), (9) and (10) of Schedule 26 to FA 2002.

1906. *Subsection (3)* prevents a company bringing into account all debits in respect of the derivative contract that are referable to the unallowable purpose. But *subsection (2)* only does so for credits that are "exchange credits" (defined in *subsection (6)*).

1907. *Subsection (4)* signposts the relief in section 692, which provides that some of the debits mentioned in subsection (3) may be brought into account in the shape of "excess accumulated net losses".

1908. *Subsection (5)* makes clear that an amount that is not brought into account because of this section (or section 692) is nevertheless regarded as brought into account for the purposes of the priority rule in section 699. That rule provides that this Part exhausts the corporation tax treatment of an amount to which it applies, unless otherwise stated. The amounts in question are therefore not to be brought into account for corporation tax purposes in any other way.

Section 691: Meaning of "unallowable purpose"

1909. This section defines "unallowable purpose" and "has an unallowable purpose" for the purposes of sections 690 and 692. It is based on paragraph 24 of Schedule 26 to FA 2002.

1910. A purpose is unallowable if it is one of the purposes for which the company is a party to the contract (or enters into related transactions in relation to it) but it is not a business or other commercial purpose of the company.

1911. *Subsection (2)* excludes any activities in respect of which the company is not within the charge to corporation tax from the business and commercial purposes of the company that are relevant to this definition. For example, if a non-UK resident company is a party to the contract for the purposes of a permanent establishment it has in the United Kingdom, the purposes of the activities of the company that are not part of the activities of the permanent establishment are disregarded.

1912. *Subsections (3)* to *(6)* exclude a tax avoidance purpose from the business and commercial purposes of the company for the purposes of this definition. The effect of this is that a tax avoidance purpose is an unallowable purpose unless it is a minor part of the company's motivation for being a party to, or entering into related transactions in relation to, the derivative contract.

Section 692: Allowance of accumulated net losses

1913. This section gives relief for some of the debits prevented from being brought into account by section 690. It is based on paragraph 23(1), (4), (5), (6) and (7) of Schedule 26 to FA 2002.

1914. The amount that is relieved under this section by being brought into account as a debit, by virtue of *subsection (4)*, is the amount of the "excess accumulated net losses" found in accordance with the method statement in *subsection (5)*.

1915. In effect, debits excluded for an accounting period because of section 690(3) are nevertheless relieved in that or a later period to the extent that there are non-excluded credits against which they can be set.

1916. The calculation of the amount to be relieved is on a cumulative basis and that amount is reduced by any debit already given under this section.

Section 693: Bringing into account adjustments under Schedule 28AA to ICTA

1917. This section brings into account under this Part credits and debits in respect of amounts treated under Schedule 28AA to ICTA (provision not at arm's length) as profits, losses or expenses. It is based on paragraph 31A of Schedule 26 to FA 2002.

1918. It brings credits and debits into account to the extent that actual amounts of such profits, losses or expenses would be brought into account.

1919. Schedule 28AA to ICTA identifies adjustments ("imputed amounts") to be made to return the profit or loss from a transaction between parties not at arm's length to what that profit or loss would be had the parties been at arm's length. This section ensures that such amounts are taken into account under this Part although they arise under Schedule 28AA rather than under this Part.

1920. *Subsections (3)* and *(5)* indicate that the credits and debits brought into account by this section are subject to the same rules as apply under this Part to credits and debits in respect of actual amounts. So, for example, debits brought into account in respect of expenses are those falling within the categories listed in section 595(4).

Section 694: Exchange gains and losses

1921. This section gives effect in this Part to adjustments or other treatment of exchange gains and losses prescribed by Schedule 28AA to ICTA, further to those in section 693. It is based on paragraph 8(1) and (4) of Schedule 28AA to ICTA and paragraph 27 of Schedule 26 to FA 2002.

1922. Under paragraph 1 of Schedule 28AA to ICTA, a company may be treated as not a party to a derivative contract. The actual exchange gains and losses on that contract are then disregarded. *Subsection (3)* provides that such exchange gains and losses are also left out of account in determining the credits and debits to be brought into account under this Part.

1923. Schedule 28AA to ICTA may also impute amounts of exchange gains and losses (the "adjusted amount") calculated on the basis that the parties to the derivative contract are acting at arm's length although in fact they do not do so. *Subsection (5)* requires the "adjusted amount" to be brought into account under this Part.

Section 695: Transfers of value to connected companies

1924. This section treats as a credit the amount paid by a company for the grant of an option by a company connected with it if the option is allowed to expire to the benefit of the connected company. It is based on paragraph 26 of Schedule 26 to FA 2002.

1925. Value is transferred on the expiry of the option because the connected company retains the amount paid for the option and does not suffer the commercial loss that would have occurred had the option been exercised. The required assumption in *subsection (6)*, that the option would have been exercised had the parties not been connected, points to the fact that it would have been advantageous to the option holder to exercise it (and therefore disadvantageous to the company granting the option).

1926. The section applies only if the connected company is not within the charge to corporation tax in respect of the derivative contract under or because of this Part. For example, it applies if the connected company is not a UK resident company (and the derivative contract is not held for the purposes of a permanent establishment it has in the United Kingdom).

1927. *Subsection (7)* indicates that, for the purposes of this section, the definition of "option" in section 580 is shorn of its usual limiting conditions (that a cash-settled option is not an option).

Section 696: Derivative contracts with non-UK residents

1928. This section excludes a debit if a company within the charge to corporation tax makes payments of notional interest in excess of payments of notional interest to it by a company which is non-UK resident. It is based on paragraph 31(1), (2), (3), (4) and (9) of Schedule 26 to FA 2002.

1929. This section typically applies to a contract for differences which is an interest rate swap. It has some similarities with section 695 in that the flow of benefit in the direction of a company outside the charge to corporation tax is countered in taxing the other company.

1930. *Subsection (4)* defines "notional interest payment". The rate applied in calculating such a payment is not necessarily an interest rate as such but paragraph (c) of the definition requires that it matches the interest rate specified in the contract.

Section 697: Exceptions to section 696

1931. This section sets out three circumstances in which section 696 does not apply. It is based on paragraph 31(5), (6), (7), (8) and (9) of Schedule 26 to FA 2002 and section 153(2) of FA 2003.

1932. The third exception is if there is a double taxation agreement between the United Kingdom and the territory in which the non-UK resident is resident which covers payments of interest (whether by relief or otherwise). Unlike the first two exceptions, where the financial institution or non-UK resident must hold the derivative contract as principal, this exception can apply if the non-UK resident holds the derivative contract as agent or nominee of another person. But in that case, the relevant territory is that in which the principal is resident.

1933. "Permanent establishment" is defined in section 148 of FA 2003.

Section 698: Disposals for consideration not fully recognised by accounting practice

1934. This section brings into account that part of the consideration for a disposal of rights or liabilities under a derivative contract that is not fully recognised under applicable generally accepted accounting practice, if the company in question made the disposal with avoidance motives. It is based on paragraph 27A of Schedule 26 to FA 2002.

1935. *Subsection (5)* gives priority to paragraph 1(2) of Schedule 28AA to ICTA, if that provision would apply a tax charge on the disposal in question. That paragraph may operate in effect through section 693.

Chapter 12: Priority rules

Section 699: Priority of this Part for corporation tax purposes

1936. This section provides that this Part has priority, as regards amounts brought into account in accordance with it in respect of any matter, over any corporation tax provision that would otherwise apply. It is based on paragraph 1(2) of Schedule 26 to FA 2002.

1937. This rule covers not only the case where an amount is dealt with under sections 573 or 574 but also a case to which Chapter 7 applies.

1938. *Subsection (3)* lists particular cases where the rule is disregarded.

1939. Section 700 deals with the case where Part 5 (loan relationships) has priority over this Part. If that Part applies to any amounts, those amounts are not in fact brought into account in accordance with this Part and so this section cannot apply.

Section 700: Relationship of this Part to Part 5: loan relationships

1940. This section gives priority to Part 5 if the amount that would otherwise be brought into account under this Part, or (if different) the profit or loss accruing to the company on the derivative contract, is brought into account under that Part. This section is based on section 101 of FA 1996.

1941. This rule covers, for example, the case where a loan relationship arises from the conduct of a derivative contract (say, if one party defaults on a payment in the course of an interest rate swap and so owes money to the other). A payment due in respect of the loan relationship is dealt with under Part 5 and not under this Part.

1942. *Subsection (3)* sets out the significant exception to the general rule, that is, in a case where section 585 (loan relationships with embedded derivatives) applies. This Part applies instead of Part 5 to profits and losses in respect of an embedded derivative that is a derivative contract.

Chapter 13: General and supplementary provisions

Section 701: Power to amend some provisions

1943. This section contains powers for the amendment of this Part (and related paragraphs in Part 10 of Schedule 2). It is based on paragraph 13 of Schedule 26 to FA 2002 and paragraph 52 of Schedule 4 to FA 2005.

1944. The permitted amendments are broadly concerned with redefining what is or is not a derivative contract (whether by reference to the underlying subject matter of a relevant contract or otherwise). They are also concerned with adjusting the regime for special cases.

1945. *Subsections (1)* and *(2)* define what provisions in this Part and Schedule 2 may be amended by an order under this section. The lists in these subsections reflect the fact that the rules in the amendable provisions of the source legislation (Parts 2 and 9 of Schedule 26 to FA 2002) are now ordered differently in this Part.

1946. *Subsection (5)* contains the commencement provisions for an order made under this section. The normal rule is that an order applies to accounting periods ending on or after the date on which the order comes into force. That rule includes a degree of retrospection in that the order may apply by reference to events that occurred in that accounting period before the order came into force. Retrospective application is partly increased by paragraph (b) of this subsection, which allows the order to apply to periods of account beginning in the year in which they are made (which would cover, for example, an accounting period of less than 12 months which has ended before the order is made).

Section 702: "Carrying value"

1947. This section defines the meaning of "carrying value" for the purposes of this Part. It is based on paragraphs 28(6) and 50A(3A) and (3B) of Schedule 26 to FA 2002.

1948. *Subsections (2)* and *(3)* ensure that the effect of various provisions dealing with special cases carries through for the purposes of calculating the carrying value under this section.

1949. *Subsection (4)* provides a definition of "impairment loss" (a term taken from international accounting standards) which is only implied by the source legislation by virtue of its reference to "amounts recognised for accounting purposes". The definition is modelled on that provided for loan relationships by section 476. See *Change 67* in Annex 1.

Section 703: "Chargeable asset"

1950. This section defines the meaning of "chargeable asset" for the purposes of this Part. It is based on paragraphs 4A(4), 4B(5), 37(6) and 43A(3) of Schedule 26 to FA 2002.

1951. The definition extends under *subsection (2)* to amounts that are treated under section 143 of TCGA as assets whose disposal falls within TCGA. Those assets are obligations under a futures contract, that is, the obligation to supply or to take delivery of a commodity or other item under the contract at an agreed price. If there has been such market movement in the price of the commodity that the obligation is heading to produce a profit, a disposal of the obligation (before the contract has run to delivery) would be a disposal of an asset for the purposes of TCGA.

Section 704: "Creditor relationship" and "debtor relationship"

1952. This section defines "creditor relationship" and "debtor relationship" for the purposes of this Part. It is based on paragraphs 30A(7) and 54(1) of Schedule 26 to FA 2002.

1953. These terms occur in this Part in connection with a loan relationship or a relevant contract within section 585(2). The section therefore defines the terms by reference to section 302 in Part 5. In short, a creditor relationship refers to a debt *owned* and a debtor relationship to a debt *owed* by the company.

Section 705: Expressions relating to exchange gains and losses

1954. This section provides for the interpretation of references in this Part to "exchange gains" or "exchange losses" in relation to a company. It is based on paragraph 54(2), (2A) and (3) of Schedule 26 to FA 2002.

1955. *Subsection (2)* provides that, in the event that the comparison of values described in *subsection (1)* gives neither a gain nor a loss, an exchange gain of nil arises. This rule applies in a case where it is necessary for there be an amount of an exchange gain or exchange loss for a provision to apply (say, section 694(6)).

1956. *Subsection (3)* provides powers for the Treasury to make regulations as to the calculation of exchange gains and losses and any other profits, gains or losses if the company uses fair value accounting. See The Loan Relationships and Derivative Contracts (Exchange Gains and Losses using Fair Value Accounting) Regulations 2005 (SI 2005/3422). As in the case of the powers in section 701, regulations made under these powers may apply to any period of account beginning in the year in which they are made.

1957. *Subsection (5)* sets out what a reference to an exchange gain or loss from a company's derivative contracts means (for the purposes of, say, section 606(1)).

Section 706: "Excluded body"

1958. This section defines "excluded body" for the purposes of this Part. It is based on paragraphs 45C(3), 45D(2), 45G(1A), 45J(2) and 45K(2) of Schedule 26 to FA 2002.

1959. The bodies which are excluded bodies are all types of collective investment scheme.

1960. "Authorised unit trust" is defined in section 832(1) of ICTA by reference to section 468(6) of that Act, which in turn refers to a scheme in respect of which an order under section 243 of FISMA is in force in the relevant accounting period.

1961. "Investment trust" has the meaning given by section 842 of ICTA and "venture capital trust" the meaning given by section 834(1) of ICTA (by reference to Part 6 of ITA).

1962. "Open-ended investment company" is defined in section 710 by reference to section 468A(2) of ICTA which in turn refers to a company incorporated in the United Kingdom to which section 236 of FISMA applies.

Section 707: "Hedging relationship"

1963. This section sets out two cases in which a company is regarded as having a "hedging relationship" for the purposes of this Part. It is based on paragraph 12(14) of Schedule 26 to FA 2002.

1964. The concept of "hedging" has to do with contracts undertaken to protect the company's assets (or to guard against increase in its liabilities) in a case where there is some form of market volatility associated with the item. The cases described in this section derive from those set out in accounting standards. Paragraph 86 of Financial Reporting Standard 26, the equivalent for UK generally accepted accounting practice of International Accounting Standard 39, describes a hedging relationship as follows:

Hedging relationships are of three types:

> fair value hedge: a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or commitment that is attributable to a particular risk and could affect profit or loss.
>
> cash flow hedge: a hedge of the exposure to variability in cash flows that is (i) attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss.
>
> hedge of a net investment in a foreign operation as defined in FRS 23.

1965. Paragraph 9 of Financial Reporting Standard 26 also provides definitions of "hedging instrument" and "hedged item".

Section 708: "Plain vanilla contract"

1966. This section defines "plain vanilla contract". It is based on paragraph 2(2B) of Schedule 26 to FA 2002.

1967. The term means any relevant contract except those to which a company is treated as a party under section 584, 585 or 586.

Section 709: "Securities house"

1968. This section defines "securities house" for the purposes of this Chapter. It is based on paragraphs 45J(10), 45JA(5) and 45K(4) of Schedule 26 to FA 2002.

Section 710: Other definitions

1969. This section defines a number of terms for the purposes of this Part. It is based on paragraphs 12(1), (2), (9), (11), (12), (13) and (17) and 54(1) and (4) of Schedule 26 to FA 2002.

1970. Where appropriate, terms used in this Part in connection with the business of a life assurance company take the meaning given in Chapter 1 of Part 12 of ICTA (see in particular section 431(2) of ICTA).

1971. The section does not rewrite those definitions in paragraph 54(1) of Schedule 26 to FA 2002 of terms that are no longer in use in that Schedule (for example, "UK company") or have been replaced by other terms (for example, "nested derivative"). Nor does it rewrite the definition of "investment trust" as that is already provided by section 842 of ICTA.

Part 8: Intangible fixed assets

Overview

1972. This Part gives a comprehensive scheme for the taxation of profits and losses arising to a company from its intangible fixed assets. It is based on Schedule 29 to FA 2002.

1973. This Part sets out a uniform and largely self-contained set of rules on the tax treatment of intangible fixed assets used for business purposes by companies. For assets within its rules, it overrides all other tax legislation. Broadly, it applies only to assets acquired from third parties, or created, after 31 March 2002. Other intangible fixed assets continue, subject to some particular exceptions, to be dealt with under general rules. The tax treatment of intangible fixed assets within this Part generally follows the accountancy treatment. In this respect, it resembles the loan relationship and derivative contract provisions which also largely erase the distinction between capital and revenue expenditure.

Chapter 1: Introduction

Section 711: Overview of Part

1974. This section provides a "route map" of the Part. It is new.

Section 712: "Intangible asset"

1975. This section explains what is meant by "intangible asset". It is based on paragraph 2 of Schedule 29 to FA 2002.

Section 713: "Intangible fixed asset"

1976. This section explains what is meant by "intangible fixed asset". It is based on paragraph 3 of Schedule 29 to FA 2002.

1977. *Subsection (2)* is an important general extension to the rules. That is, if an asset is an "intangible fixed asset" under the rules in this Part, so is an option or other right to acquire or dispose of that asset. There is a counterpart, obverse rule in section 805.

Section 714: "Royalty"

1978. This section is definitional. It is based on paragraph 139 of Schedule 29 to FA 2002.

Section 715: Application of this Part to goodwill

1979. This section brings goodwill within the intangible fixed assets regime. It is based on paragraph 4 of Schedule 29 to FA 2002.

1980. The inclusion of goodwill extends the relevance of these rules to a far wider range of companies than would otherwise be the case.

Section 716: "Recognised" amounts and "GAAP-compliant accounts"

1981. This section identifies the accountancy amounts from which the related tax amounts are derived. It is based on paragraph 134 of Schedule 29 to FA 2002.

1982. *Subsection (4)* rewrites part of paragraph 5(1) of Schedule 29 to FA 2002. The subsection uses the label "GAAP-compliant accounts" as being a more neutral term than the label "correct accounts" used in the source legislation.

Section 717: Companies without GAAP-compliant accounts

1983. This section deals with the case where a company does not draw up accounts in accordance with generally accepted accounting practice or, exceptionally, does not draw up accounts at all. It is based on paragraph 5 of Schedule 29 to FA 2002.

1984. In both cases the rules apply as though GAAP-compliant accounts had been drawn up.

1985. *Subsection (3)* applies where accounts are GAAP-compliant in themselves but follow on from a period for which the accounts were not. It allows the later accounts to be adjusted to reflect the adjustments required in the earlier accounts.

Section 718: GAAP-compliant accounts: reference to consolidated group accounts

1986. This section allows reference to be made to consolidated group accounts in determining whether a company's accounts are GAAP-compliant. It is based on paragraph 6 of Schedule 29 to FA 2002.

Section 719: Accounting value

1987. This section is definitional. It is based on paragraph 135 of Schedule 29 to FA 2002.

Chapter 2: Credits in respect of intangible fixed assets

Section 720: Introduction

1988. This section introduces the rules dealing with the main category of accounting gains to be brought into account as credits for tax purposes. It is based on paragraph 13 of Schedule 29 to FA 2002.

1989. The rules in this Chapter do not apply on a realisation of an intangible fixed asset. *Subsection (3)* gives a signpost to the rules that do.

Section 721: Receipts recognised as they accrue

1990. This section covers all kinds of receipts (including most ordinary royalties) from the exploitation of intangible fixed assets, apart from those deriving from the realisation of such assets. It is based on paragraph 14 of Schedule 29 to FA 2002.

Section 722: Receipts in respect of royalties so far as not dealt with under section 721

1991. This section applies to credits in respect of some exceptional royalties to bring them within the charge when this would not otherwise happen. It is based on paragraph 14A of Schedule 29 to FA 2002.

Section 723: Revaluation

1992. This section applies when an intangible fixed asset is revalued upwards. It is based on paragraph 15 of Schedule 29 to FA 2002.

Section 724: Negative goodwill

1993. This section applies to certain releases of negative goodwill. It is based on paragraph 16 of Schedule 29 to FA 2002.

Section 725: Reversal of previous accounting loss

1994. This section applies to an accounting gain that reverses a previous loss for which relief was given. It is based on paragraph 17 of Schedule 29 to FA 2002.

1995. *Subsection (3)* ensures that if the tax debit in the previous period was not the same figure as the accounting loss, the credit on the reversal of the loss is the accounting gain adjusted in the ratio which the debit bears to the loss.

1996. There is a parallel, converse rule in section 732.

Chapter 3: Debits in respect of intangible fixed assets

Section 726: Introduction

1997. This section introduces the rules dealing with the main category of accounting losses which may be brought into account as a debit for tax purposes. It is based on paragraph 7 of Schedule 29 to FA 2002.

1998. The rules in this Chapter do not apply to the realisation of an intangible fixed asset. S*ubsection (3)* provides a signpost to the Chapter that does.

Section 727: References to expenditure on an asset

1999. This section explains what is meant by "expenditure on an asset". It is based on paragraph 133 of Schedule 29 to FA 2002.

2000. *Subsection (2)* puts beyond doubt the exclusion of capital expenditure on tangible assets that might otherwise appear to come within *subsection (1)* such as expenditure on cars used by company staff promoting the company's brand name.

Section 728: Expenditure written off as it is incurred

2001. This section gives a deduction for expenditure never capitalised but written off in the period of account in which it is incurred. It is based on paragraph 8 of Schedule 29 to FA 2002.

2002. An example of expenditure within this section might be expenditure on maintaining an asset or expenditure on acquiring an asset which, in the event, proves abortive.

Section 729: Writing down on accounting basis

2003. This section gives a deduction for amounts written off an intangible fixed asset that has been capitalised in the company's accounts. It is based mainly on paragraph 9 of Schedule 29 to FA 2002.

Section 730: Writing down at fixed rate: election for fixed-rate basis

2004. This section gives the option of a writing down deduction at a fixed rate, regardless of the accounting treatment of the intangible fixed asset. It is based on paragraph 10 of Schedule 29 to FA 2002.

2005. The main purpose of this option is to make relief available for the cost of acquiring the most durable of intangible assets which either are not amortised at all in the accounts or are amortised over a very long period. An example of such an asset could be a very strong brand name.

Section 731: Writing down at fixed rate: calculation

2006. This section gives the calculation rule that applies when the fixed rate writing down option is taken under the previous section. It is based on paragraph 11 of Schedule 29 to FA 2002.

Section 732: Reversal of previous accounting gain

2007. This section gives relief if a previous, taxed, accounting gain is reversed. It is based on paragraph 12 of Schedule 29 to FA 2002.

2008. The debit will usually be the same as the accounting loss. If, however, the credit brought into account for the earlier period was different from the accounting gain, the formula in *subsection (3)* ensures that the debit to be recognised is the accounting loss adjusted in the ratio which the earlier credit bears to the earlier accounting gain.

2009. There is a parallel, converse rule in section 725.

Chapter 4: Realisation of intangible fixed assets

Section 733: Overview of Chapter

2010. This section introduces the provisions that provide for credits or debits for tax purposes when an intangible fixed asset is realised. It is based on paragraph 18 of Schedule 29 to FA 2002.

2011. *Subsection (3)* rewrites paragraph 25 of Schedule 29 to FA 2002 as an early signpost to the possibility of roll-over relief in realisation cases.

Section 734: Meaning of "realisation"

2012. This section defines "realisation". It is based on paragraph 19 of Schedule 29 to FA 2002.

2013. Consistent with the underlying principle of this Part, "realisation" is defined by reference to generally accepted accounting practice. Only events which are "realisations" in these terms are within this Chapter. And only events within this Chapter can come within the roll-over rules in Chapter 7 of this Part.

2014. *Subsection (3)* is relevant to assets that have been wholly written off or to assets which have been generated internally (such as goodwill) which cannot be capitalised under generally accepted accounting practice.

Section 735: Asset written down for tax purposes

2015. This section gives the rules quantifying the credit or debit for an intangible fixed asset which has previously been written down for tax purposes. It is based on paragraph 20 of Schedule 29 to FA 2002.

Section 736: Asset shown in balance sheet and not written down for tax purposes

2016. This section gives the rules quantifying the credit or debit for an intangible fixed asset shown in the company's balance sheet and not previously written down for tax purposes. It is based on paragraph 21 of Schedule 29 to FA 2002.

2017. Examples of intangible fixed assets to which this section applies include those sold soon after acquisition.

Section 737: Apportionment in case of part realisation

2018. This section deals with cases where either of the two previous sections apply to a part realisation of an intangible fixed asset. It is based on paragraph 22 of Schedule 29 to FA 2002.

2019. The section determines the appropriate proportion of the tax written-down value or cost of the asset to be set off.

2020. *Subsection (2)* gives a formula that covers both the simple case, where the tax written-down value has not diverged from the book value in the accounts, and the more complicated case where the tax and book values have diverged.

Section 738: Asset not shown in balance sheet

2021. This section deals with cases where the intangible fixed asset that is realised is never shown in the balance sheet. It is based on paragraph 23 of Schedule 29 to FA 2002.

2022. Internally-generated goodwill is probably the most common example of an intangible fixed asset to which this section applies.

Section 739: Meaning of "proceeds of realisation"

2023. This section defines "proceeds of realisation". It is based on paragraph 24 of Schedule 29 to FA 2002.

Section 740: Abortive expenditure on realisation

2024. This section provides for a debit for tax purposes in respect of abortive realisation expenditure. It is based on paragraph 26 of Schedule 29 to FA 2002.

2025. "Abortive" expenditure is expenditure incurred for the purposes of a transaction which would have amounted to a realisation of the intangible fixed asset if it had proceeded to completion. Such expenditure would not be allowable under any other rules.

Section 741: Meaning of "chargeable intangible asset" and "chargeable realisation gain"

2026. This section defines two related key terms used in this Part. It is based on paragraph 137 of Schedule 29 to FA 2002.

Chapter 5: Calculation of tax written-down value

Overview

2027. Identifying the "tax written-down value" of an intangible fixed asset is an essential part of calculating the credit or debit for tax purposes.

2028. This Chapter provides rules to determine the "tax written-down value".

Section 742: Asset written down on accounting basis

2029. This section provides the tax written-down value when the intangible fixed asset has been written down on the accounting basis under section 729. It is based on paragraph 27 of Schedule 29 to FA 2002.

Section 743: Asset written down at fixed rate

2030. This section provides the tax written-down value when the intangible fixed asset has been written down on the fixed-rate basis under section 730. It is based on paragraph 28 of Schedule 29 to FA 2002.

Section 744: Effect of part realisation of asset

2031. This section provides the tax written-down value when there has been a part realisation of the intangible fixed asset. It is based on paragraph 29 of Schedule 29 to FA 2002.

Chapter 6: How credits and debits are given effect

Section 745: Introduction

2032. This section introduces this Chapter which deals with how effect is given to credits and debits brought into account under this Part. It is based on paragraph 30 of Schedule 29 to FA 2002.

2033. In this Part, accounting gains and accounting losses are translated, respectively, into credits and debits for tax purposes. Although all the credits and debits are brought into account as revenue items, different rules govern how they enter the calculation depending on the nature of the business activity for which the intangible fixed asset in respect of which they arise is held.

Section 746: "Non-trading credits" and "non-trading debits"

2034. This section explains two key terms. It is new.

Section 747: Assets held for purposes of trade

2035. This section incorporates the credits and debits directly into the trade profit calculation if the intangible fixed asset is held for the purposes of a trade. It is based on paragraph 31 of Schedule 29 to FA 2002.

Section 748: Assets held for purposes of property business

2036. This section incorporates the credits and debits directly into the property business profit calculation if the intangible fixed asset is held for the purposes of a property business. It is based on paragraph 32 of Schedule 29 to FA 2002.

2037. Paragraph 32(4) of Schedule 29 to FA 2002 has not been rewritten because it is not necessary. It is intended to make clear that losses of a furnished holiday lettings business consisting of Schedule 29 debits are still to be treated as trade losses but it is difficult to see what alternative, without paragraph 32(4), could ensue. Paragraph 32(4) applies the provisions of section 503 of ICTA which treats all a company's lettings of furnished holiday accommodation (as defined in section 504 of ICTA) as a separate and single trade for (and only for) the purposes of loss relief although the income remains chargeable as income from property. But paragraph 32(3) of Schedule 29 to FA 2002 already ensures that the furnished holiday lettings profits and other property profits are kept separate. That being the case, the fact that the debits and credits are (under paragraph 32(1) of Schedule 29 to FA 2002) brought into account as part of the separate furnished holiday lettings business identified by paragraph 32(3) would seem to be enough. Once that has taken place, the general corporation tax loss rules (of which section 503 of ICTA is really part) then apply in the ordinary way to the result.

Section 749: Assets held for purposes of mines, transport undertakings, etc

2038. This section incorporates the credits and debits directly into the profit calculation of a relevant business if the intangible fixed asset is held for the purposes of that business. It is based on paragraph 33 of Schedule 29 to FA 2002.

Section 750: Assets held for purposes falling within more than one section

2039. This section provides an apportionment rule. It is based on paragraph 30 of Schedule 29 to FA 2002.

Section 751: Non-trading gains and losses

2040. This section sets out rules to give effect to non-trading credits and debits. It is based on paragraph 34 of Schedule 29 to FA 2002.

Section 752: Charge to tax on non-trading gains on intangible fixed assets

2041. This section applies the charge to corporation tax on income when there is a non-trading gain under section 751. It is based on section 18 of ICTA.

2042. It is necessary because the general charge label of the source referred to in paragraph 34(4) of Schedule 29 to FA 2002 ("Case VI of Schedule D") ceases to exist in this Act.

Section 753: Treatment of non-trading losses

2043. This section provides for loss relief when there is a non-trading loss under section 751. It is based on paragraph 35 of Schedule 29 to FA 2002.

2044. Relief under this section is subject to a claim in accordance with *subsection (2)* Under the source legislation a discretionary power of extension of the time limit for the claim is exercised by the Commissioners for HMRC. In practice it would be exercised by an officer of HMRC and the Act reflects that. See *Change 1* in Annex 1.

Chapter 7: Roll-over relief in case of realisation and reinvestment

Section 754: The relief: the "old asset" and "other assets"

2045. This section introduces a form of roll-over relief enabling some or all of a credit arising under Chapter 4 of this Part on the realisation of an intangible fixed asset (including goodwill) to be deferred. It is based on paragraph 37 of Schedule 29 to FA 2002.

2046. *Subsection (4)* is new. The rules in this Chapter deal only with mainstream cases where, broadly, assets already within the intangible fixed assets regime are replaced in arm's length transactions by a single company by assets that, on acquisition, are also within the regime. This is the simplest case. Subsection (4) gives a signpost to additional, more complex, rules that deal with those cases involving group company and related party transactions as well as transitional interaction with the capital gains rules.

Section 755: Conditions relating to the old asset and its realisation

2047. This section states the conditions for roll-over relief that must be met in respect of the intangible fixed asset that is replaced. It is based on paragraph 38 of Schedule 29 to FA 2002.

2048. *Subsection (4)* applies to such assets as internally-generated goodwill.

Section 756: Conditions relating to expenditure on other assets

2049. This section states the conditions that must be met in respect of the intangible fixed asset that replaces the old asset. It is based on paragraph 39 of Schedule 29 to FA 2002.

2050. *Subsection (1)* sets a reinvestment period which is subject to discretionary extension. Under the source legislation this power is exercised by the Commissioners for HMRC. In practice it would be exercised by an officer of HMRC and the Act reflects that. See *Change 1* in Annex 1.

Section 757: Claim for relief

2051. This section sets out the required contents of a claim for relief. It is based on paragraph 40 of Schedule 29 to FA 2002.

Section 758: How the relief is given: general

2052. This section states how the relief is given. It is based on paragraph 41 of Schedule 29 to FA 2002.

Section 759: Determination of appropriate proportion of cost and adjusted cost

2053. This section adjusts the cost of the intangible fixed asset that is replaced in cases of part realisation. It is based on paragraph 42 of Schedule 29 to FA 2002.

Section 760: References to cost of asset where asset affected by change of accounting policy

2054. This section modifies the cost of the intangible fixed asset that is replaced, for the purposes of the reinvestment relief rules, in cases where there has been a change of accounting policy resulting in adjustments under Chapter 15 of this Part. It is based on paragraph 42A of Schedule 29 to FA 2002.

Section 761: Declaration of provisional entitlement to relief

2055. This section allows a company reinvestment relief on a provisional basis if it intends to incur expenditure on other assets within the prescribed time limit. It is based on paragraph 43 of Schedule 29 to FA 2002.

Section 762: Realisation and reacquisition

2056. This section treats an intangible fixed asset that is realised and subsequently reacquired as a different asset for the purposes of the reinvestment relief rules. It is based on paragraph 44 of Schedule 29 to FA 2002.

2057. This enables relief to be given where, for example, a company has a change of business plans.

Section 763: Disregard of deemed realisations and reacquisitions

2058. This section gives a general rule that deemed realisations and reacquisitions are ignored for the purposes of the reinvestment relief rules. It is based on paragraph 45 of Schedule 29 to FA 2002.

Chapter 8: Groups of companies: introduction

Section 764: Meaning of "company", "group" and "subsidiary"

2059. This section gives rules of interpretation. It is based on paragraph 46 of Schedule 29 to FA 2002.

Section 765: General rule: a company and its 75% subsidiaries form a group

2060. This section gives the basic group membership rule for the purposes of the intangible fixed assets regime. It is based on paragraph 47 of Schedule 29 to FA 2002.

Section 766: Only effective 51% subsidiaries of principal company to be members of group

2061. This section imposes an additional group requirement for the purposes of the intangible fixed asset rules. It is based on paragraph 48 of Schedule 29 to FA 2002.

2062. *Subsection (2)* is new and gives a signpost to the definition of "effective 51% subsidiary".

Section 767: Principal company cannot be 75% subsidiary of another company

2063. This section gives a general rule that prevents a 75% subsidiary company from being the principal company of a group. It is based on paragraph 49 of Schedule 29 to FA 2002.

2064. *Subsection (3)* defines the only exception to the general rule.

Section 768: Company cannot be member of more than one group

2065. This section gives a general rule that prevents a company from belonging to more than one group for the purposes of the reinvestment relief rules. It is based on paragraph 50 of Schedule 29 to FA 2002.

2066. If a company *is* a member of more than one group, this section sets out tests that are applied sequentially to determine to which group that company belongs for the purposes of the reinvestment relief rules.

Section 769: Continuity of identity of group

2067. This section gives a general rule that preserves the identity of a group as long as the same company remains the principal company of the group. It is based on paragraph 51 of Schedule 29 to FA 2002.

Section 770: Continuity where group includes an SE

2068. This section preserves group identity in certain cases involving the formation of an SE. It is based on paragraph 51A of Schedule 29 to FA 2002.

2069. This provision and the other rules specifically concerning SEs remove any uncertainty about their tax position. The section preserves continuity of group identity in the circumstances set out in *subsection (1)*.

Section 771: Meaning of "effective 51% subsidiary"

2070. This section defines a key term. It is based on paragraph 52 of Schedule 29 to FA 2002.

Section 772: Equity holders and profits or assets available for distribution

2071. This section imports definitions, adapted as necessary, from ICTA. It is based on paragraph 53 of Schedule 29 to FA 2002.

Section 773: Supplementary provisions

2072. This section gives minor supplementary "group" rules. It is based on paragraph 54 of Schedule 29 to FA 2002.

2073. *Subsection (2)* applies certain provisions of TCGA. Those TCGA provisions cover certain statutory bodies created to run an industry (or part of an industry) under public ownership. They include, in particular, those set up under the Transport Acts of 1962 and 1968. The effect of subsection (2) is that they can be treated as companies for the purposes of testing whether their subsidiaries form a group with them.

Chapter 9: Application of this Part to groups of companies

Section 774: Overview of Chapter

2074. This Chapter sets out the special rules that apply to companies that are "grouped" under the rules in Chapter 8 of this Part and this section introduces them. It is new.

Section 775: Transfers within a group

2075. This section allows the transfer of intangible fixed assets on a tax-neutral basis between group members. It is based on paragraph 55 of Schedule 29 to FA 2002.

2076. Without this rule, intra-group transfers, being transactions between related parties, would be regarded as taking place at market value (under section 845) and would trigger the normal realisation rules.

Section 776: Meaning of "tax-neutral" transfer

2077. This section defines a key term. It is based on paragraph 140 of Schedule 29 to FA 2002.

2078. Here and elsewhere in this Part the provisions refer to transfers that *are* tax-neutral rather than, as in the source legislation, transfers that are *treated* as tax-neutral. Since "tax-neutral" is a defined term, the abstractness of the source is not necessary.

Section 777: Relief on realisation and reinvestment: application to group member

2079. This section allows, subject to certain conditions, group members to be treated as the same company for reinvestment relief purposes. It is based on paragraph 56 of Schedule 29 to FA 2002.

2080. *Subsection (3)(e)* aligns the reference in this section to a "dual resident investing company" with other such references in the source legislation (reproduced in this Part) by introducing a signpost to the provision defining that term.

Section 778: Relief on reinvestment: acquisition of group company: introduction

2081. This section, along with section 779, extends reinvestment relief to reinvestment in shares in a company which owns assets within the intangible fixed assets regime. It is based on paragraph 57 of Schedule 29 to FA 2002.

Section 779: Rules that apply to cases within section 778

2082. This section is supplementary to the previous section and provides reinvestment relief for reinvestment in shares in a company which owns assets within the intangible fixed assets regime. It is based on paragraph 57 of Schedule 29 to FA 2002.

Section 780: Deemed realisation and reacquisition at market value

2083. This section provides for a deemed realisation and reacquisition of an asset in certain cases where a company leaves a group following an earlier transfer to it of intangible fixed assets on a tax-neutral basis. It is based on paragraph 58 of Schedule 29 to FA 2002.

2084. It is the first of several sections dealing with degrouping transactions which amount to disposals of the underlying intangible fixed asset by means of a disposal of the shares in the company to which it belongs. They are needed to ensure that such an indirect disposal of intangible fixed assets does not provide a tax advantage over a direct disposal.

2085. The broad effect of these provisions is to recognise a gain or loss deferred on an earlier tax-neutral disposal if the asset in question leaves the group otherwise than by a direct disposal of the asset. The rules achieve this by creating a deemed realisation and reacquisition of the asset by the company at market value immediately after the time it acquired the asset from another group company.

2086. S*ubsection (5)(d)* gives a signpost to an exception to this rule where degrouping is part of a commercially motivated merger the purpose of which is not tax avoidance. Consistent with the approach elsewhere, "bona fide" in the source legislation is rewritten as "genuine".

Section 781: Character of credits and debits brought into account as a result of section 780

2087. This section supplements the previous section to determine how credits and debits are brought into account. It is based on paragraph 58 of Schedule 29 to FA 2002.

Section 782: Certain transferees of businesses etc not treated as leaving group

2088. This section disapplies section 780 in the case of certain European cross-border transfers of business. It is based on paragraph 58 of Schedule 29 to FA 2002.

Section 783: Associated companies leaving group at the same time

2089. This section modifies the effect of section 780 so that, when more than one company degroups at the same time, a degrouping charge arises only in circumstances that

amount to a subsequent effective disposal of the intangible fixed asset. It is based on paragraph 59 of Schedule 29 to FA 2002.

2090. *Subsection (4)* is new and gives a signpost to an exception to this rule where degrouping is part of a commercially motivated merger the purpose of which is not tax avoidance. That exception may be relevant because section 780 is subject to that exception and section 783 merely modifies the effect of section 780.

Section 784: Groups with a relevant connection

2091. This section defines the link between groups that must exist if the previous section is to apply. It is based on paragraph 59 of Schedule 29 to FA 2002.

Section 785: Principal company becoming member of another group

2092. This section modifies the effect of section 780 in cases where degrouping occurs only because the principal company becomes a member of another group: a degrouping charge then arises only in circumstances which amount to a subsequent effective disposal of the intangible fixed asset within six years. It is based on paragraph 60 of Schedule 29 to FA 2002.

Section 786: Character of credits and debits brought into account as a result of section 785

2093. This section supplements the previous section to determine how credits and debits are brought into account. It is based on paragraph 60 of Schedule 29 to FA 2002.

Section 787: Company ceasing to be member of group because of exempt distribution

2094. This section disapplies the degrouping rules in sections 780 and 785 for certain demergers unless there is a "chargeable payment" to members within five years of the related "exempt distribution". It is based on paragraph 61 of Schedule 29 to FA 2002.

2095. *Subsection (5)* gives a signpost to the meaning of terms that are part of the general demergers tax rules.

Section 788: Provisions supplementing sections 780 to 787

2096. This section gives interpretative rules for the degrouping provisions. It is based on paragraphs 63 and 64 of Schedule 29 to FA 2002.

Section 789: Merger carried out for genuine commercial reasons

2097. This section disapplies the degrouping rules in sections 780 to 787 in the case of company mergers where exploitation of the group rules is not the object. It is based on paragraph 62 of Schedule 29 to FA 2002.

2098. The definition of "merger" in paragraph 62 of Schedule 29 to FA 2002 is restructured to make it clearer. This involves relocating some of the detail of the definition in a separate section (section 790).

Section 790: Provisions supplementing section 789

2099. This section gives interpretative provisions to identify a "merger" for the purposes of the preceding section. It is based on paragraph 62 of Schedule 29 to FA 2002.

Section 791: Application of roll-over relief in relation to degrouping charge

2100. This section allows reinvestment relief in cases where a company is treated as realising an intangible fixed asset under the degrouping rules. It is based on paragraph 65 of Schedule 29 to FA 2002.

2101. This is one of the two exceptions to the general rule in section 763 that deemed realisations do not count for the purposes of the reinvestment rules. The other is dealt with in section 794.

Section 792: Reallocation of charge within group

2102. This section provides, subject to certain conditions, for the transfer of a degrouping charge from the company leaving the group to another company in the group it is leaving. It is based on paragraph 66 of Schedule 29 to FA 2002.

2103. This transfer of charge may allow, for example, the charge to be sheltered by reliefs available elsewhere in the main group.

Section 793: Further requirements about elections under section 792

2104. This section sets out the conditions for, and the form of, the election required for the reallocation provided for in the previous section. It is based on paragraph 66 of Schedule 29 to FA 2002.

Section 794: Application of roll-over relief in relation to reallocated charge

2105. This section allows reinvestment relief for the company to which a degrouping charge is transferred under section 792. It is based on paragraph 67 of Schedule 29 to FA 2002.

2106. This is the second of the two exceptions to the general rule in section 763 that deemed realisations do not count for the purposes of the reinvestment rules. The other is dealt with in section 791.

Section 795: Recovery of charge from another group company or controlling director

2107. This section gives alternative rights of recovery if any corporation tax arising from a degrouping charge is not paid within six months of it falling due. It is based on paragraph 68 of Schedule 29 to FA 2002.

Section 796: Interpretation of section 795

2108. This section gives interpretative rules for the previous section. It is based on paragraph 68 of Schedule 29 to FA 2002.

Section 797: Recovery under section 795: procedure etc

2109. This section sets out the procedural aspects of the recovery provision in section 795. It is based on paragraph 69 of Schedule 29 to FA 2002.

Section 798: Recovery under section 795: time limit

2110. This section sets a three year time limit for the service of a recovery notice under section 795. It is based on paragraph 70 of Schedule 29 to FA 2002.

2111. *Subsections (3)* to *(6)* determine the start date of the three year period depending on the origins of the original charge.

Section 799: Disregard of payments between group members for reliefs

2112. This section ensures that a payment by one group company to another for the transfer of relief is left out of account provided it does not exceed the "amount of the relief". It is based on paragraph 71 of Schedule 29 to FA 2002.

Chapter 10: Excluded assets

Section 800: Introduction

2113. Not all assets that might fall within the definition of "intangible fixed asset" are intended to come within the rules in this Part. This section introduces the rules on assets that are excluded. It is new.

Section 801: Right to dispose of or acquire excluded asset also excluded

2114. This section gives an important general extension to the exclusion rules in this Chapter: if an asset is excluded by those rules, so is an option or other right to acquire or dispose of that asset. It is based on paragraph 72 of Schedule 29 to FA 2002.

2115. There is a counterpart, obverse rule in section 713(2).

Section 802: Effect of partial exclusion

2116. This section addresses the case where an asset falls partly within and partly outside the intangible fixed asset rules. It is based on paragraph 72 of Schedule 29 to FA 2002.

Section 803: Non-commercial purposes etc

2117. This section is an exclusion rule of general application which can exclude any asset by reference to the purpose for which it is held. It is based on paragraph 77 of Schedule 29 to FA 2002.

2118. This section is necessary because the intangible fixed assets regime is largely autonomous and does not contain general calculation rules that apply elsewhere for corporation tax such as the prohibition of a deduction for expenses not incurred wholly and exclusively for the purposes of a trade. Without this rule there would be no test of purpose or commerciality for non-trading gains and losses.

Section 804: Assets for which capital allowances previously made

2119. This section excludes entirely assets in respect of which capital allowances have previously been made. It is based on paragraph 73A of Schedule 29 to FA 2002.

Section 805: Rights over tangible assets

2120. This section excludes rights over tangible assets. It is based on paragraph 73 of Schedule 29 to FA 2002.

Section 806: Financial assets

2121. This section excludes financial assets. It is based on paragraph 75 of Schedule 29 to FA 2002.

2122. *Subsection (3)* lists the main financial assets but is not intended to be exhaustive.

Section 807: Rights in companies, trusts etc

2123. This section excludes shares and other rights in companies, rights under a trust and the interest of a partner in a partnership. It is based on paragraph 76 of Schedule 29 to FA 2002.

2124. *Subsections (2)* and *(3)* provide for exceptions that follow the accounting treatment. They are exceptions to an exclusion, so the assets they refer to come within the intangible fixed assets regime.

Section 808: Assets representing production expenditure on films

2125. This section excludes certain expenditure on films. It is based on paragraph 80A of Schedule 29 to FA 2002.

Section 809: Oil licences

2126. This section excludes oil licenses. It is based on paragraph 74 of Schedule 29 to FA 2002.

2127. Oil licences are potentially only transitory intangible assets in that they may subsequently be charged to a tangible asset account representing successful exploration costs. They are outside the accountancy definition of goodwill and intangible assets and are subject to their own industry reporting standard.

Section 810: Mutual trade or business

2128. This section excludes, except as respects royalties, intangible fixed assets to the extent they are held for the purposes of a mutual trade or business. It is based on paragraph 79 of Schedule 29 to FA 2002.

2129. *Subsection (2)* is new. It gives a signpost to an exception relevant to certain insurance companies.

Section 811: Sound recordings

2130. This section excludes, except as regards royalties, intangible fixed assets to the extent they represent certain expenditure on sound recordings. It is based on paragraph 80B of Schedule 29 to FA 2002.

Section 812: Master versions of films

2131. This section excludes certain recent film expenditure from the intangible fixed assets regime. It is based on paragraph 80A of Schedule 29 to FA 2002.

Section 813: Computer software treated as part of cost of related hardware

2132. This section excludes, except as regards royalties, intangible fixed assets to the extent they represent expenditure on certain computer software. It is based on paragraph 81 of Schedule 29 to FA 2002.

2133. Software acquired with the related hardware is not treated as an intangible asset under accountancy rules, so it is excluded from the intangible fixed assets regime.

Section 814: Research and development

2134. This section limits the application of the rules in this Part to the extent specified where intangible fixed assets represent expenditure on research and development. It is based on paragraph 82 of Schedule 29 to FA 2002.

Section 815: Election to exclude capital expenditure on software

2135. This section, if the company so elects, limits the application of the rules in this Part to the extent specified where intangible fixed assets represent capital expenditure on computer software. It is based on paragraph 83 of Schedule 29 to FA 2002.

2136. This section sets out the substantive rule and its tax effects. This rule reflects the existence of capital allowances rules that would normally offer a company more

beneficial relief. The election switches off the intangible fixed assets rules in this Part that would otherwise override those capital allowances rules.

2137. *Subsection (8)* is new. It gives a signpost to the extension of the right to make an election under this section to some insurance companies.

Section 816: Further provision about elections under section 815

2138. This section gives procedural rules in respect of the election under the preceding section. It is based on paragraph 83 of Schedule 29 to FA 2002.

Chapter 11: Transfer of business or trade

Section 817: Overview of Chapter

2139. This section introduces the rules that allow transfers of intangible fixed assets to be made on a tax-neutral or other tax advantageous basis when they are made as part of certain transfers of businesses. It is new.

2140. The purpose of these rules is to ensure continuity or consistency of treatment where those assets change hands in the course of genuine commercial business reorganisations.

2141. *Subsection (2)* gives a signpost to provisions dealing with the "genuine commercial transaction requirement". This requirement limits the application of the reliefs under this Chapter to cases where the transfer is not motivated by tax avoidance.

Section 818: Company reconstruction involving transfer of business

2142. Where there are certain transfers of a business (or part of a business) as part of a company reconstruction, this section allows the tax-neutral transfer of intangible fixed assets that are within the intangible fixed asset rules. It is based on paragraph 84 of Schedule 29 to FA 2002.

2143. A "tax-neutral transfer" is defined in section 776.

Section 819: European cross-border transfers of business: introduction

2144. This section introduces the rule in section 820 providing for the tax-neutral transfer of assets in the case of certain European cross-border transfers of business and states the main conditions for it to apply. It is based on paragraph 85 of Schedule 29 to FA 2002.

Section 820: Transfer of assets on European cross-border transfer of business

2145. This section provides for the tax-neutral transfer of assets in the case of certain European cross-border transfers of business. It is based on paragraph 85 of Schedule 29 to FA 2002.

Section 821: European cross-border mergers: introduction

2146. This section introduces the rule in section 822 providing for the tax-neutral transfer of assets in the case of certain European cross-border mergers and states the main conditions for it to apply. It is based on paragraph 85A of Schedule 29 to FA 2002.

Section 822: Transfer of assets on European cross-border merger

2147. This section provides for the tax-neutral transfer of assets in the case of certain European cross-border mergers. It is based on paragraph 85A of Schedule 29 to FA 2002.

Section 823: Interpretation of sections 821 and 822

2148. This section gives rules of interpretation relevant to the two preceding sections. It is based on paragraph 85A of Schedule 29 to FA 2002.

Section 824: Transfer of business of building society to company

2149. This section allows the tax-neutral transfer of intangible fixed assets within the intangible fixed assets rules when the business of a building society is transferred to a company. It is based on paragraph 90 of Schedule 29 to FA 2002.

Section 825: Application of sections 780 and 785 where transfer within section 824 occurs

2150. This section relaxes certain degrouping rules in Chapter 9 of this Part on the transfer of a building society's business to a company. It is based on paragraph 90 of Schedule 29 to FA 2002.

Section 826: Amalgamation of, or transfer of engagements by, certain societies

2151. This section allows the tax-neutral transfer between certain societies of intangible fixed assets within the intangible fixed assets rules when the transfer is part of an amalgamation of the societies or when the whole or a part of the business of one society is transferred to the other ("a transfer of engagements"). It is based on paragraph 91 of Schedule 29 to FA 2002.

Section 827: Claims to postpone charge on transfer

2152. This section sets out the circumstances under which a charge under this Part can be postponed when a trade is transferred to a non-UK resident company. It is based on paragraph 86 of Schedule 29 to FA 2002.

Section 828: Relief on transfer

2153. This section sets out the effect of the section 827 postponement of charge. It is based on paragraph 86 of Schedule 29 to FA 2002.

Section 829: Charge on subsequent realisations

2154. This section provides for a whole or partial reinstatement of the charge postponed under 827. It is based on paragraph 86 of Schedule 29 to FA 2002.

Section 830: Exclusion from section 829 of group transfers

2155. This section allows transfers, subsequent to the transfer of the trade under 827, of assets between group members without triggering the reinstatement rules in section 829. It is based on paragraph 86 of Schedule 29 to FA 2002.

Section 831: The genuine commercial transaction requirement and clearance

2156. This section states the genuine commercial transaction conditions and provides for an advance clearance procedure in respect of it. It is based on paragraph 84 of Schedule 29 to FA 2002.

2157. Many of the relieving provisions in Part 11 of Schedule 29 to FA 2002 are conditional on the transactions involved not having an avoidance purpose. And to provide certainty to those contemplating a transaction they provide for an advance clearance application. In the source legislation these matters are repeated in each relieving provision to which they apply. Rather than rewrite the same condition and clearance as part of each of the sections to which they apply, they are rewritten only once, in this section, and

applied, where appropriate, by reference, in the sections to which they are relevant, to the "genuine commercial transaction requirement".

2158. *Subsection (3)* defines the "appropriate applicant" referred to in *subsection (2)*. The source legislation defines in each relevant paragraph who should make the clearance application. Rewriting the clearance rule only once (as described in the previous paragraph) necessitates identification of the appropriate applicant depending on the transaction in respect of which the application is to be made.

Section 832: Procedure on application for clearance

2159. This section deals with procedural matters in respect of the clearance application under the previous section. It is based on paragraph 88 of Schedule 29 to FA 2002.

Section 833: Decision on application for clearance

2160. This section deals with the outcome of a clearance application under section 831. It is based on paragraph 88 of Schedule 29 to FA 2002.

Chapter 12: Related parties

Section 834: Overview of Chapter

2161. This section introduces the Chapter that gives rules to determine whether parties to a transaction are "related parties" and therefore subject to special rules (set out in Chapter 13 of this Part). It is new.

2162. The approach in this Act to "related parties" differs in two ways from that in the source legislation.

2163. First, the provisions that define who are "related parties" *precede* the rules that then apply to them.

2164. Second, those two groups of rules are separated into different Chapters.

Section 835: "Related party"

2165. This section defines "related party". It is based on paragraph 95 of Schedule 29 to FA 2002.

2166. The definition depends on terms that are defined in the eight sections that immediately follow this section.

Section 836: "Control"

2167. This section defines "control" for the related party rules. It is based on paragraph 96 of Schedule 29 to FA 2002.

Section 837: "Major interest"

2168. This section defines "major interest" for the related party rules. It is based on paragraph 96 of Schedule 29 to FA 2002.

Section 838: General rule

2169. This section gives a general rule about the attribution of rights and powers for the related party rules. It is based on paragraph 97 of Schedule 29 to FA 2002.

Section 839: Rights and powers held jointly

2170. This section gives a further rule about the attribution of rights and powers, held jointly, for the related party rules. It is based on paragraph 98 of Schedule 29 to FA 2002.

Section 840: Partnerships

2171. This section gives a further rule about the attribution of rights and powers for the related party rules. It is based on paragraph 99 of Schedule 29 to FA 2002.

Section 841: "Participator" and "associate"

2172. This section defines certain terms used in the related party rules. It is based on paragraph 100 of Schedule 29 to FA 2002.

Section 842: Introduction

2173. This section introduces the rules that determine whether a person is connected with another for the purposes of the related party rules. It is based on paragraph 101 of Schedule 29 to FA 2002.

Section 843: Who are connected persons

2174. This section states which persons are connected for the purposes of the related party rules. It is based on paragraph 101 of Schedule 29 to FA 2002.

Chapter 13: Transactions between related parties

Section 844: Overview of Chapter

2175. This section gives a "route map" of the Chapter. It is new.

2176. The Chapter sets out the special rules that apply to transactions between persons who are "related parties" within the meaning of the rules in Chapter 12 of this Part.

Section 845: Transfer between company and related party treated as at market value

2177. This section gives the main related party, market value rule. It is based on paragraph 92 of Schedule 29 to FA 2002.

2178. Paragraph 92 of Schedule 29 to FA 2002 also sets out the exceptions to the basic rule. When the intangible fixed assets rules were first introduced there were only two exceptions. But, subsequently, further exceptions were added and the paragraph grew in both length and complexity with little commonality in the substance of the exceptions. It is therefore rewritten in five sections in this Act, the first stating the basic market value rule and the four immediately following stating the exceptions.

Section 846: Transfers not at arm's length

2179. This section disapplies the market value rule in section 845 when a transfer falls within the provisions mentioned because it is not at arm's length. It is based on paragraph 92 of Schedule 29 to FA 2002.

Section 847: Transfers involving other taxes

2180. This section partially disapplies the market value rule in section 845 in prescribed circumstances. It is based on paragraph 92 of Schedule 29 to FA 2002.

2181. Where the section has effect, it is only in respect of the party to the transaction that is *not* within the intangible fixed asset rules.

Section 848: Tax-neutral transfers

2182. This section disapplies the market value rule in section 845 when the transfer is "tax-neutral" within the meaning of this Part. It is based on paragraph 92 of Schedule 29 to FA 2002.

Section 849: Transfers involving gifts of business assets

2183. This section disapplies the market value rule in section 845 when the transfer is a gift of a business asset qualifying for relief under the capital gains rules. It is based on paragraph 92 of Schedule 29 to FA 2002.

Section 850: Part realisation involving related party acquisition: exclusion of roll-over relief

2184. This section prohibits roll-over relief under Chapter 7 of this Part if an intangible fixed asset is partly realised and an interest in it is acquired by a related party. It is based on paragraph 93 of Schedule 29 to FA 2002.

Section 851: Delayed payment of royalty by company to related party

2185. This section gives a timing rule for the deduction of a royalty paid to a related party. It is based on paragraph 94 of Schedule 29 to FA 2002.

2186. The effect of *subsection (2)* is to bring approximate symmetry to the timing of the charge on the recipient of the royalty and relief for the payer.

Chapter 14: Miscellaneous provisions

Overview

2187. This Chapter groups together a number of miscellaneous rules, many of relatively limited or specialised application.

Section 852: Treatment of grants and other contributions to expenditure

2188. This section brings grants and other contributions in respect of intangible fixed assets into account. It is based on paragraph 102 of Schedule 29 to FA 2002.

2189. S*ubsection (2)* refers to a gain recognised in the profit and loss account. This includes amounts recognised separately as incomings or netted off against expenditure.

Section 853: Grants to be left out of account for tax purposes

2190. This section excludes from the previous section certain grants made out of UK public funds. It is based on paragraph 103 of Schedule 29 to FA 2002.

Section 854: Finance leasing etc

2191. This section provides for finance leased intangible fixed assets to be brought within this Part, in respect of the lessor. It is based on paragraph 104 of Schedule 29 to FA 2002.

2192. The rules in this Part apply automatically without adaptation to a finance leased intangible fixed asset of the lessee in the same way as they would if the asset were simply purchased with the aid of a loan. But special provisions are required to bring finance leased assets within the scope of this Part for the lessor**.** That is because finance leases are, for the lessor, financial assets and financial assets are excluded by section 806(1).

Section 855: Further provision about regulations under section 854

2193. This section states the regulations that may be made in respect of finance leased intangible fixed assets under section 854. It is based on paragraph 104 of Schedule 29 to FA 2002.

2194. Regulations have been made and are in SI 2002/1967.

Section 856: Assets acquired or realised together

2195. This section requires individual values to be allocated to assets acquired or realised together with others as part of the same bargain. It is based on paragraph 105 of Schedule 29 to FA 2002.

Section 857: Deemed market value acquisition: adjustment where nil accounting value

2196. This section provides for accounting entries based on market value for the purposes of the calculation rules. It is based on paragraph 106 of Schedule 29 to FA 2002.

2197. This section is relevant when an intangible fixed asset is transferred at a nil accounting value but is treated under the rules in this Part as acquired at market value. The most common example is internally-generated goodwill.

Section 858: Fungible assets

2198. This section gives a "single asset" rule for assets that are "fungible". It is based on paragraph 107 of Schedule 29 to FA 2002.

2199. *Subsection (2)* defines "fungible assets". An example (from the dairy farming industry) is milk quota.

Section 859: Asset ceasing to be chargeable intangible asset: deemed realisation at market value

2200. This section gives a market value deemed realisation and reacquisition rule in three particular cases. It is based on paragraph 108 of Schedule 29 to FA 2002.

2201. *Subsection (2)* lists the cases to which the section applies. In each, without changing ownership, the asset ceases to be a "chargeable intangible asset". That is, any gain on realisation would cease to fall within the intangible fixed assets rules (see section 741).

2202. There is an obverse rule in section 863 which applies when an asset *becomes* a chargeable intangible asset.

Section 860: Asset ceasing to be chargeable intangible asset: postponement of gain

2203. This section gives relief in certain cases where section 859(2)(a) applies. It is based on paragraph 109 of Schedule 29 to FA 2002.

Section 861: Treatment of postponed gain on subsequent realisation

2204. This section recovers the relief given under section 860 if there is a subsequent realisation of the intangible fixed asset within six years of the company ceasing to be UK resident. It is based on paragraph 109 of Schedule 29 to FA 2002.

Section 862: Treatment of postponed gain in other cases

2205. This section recovers the relief given under section 860 in three other particular cases. It is based on paragraph 109 of Schedule 29 to FA 2002.

Section 863: Asset becoming chargeable intangible asset

2206. This section gives an accounting value deemed acquisition rule in three particular cases. It is based on paragraph 110 of Schedule 29 to FA 2002.

2207. *Subsection (1)* lists the cases to which the section applies. In each, without changing ownership, the asset becomes a "chargeable intangible asset". That is, any gain on realisation would fall within the intangible fixed assets rules (see section 741).

2208. This is the obverse of the rule in section 859 which applies when an asset *ceases* to be a chargeable intangible asset.

Section 864: Tax avoidance arrangements to be ignored

2209. This section neutralises the effect on the calculations where there are transactions intended to exploit the intangible fixed asset rules. It is based on paragraph 111 of Schedule 29 to FA 2002.

2210. If "tax avoidance arrangements" are entered into they are ignored in calculating entitlement to credits and debits in respect of intangible fixed assets.

Section 865: Debits for expenditure not generally deductible for tax purposes

2211. This section applies some general rules, outside this Part, which restrict deductions. It is based on paragraph 112 of Schedule 29 to FA 2002.

Section 866: Delayed payment of employees' remuneration

2212. This section prevents a deduction for employees' remuneration paid late. It is based on paragraph 113 of Schedule 29 to FA 2002.

2213. It is possible, in certain circumstances, for employees' remuneration to come within the intangible fixed asset rules. An example might be the remuneration of staff employed in promoting a company's product brands. If the remuneration is not paid within nine months from the end of the accounting period for which it is charged in the accounts, paragraph 113 of Schedule 29 to FA 2002 defers the tax deduction for that remuneration until it is paid.

2214. Paragraph 113 of Schedule 29 to FA 2002 is modelled on section 43 of FA 1989 which applies the same restriction outside this Part to other income types. For income tax, section 43 was rewritten in sections 36 and 37 of ITTOIA as two sections. For clarity and consistency that model is followed for corporation tax. This section rewrites that part of paragraph 113 of Schedule 29 to FA 2002 that states the main restriction and, in so doing, is consistent with the approach to rewriting section 43 of FA 1989.

Section 867: Provisions supplementing section 866

2215. This section gives interpretative and other supporting rules for the previous section. It is based on paragraph 113 of Schedule 29 to FA 2002.

2216. *Subsection (5)* rewrites paragraph 113(5) of Schedule 29 to FA 2002 and contains a Change. *Subsection (4)* deals with the case in which the company submits its tax return before the end of the nine months period mentioned in section 866(2) and all or any of the remuneration is unpaid. The company must assume the remuneration will remain unpaid. If, subsequently, the remuneration is paid within the time limit the calculation can be adjusted and the return amended. This Act drops the requirement under paragraph 113(5) of a claim for that adjustment. This mirrors the rewrite of section 43(5) of FA 1989 as a general calculation rule in section 1289(3). See *Change 68* in Annex 1.

Section 868: Delayed payment of pension contributions

2217. This section delays a deduction for employees' pension contributions paid late. It is based on paragraph 114 of Schedule 29 to FA 2002.

Section 869: Bad debts etc

2218. This section gives special rules applying to debts. It is based on paragraph 115 of Schedule 29 to FA 2002.

2219. The rules in paragraph 115 of Schedule 29 to FA 2002 correspond to general rules that apply outside this Part; that is, the rules in sections 88D and 94 of ICTA rewritten in Part 3 (trading income).

Section 870: Assumptions for calculating chargeable profits

2220. This section gives special rules when this Part applies to a "controlled foreign company". It is based on paragraph 116 of Schedule 29 to FA 2002.

Chapter 15: Adjustments on change of accounting policy

Overview

2221. This Chapter rewrites the rules in Part 13A of Schedule 29 to FA 2002. Part 13A gives rules dealing with a company's change of accounting policy where it affects assets within the intangible fixed assets regime.

2222. Part 13A of Schedule 29 to FA 2002 applies, in particular, when a company changes between UK generally accepted accounting practice and International Accounting Standards. It ensures that any change in accounting value of the assets resulting from the change of accounting policy will be brought into account for tax purposes.

Section 871: Introduction to Chapter

2223. This section explains when the rules in this Chapter apply. It is based on paragraph 116A of Schedule 29 to FA 2002.

Section 872: Adjustments in respect of change

2224. This section provides for an adjustment when the value of an intangible fixed asset changes as a result of a change of accounting policy. It is based on paragraph 116B of Schedule 29 to FA 2002.

2225. This section provides for the change in value to translate into a corresponding credit or debit.

Section 873: Effect of application of section 872 in later period and subsequently

2226. This section sets out the effects of an adjustment under the previous section. It is based on paragraph 116B of Schedule 29 to FA 2002.

Section 874: Original asset not subject to fixed-rate writing down

2227. This section provides for an adjustment when a change of accounting policy results in one intangible fixed asset being treated as two or more assets and gives the calculation rules. It is based on paragraph 116C of Schedule 29 to FA 2002.

Section 875: Effect of application of section 874 in later period and subsequently

2228. This section sets out the effects of an adjustment under the previous section. It is based on paragraph 116C of Schedule 29 to FA 2002.

Section 876: Original asset subject to fixed-rate writing down

2229. This section ensures the calculation rules work properly when a change of accounting policy results in an intangible fixed asset that was subject to a fixed-rate writing down election under section 730 being treated as two or more assets. It is based on paragraph 116D of Schedule 29 to FA 2002.

2230. It gives rules:

- to apportion the former tax written-down value of the original intangible fixed asset to each disaggregated asset on the basis of the ratio of their new accounting values; and
- to determine how written-down value and cost recognised for tax purposes will be identified subsequently.

2231. The election under section 730 in respect of the original intangible fixed asset applies to that asset for the period prior to the change and to each of the disaggregated assets subsequently.

Section 877: Election for fixed-rate writing down in relation to resulting asset

2232. This section allows a fixed rate writing down election under section 730 to be made in respect of disaggregated assets and gives calculation rules to deal with the effects. It is based on paragraph 116E of Schedule 29 to FA 2002.

Section 878: Exclusion of credits or debits brought into account under other provisions

2233. This section prevents double counting and gives priority to other rules in this Part where double counting might otherwise arise. It is based on paragraph 116G of Schedule 29 to FA 2002.

Section 879: Subsequent events affecting asset subject to adjustment under this Chapter

2234. This section gives rules on subsequent accounting adjustments in respect of intangible fixed assets which have already been subject to the provisions of this Chapter on a change of accounting policy. It is based on paragraph 116H of Schedule 29 to FA 2002.

Chapter 16: Pre-FA 2002 assets etc

Overview

2235. The sections in this Chapter are based on the provisions in Part 14 of Schedule 29 to FA 2002 "Commencement and transitional provisions" and some of the key terms used in the source legislation have been revised.

2236. There are two tests which together determine whether an asset can come within this Part of the Act. The first is that the asset must be goodwill or an intangible fixed asset for accountancy purposes and not fall within certain statutory exceptions.

2237. The second brings within the scope of this Part only those intangible fixed assets which:

- came into existence on or after 1 April 2002; or
- were acquired directly or indirectly from independent parties on or after that date.

2238. Assets in existence before 1 April 2002 remain outside this Part and subject to general corporation tax rules for as long as they remain within the same economic family as they did before that date. This basic rule is subject to a number of exceptions.

2239. The source legislation identifies intangible fixed assets that do not fall within the regime as "existing assets" and the law which governs their tax treatment as the "existing law". This Part replaces these terms with new, more appropriate terms.

Section 880: Overview of Chapter

2240. This section gives a "route map" of the Chapter and introduces a revised approach to some key terms. It is new.

Section 881: Meaning of "pre-FA 2002 assets"

2241. This section defines a key term. It is new.

2242. This and section 880 together replace paragraph 117 of Schedule 29 to FA 2002 as a general introduction to the intangible fixed assets regime. The focus of paragraph 117 of Schedule 29 is the "commencement date", that is the date at which the intangible fixed assets regime came into force: 1 April 2002. And it refers to the law which applied up to that date as "the existing law". This Part revises the approach to both these concepts.

2243. This Part drops "the commencement date" as a defined term, throughout the rules and refers instead directly to 1 April 2002 on each occasion that such reference is necessary.

2244. This Part also drops the expression "the existing law" and refers to "the pre-FA 2002 law". Similarly dropped is the related expression "existing assets" (defined in paragraph 118(3) of Schedule 29 to FA 2002) in favour of "pre-FA 2002 assets" (defined in this section).

Section 882: Application of this Part to assets created or acquired on or after 1 April 2002

2245. This section gives the general timing rule to identify which assets come within this Part. It is based on paragraph 118 of Schedule 29 to FA 2002.

Section 883: Assets treated as created or acquired when expenditure incurred

2246. This section defines when an asset is created or acquired for the purposes of section 882: when the expenditure is incurred. It is based on paragraph 120 of Schedule 29 to FA 2002.

Section 884: Internally-generated goodwill: time of creation

2247. This section gives a special rule defining when internally-generated goodwill is created for the purposes of section 882. It is based on paragraph 121 of Schedule 29 to FA 2002.

Section 885: Certain other internally-generated assets: time of creation

2248. This section gives a special rule defining when internally-generated assets (other than goodwill) not qualifying for capital allowances, are created for the purposes of section 882. It is based on paragraph 122 of Schedule 29 to FA 2002.

Section 886: Assets representing production expenditure on films: time of creation

2249. This section gives a special rule defining when an asset representing production expenditure on films is treated as created for the purposes of section 882. It is based on section 51(2) of FA 2006.

Section 887: General rule

2250. This section gives a general rule to define when expenditure on acquisition of an asset is incurred for the purposes of section 883 and, ultimately, section 882. It is based on paragraph 123 of Schedule 29 to FA 2002.

2251. The general rule in *subsection (1)* is subject to two qualifications to which *subsection (2)* gives a signpost and which limit any conflict with pre-FA 2002 timing rules for capital gains and capital allowances.

Section 888: Cases where chargeable gains rule applies

2252. This section qualifies the rule in section 887 in respect of certain expenditure that would not have qualified for any form of tax relief under the pre-FA 2002 law. It is based on paragraph 124 of Schedule 29 to FA 2002.

2253. Goodwill is an example of an asset potentially within this rule.

2254. If the expenditure does not fall within *subsection (1)(c)* (that is, it would have been treated as incurred on or after 1 April 2002 for capital gains purposes) this section is not in point and the general rule in section 887 applies to the expenditure.

Section 889: Cases where capital allowances general rule applies

2255. This section qualifies the rule in section 887 in respect of certain expenditure that would, before FA 2002, have qualified for relief under the capital allowances provisions. It is based on paragraph 125 of Schedule 29 to FA 2002.

2256. A patent is an example of an asset potentially within this rule.

2257. This section replicates the general rule for capital allowances in section 5 of CAA.

Section 890: Fungible assets: application of section 858

2258. This section provides for separate pools of fungible assets in order that expenditure on them after 1 April 2002 can come within this Part. It is based on paragraph 126 of Schedule 29 to FA 2002.

2259. This and the next section complement section 858 which treats fungible assets held by the same person in the same capacity as indistinguishable parts of a single asset. An example of a fungible asset is a milk quota which grows or diminishes as additional assets of the same kind are acquired or realised. So successive acquisitions are treated as increasing the size of the single asset, whereas a disposal of some, but not all, of the units comprising the single asset is treated as a part realisation.

2260. The general principle of the intangible fixed assets rules is that only expenditure on or after 1 April 2002 should come within the regime. But without further rules this would not be achieved for fungible assets. If fungible assets of a particular kind are held by a company before 1 April 2002 any additional assets of that kind acquired subsequently would fail the time test in section 882 because the acquisitions would be regarded as merely enlarging an existing single asset.

2261. The separate pool approach of this section enables the time test in section 882 to be satisfied by fungible assets acquired on or after 1 April 2002 which are additions to assets of the same kind.

Section 891: Realisation and acquisition of fungible assets

2262. This section gives identification rules for transactions involving fungible assets treated as comprising separate pools under the previous section. It is based on paragraph 126 of Schedule 29 to FA 2002.

2263. Identification rules are necessary to determine which of the two pools a transaction in fungible assets diminishes or expands. And they are also necessary because the nature of fungible assets is such that it could often be relatively easy to dispose of an asset of this kind held before 1 April 2002 and replace it immediately afterwards with a newly acquired, identical asset. The intangible fixed assets rules are not intended to apply to assets “recycled” in this way.

Section 892: Certain assets acquired on transfer of business

2264. This section preserves symmetry of tax treatment between the intangible fixed assets rules and the capital gains rules on certain transfers of intangible fixed assets that are outside the intangible fixed assets regime. It is based on paragraph 127 of Schedule 29 to FA 2002.

2265. The capital gains provisions listed in *subsection (2)* allow a no gain/no loss treatment on the transferor of an intangible asset to a transferee who is not a related party. Without

a special rule, in the circumstances described in *subsection (1)*, the asset transferred would be within this Part in the hands of the transferee and carry an acquisition cost based on the "fair value" of the asset in the accounts of the transferee. This could result in relief under this Part being available on a sum that was not liable to tax in the hands of the transferor.

2266. To avoid this mismatch between the treatment of the transferor and the transferee, this section ensures that the asset transferred in these circumstances is excluded from this Part in the hands of the transferee as well as the transferor. The asset remains within the capital gains rules in the hands of the transferee, with an acquisition cost equal to the transferor's disposal value.

Section 893: Assets whose value derives from pre-FA 2002 assets

2267. This section excludes certain assets from the intangible fixed assets rules to the extent that they derive their value from excluded assets. It is based on paragraph 127A of Schedule 29 to FA 2002..

2268. *Subsection (1)(e)* introduces a new term ("the preserved status conditions") to refer to the conditions set out in section 894.

Section 894: The preserved status conditions etc

2269. This section defines a key term in the previous section. It is based on paragraph 127A of Schedule 29 to FA 2002.

Section 895: Assets acquired in connection with disposals of pre-FA 2002 assets

2270. This section excludes certain assets from the intangible fixed assets rules if acquired from a related party in connection with the disposal of other excluded assets. It is based on paragraph 127B of Schedule 29 to FA 2002.

Section 896: Application to royalties

2271. This section brings royalties within the intangible fixed assets regime. It is based on paragraph 119 of Schedule 29 to FA 2002.

2272. This section rewrites only those parts of paragraph 119 of Schedule 29 to FA 2002 which have enduring effect and are not transitional.

2273. Paragraph 119(2) to (4) of Schedule 29 to FA 2002 ensures the correct tax treatment of royalties during the transitional period spanning 1 April 2002. They are spent and are not rewritten.

Section 897: Application to pre-FA 2002 assets consisting of telecommunication rights

2274. This section brings certain telecommunication rights within the intangible fixed assets regime. It is based on paragraph 128 of Schedule 29 to FA 2002.

2275. *Subsection (2)* ensures that the intangible fixed assets rules work properly for telecommunication rights dealt with under a previous special tax regime.

2276. Paragraph 128(4) of Schedule 29 to FA 2002 is spent and is not rewritten.

Section 898: Relief where assets disposed of on or after 1 April 2002

2277. This section extends roll-over relief under Chapter 7 of this Part to the disposal of certain intangible fixed assets otherwise remaining within the capital gains rules. It is based on paragraph 130 of Schedule 29 to FA 2002.

2278. The effect of this section is that the "amount available for relief" (in section 758(1)) reduces the company's consideration received for the existing asset for the purposes of the capital gains rules and the tax cost of the new asset.

Section 899: Relief where degrouping charge on asset arises on or after 1 April 2002

2279. This section extends roll-over relief under Chapter 7 of this Part to the deemed disposal of certain intangible fixed assets otherwise remaining within the capital gains rules. It is based on paragraph 131 of Schedule 29 to FA 2002.

2280. It applies when a capital gains degrouping charge under section 179 of TCGA arises on the deemed disposal of intangible fixed assets which would have come within the intangible fixed assets rules had they not been pre-FA 2002 assets and when the event triggering the degrouping charge is on or after 1 April 2002.

2281. The effect of this section is that the "amount available for relief" (in section 758(1)) reduces the company's consideration deemed received for the pre-FA 2002 asset for the purposes of the capital gains rules and the tax cost of the new asset.

Section 900: Meaning of "chargeable asset within TCGA" in sections 898 and 899

2282. This section defines the key term used in the two preceding sections. It is based on paragraph 130 of Schedule 29 to FA 2002.

2283. *Subsection (3)* substitutes a cross-reference to section 10B of TCGA for the cross-reference to section 10(3) of TCGA in the source legislation. Section 10(3) was repealed in FA 2003 and replaced by section 10B. The substitution in this section reflects the implied substitution by section 17(2)(a) of the Interpretation Act 1978 and so preserves the effect of the source legislation.

Chapter 17: Insurance companies

Overview

2284. The sections in this Chapter rewrite a small number of provisions in Schedule 29 of FA 2002 that apply only to insurance companies.

Section 901: Effect of application of the I minus E basis: non-trading amounts

2285. This section ensures that credits and debits referable to life assurance business are taxed in a way consistent with the I minus E basis. It is based on paragraph 36 of Schedule 29 to FA 2002.

Section 902: Excluded assets

2286. This section gives particular excluded asset rules that apply to an insurance company with life assurance business. It is based on paragraph 78 of Schedule 29 to FA 2002.

Section 903: Elections to exclude capital expenditure on computer software

2287. This section extends the right to elect under section 815 for exclusion of capital expenditure on computer software to insurance companies with life assurance business. It is based on paragraph 83 of Schedule 29 to FA 2002.

Section 904: Transfers of life assurance business: transfers of assets treated as tax-neutral

2288. This section allows the tax-neutral transfer of intangible fixed assets within the rules in this Part where those assets are included in certain transfers of life assurance business between insurance companies. It is based on paragraph 89 of Schedule 29 to FA 2002.

Section 905: Pre-FA 2002 assets: Lloyd's syndicate capacity

2289. This section integrates intangible fixed assets within the income regime syndicate capacity rules in FA 1994 into the intangible fixed assets rules in this Part. It is based on paragraph 129 of Schedule 29 to FA 2002.

Chapter 18: Priority rules

Section 906: Priority of this Part for corporation tax purposes

2290. This section states the priority of the provisions in this Part over other tax rules. It is based on paragraph 1(3) of Schedule 29 to FA 2002.

Part 9: Intellectual property: know-how and patents

Overview

2291. This Part rewrites some special provisions in Chapter 1 of Part 13 of ICTA which charge to corporation tax certain receipts from intellectual property. The corresponding rules for income tax are in Chapter 2 of Part 5 of ITTOIA.

2292. This Part applies to capital sums arising from the disposal of know-how in certain circumstances and capital sums from the sale of patent rights.

2293. This Part does not rewrite those parts of the provisions in Chapter 1 of Part 13 of ICTA which apply to trades (such as section 531(1) to (3) of ICTA). Such parts of the source provisions are rewritten in Chapter 13 of Part 3 of this Act.

2294. This Part does not apply to amounts arising from intangible fixed assets within Part 8 of this Act. The rules in Chapter 16 of Part 8 define which assets and amounts come within Part 8. If an asset is within Part 8 that Part gives all the tax rules that apply.

2295. The rules in this Part largely mirror the corresponding rules for income tax and bring the corporation tax provisions back into line with their income tax counterparts. Where there are differences between the two they derive mainly from the way in which the two taxes are charged and the possibility that accounting periods, unlike tax years, will not be of 12 months duration.

Chapter 1: Introduction

Section 907: Overview of Part

2296. This section introduces the charges applied by the Part. It is new.

2297. *Subsections (4)* and *(5)* alert readers to the primacy of the intangible fixed assets rules in Part 8 of the Act. Very broadly, the rules in Part 8 apply only to intangible fixed assets that were created or acquired on or after 1 April 2002. Otherwise the rules in this Part continue to apply.

2298. Royalties from intellectual property are an exception to this as they automatically fall within Part 8 if they are recognised for accounting purposes on or after 1 April 2002. Most income from intellectual property is in the form of royalties. So specific rules in the source legislation applying to royalties are obsolete in a way that rules applying to other (mainly capital) amounts are not. To the extent that, exceptionally, other income receipts from intellectual property not within Part 8 may arise (such as casual profits from the exploitation of intellectual property charged in the source legislation under Case V or VI of Schedule D) those receipts will be subject to the "sweep–up" charge in section 979 of this Act.

2299. For this reason there is no need, in the corporation tax context, for rules equivalent to those in sections 579 to 582 of ITTOIA (which apply to royalties and other income from intellectual property).

Chapter 2: Disposals of know-how

Section 908: Charge to tax on profits from disposals of know-how

2300. The sections in Chapter 2 deal with consideration received for the disposal of know-how. This section applies the charge to corporation tax on income to the proceeds of certain disposals of know-how. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 583 of ITTOIA.

2301. Under the source legislation, income from disposals of know-how is charged to tax under Schedule D Case VI of ICTA.

2302. *Subsection (1)* applies the charge to corporation tax on income. Subsection (1)(b) is based on section 531(8) of ICTA but the words "whether absolute or qualified" are omitted since they are superfluous.

2303. *Subsection (5)* restores a definition of "mineral deposits" that applied before CAA was enacted. This change reproduces Change 51 in ITTOIA and so brings the income and corporation tax codes back into line. See *Change 41* in Annex 1.

Section 909: Exceptions to charge under section 908

2304. This section sets out the exceptions to the charge under section 908. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 584 of ITTOIA.

Section 910: Profits charged under section 908

2305. This section sets out the amount charged to tax under section 908. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 585 of ITTOIA.

2306. *Subsection (3)* is new and gives a signpost to the section which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 531 of ICTA as if it were contained in CAA.

Chapter 3: Sales of Patent Rights

Section 911: Overview of Chapter

2307. This section introduces the rules in this Chapter about the sales of patent rights. It is new.

Section 912: Charge to tax on profits from sales of patent rights

2308. This section applies the charge to corporation tax on income to capital sums from the sale of patent rights. It is based on sections 524 and 533 of ICTA. The corresponding rule for income tax is in section 587 of ITTOIA.

2309. Section 524(5) of ICTA is not rewritten because it does not appear to add anything to the proposition set out in section 5(3) of this Act (which defines the scope of the charge to corporation tax on a non-UK resident company trading in the UK through a permanent establishment in the UK). Any non-capital proceeds of the sale of patent rights will be amounts of income forming part of a non-UK resident company's chargeable profits by virtue of section 19(3)(b) of this Act (which defines the chargeable profits of a non-UK resident company). So the company will be within the charge to corporation tax in respect of such amounts.

Section 913: Profits charged under section 912

2310. This section sets out the amount charged to tax under section 912. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 588 of ITTOIA.

2311. This section is subject to the spreading rules in sections 914 to 917.

2312. *Subsection (2)* defines deductible costs as the capital cost of the rights sold plus any incidental expenses of sale. This makes it explicit that such expenses may be deducted. The types of expenses which may be allowed under this section are not listed. Incidental expenses which relate to both capital sale proceeds and other sums not chargeable to tax under section 912 are effectively apportioned under the rules about net proceeds of sale in section 929.

2313. *Subsection (5)* is new and includes a signpost to section 926 which deals with contributions to expenditure. This signpost is necessary because section 532 of ICTA treats section 524 of ICTA as if it were contained in CAA.

Section 914: UK resident companies: proceeds of sale not received in instalments

2314. This section sets out the spreading rules if the company chargeable by virtue of section 912 is UK resident and does not receive the proceeds of sale in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 590(1) to (3) and (6) of ITTOIA.

2315. The approach in this section differs from that in section 590 of ITTOIA. The latter also deals with the case where the taxpayer is UK resident and receives the proceeds of sale in instalments but in this Part that case is dealt with in a separate section (see section 915).

2316. *Subsection (5)* states the time limit for elections under *subsection (4)*. Unlike the source legislation this section does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

Section 915: UK resident companies: proceeds of sale received in instalments

2317. This section sets out the spreading rules if the company chargeable by virtue of section 912 is UK resident and receives the proceeds of sale in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 590(1) and (4) to (6) of ITTOIA.

2318. *Subsection (5)* states the time limit for elections under *subsection (4)*. Unlike the source legislation this section does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

Section 916: Non-UK resident companies: proceeds of sale not received in instalments

2319. This section sets out how non-UK resident companies are taxed on capital sums from the sale of patent rights if the sale proceeds are not received in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 591 of ITTOIA.

2320. *Subsection (4)* states the time limit for making an election under *subsection (3)*. The reference in section 524(6) of ICTA to "the Board" has not been reproduced and this section does not specify to whom the election must be made. But the general rules about

claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to an "officer of Revenue and Customs" in accordance with Schedule 1A to TMA. This change reproduces Change 149 in ITTOIA and so brings the income and corporation tax codes back into line. See *Change 1* in Annex 1.

2321. A non-UK resident company is within the charge to corporation tax in respect of sales of patent rights only if it is carrying on a trade in the UK through a UK permanent establishment and the patent is held for that trade (see section 19). *Subsection (5)* of this section (and of section 917) is relevant if such a company, having elected for spreading under *subsection (3)* of this section (or of section 917) ceases within the maximum allowed spreading period of six years to be within the charge to corporation tax in respect of the trade it was carrying on through its UK permanent establishment. If (for example) in year four the company ceased to carry on the trade through a UK permanent establishment then the capital sum would be spread rateably over four years and any earlier spreading based on a presumption that it would continue to carry on the trade in the UK through a UK permanent establishment for the whole six years would be revised in accordance with *subsection (6)* of this section (or of section 917).

Section 917: Non-UK resident companies: proceeds of sale received in instalments

2322. This section sets out how non-UK resident companies are taxed on capital sums from the sale of patent rights if the sale proceeds are received in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 592 of ITTOIA.

2323. *Subsection (2)* makes explicit what is implicit in the source legislation.

2324. *Subsection (4)* states the time limit for elections under *subsection (3)*. The reference in section 524(6) of ICTA to "the Board" has not been reproduced and this section does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA. So Change 149 in ITTOIA is reproduced to bring the income and corporation tax codes back into line. See *Change 1* in Annex 1.

2325. The note on section 916(5) is also relevant to *subsection (5)* of this section.

2326. Section 524(10) of ICTA is not rewritten. Section 524 of ICTA prescribes particular tax treatments with alternatives available by election. Section 524(10) of ICTA requires claims for relief under section 524 to be made to the Board. The claim relates to the spreading over six years of capital sums received from the sale of patent rights for the purposes of charging the sum to tax. As spreading is automatic for UK resident companies, the claim can be relevant only to non-UK resident companies. However, section 524(6) of ICTA, which deals with spreading rules for non-UK resident companies, refers to an election the rules for which are fully stated in that subsection and rewritten in sections 916 and 917. Section 524(10) of ICTA is, therefore, superfluous.

Section 918: Winding up of a body corporate

2327. This section deals with a body corporate which is chargeable to corporation tax under section 912 if it commences to be wound up. It is based on section 525 of ICTA. The corresponding rule for income tax is in section 594 of ITTOIA.

Section 919: Deduction of tax from payments to non-UK resident companies

2328. This section provides rules relating to the deduction of tax from payments to non-UK resident companies which are liable for tax under section 912 on profits from the sale of the whole or part of any patent rights. It is based on section 524 of ICTA. The corresponding rules for income tax are in section 595 of ITTOIA.

Section 920: Adjustments where tax has been deducted

2329. This section provides a rule relating to adjustments which may be necessary if tax is deducted from payments to a non-UK resident company under section 919. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 596 of ITTOIA.

Section 921: Licences connected with patents

2330. This section provides that certain matters relating to the acquisition or grant of a licence in respect of patent rights are treated for the purposes of the Chapter as a purchase or (as the case may be) sale of patent rights. The section is based on section 533 of ICTA. The corresponding rule for income tax is in section 597 of ITTOIA.

Section 922: Rights to acquire future patent rights

2331. This section brings rights to acquire future patent rights within the patent rights rules in this Chapter. It is based on section 533 of ICTA. The corresponding rule for income tax is in section 598 of ITTOIA.

Section 923: Sums paid for Crown use etc treated as paid under licence

2332. This section provides that sums paid for Crown use, or by a government of a country outside the United Kingdom are, in certain circumstances, to be treated as paid under a licence. It is based on section 533 of ICTA. The corresponding rule for income tax is in section 599 of ITTOIA.

2333. The reference in section 533(4) of ICTA to "sections 46 to 49 of the Patents Act 1949" has not been reproduced in this section. This is because patents granted under these provisions have ceased to have effect so it is unnecessary to reproduce this reference. The removal of this unnecessary material follows the line adopted in section 482 of CAA and mirrors what was done in section 599 of ITTOIA.

2334. The words "used" and "use" in this section (which correspond with the relieving legislation in section 482 of CAA) are intended to be read widely and cover "make" and "sell".

Chapter 4: Relief from corporation tax on patent income

Section 924: Relief for expenses: patent income

2335. This section provides relief for certain expenses in connection with patents. It is based on sections 526 and 528 of ICTA. The corresponding rule for income tax is in section 600 of ITTOIA.

2336. The relief is on the basis of expenses incurred. This relaxes any requirement in the source legislation that fees have to be paid before a deduction can be made.

2337. *Subsection (2)* defines "patent application and maintenance expenses" for the purposes of this section. Relief for such expenses is excluded from the scope of this section if the expenditure is incurred for the purposes of a trade carried on by the payer. This is because there is a similar provision for trading expenses connected with patents (in section 89 of the Act).

2338. *Subsection (4)* gives a signpost to section 926 which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 526 and 528 of ICTA as if those provisions were contained in CAA.

Section 925: How relief is given under section 924

2339. This section sets out how relief is given when a claim is made under section 924 for patent expenses to be set against patent income. It is based on sections 526, 528 and 533 of ICTA. The corresponding rule for income tax is in section 601 of ITTOIA.

2340. *Subsection (2)* allows relief for expenditure against patent income in the accounting period in which the expenditure is incurred. However, if the expenses exceed the patent income in the accounting period, the surplus expenses cannot be used to create a loss under this section. Any such surplus is dealt with in accordance with *subsection (3)*.

Chapter 5: Supplementary

Section 926: Contributions to expenditure

2341. This section restricts expenditure allowable under section 910, section 913 and section 924 to the extent that the expenditure is met by a public body or someone other than the company. It is based on section 532 of ICTA and section 532 of CAA. The corresponding rule for income tax is in section 603 of ITTOIA.

2342. *Subsection (3)* is new and excludes the application of this section to incidental expenses incurred by the seller of patent rights (see section 913(2)(b)). This is because section 524 of ICTA only bites in the first place on the net proceeds of a sale.

Section 927: Contributions not made by public bodies nor eligible for tax relief

2343. This section qualifies the general rule in section 926 by providing that contributions not made by public bodies may still be eligible as deductible expenditure in certain circumstances. The section is based on section 532 of ICTA and section 536 of CAA. The corresponding rule for income tax is in section 604 of ITTOIA.

Section 928: Exchanges

2344. This section extends the definition of a sale of property to include exchanges of property for the purposes of this Part. It is based on section 532 of ICTA and sections 453 and 572 of CAA. The corresponding rule for income tax is in section 605 of ITTOIA.

Section 929: Apportionment where property sold together

2345. This section provides for the apportionment of sale proceeds and expenditure on a just and reasonable basis if property within the scope of this Part is sold with other property. It is based on section 532 of ICTA and sections 453 and 562 of CAA. The corresponding rule for income tax is in section 606 of ITTOIA.

Section 930: Questions about apportionments affecting two or more persons

2346. This section provides for questions relating to apportionment under section 929 that affect two or more persons to be determined by the body prescribed by section 563 of CAA. It is based on section 532 of ICTA and section 563 of CAA. The corresponding rule for income tax is in section 607 of ITTOIA.

Section 931: Meaning of "capital sums" etc

2347. This section applies section 4 of CAA (which defines "capital expenditure" and "capital sums") for the purposes of the Part. It is based on section 532 of ICTA. The corresponding rule for income tax is in section 608 of ITTOIA.

Part 10: Miscellaneous income

Chapter 1: Introduction

Section 932: Overview of Part

2348. This section describes the function and contents of the Part. It is new.

Chapter 2: Dividends from non-UK resident companies

Section 933: Charge to tax on dividends of non-UK resident companies

2349. This section sets out the charge to corporation tax on dividends from a company that is not resident in the UK. It is based on sections 9, 18 and 70 of ICTA. The corresponding income tax provision is section 402 of ITTOIA.

2350. The approach adopted in ICTA is to compute income for corporation tax from each type of source in the same way as for income tax, and then apply any specific corporation tax rules. Following the enactment of ITTOIA, which set up a different scheme for income tax, sources of income for corporation tax have continued to be computed under the rules of the separate Schedules and Cases. Dividends paid by a non-UK resident company were charged under Schedule D Case V.

2351. The section mirrors section 402 of ITTOIA by explicitly excluding capital dividends – the Schedule D Case V charge was a charge on income and the wording of the section reflects this.

Chapter 3: Beneficiaries' income from estates in administration

Overview

2352. This Chapter charges to corporation tax income paid or payable by personal representatives to residuary beneficiaries from estates in administration. The Chapter rewrites sections 695 to 702 of ICTA. The corresponding rules for income tax are in Chapter 6 of Part 5 of ITTOIA.

2353. Personal representatives are taxable at the basic rate or the dividend ordinary rate on any income they receive during the administration period. When the income which arises to the personal representatives is paid to the residuary beneficiaries, it is treated as having borne income tax at those rates.

Section 934: Charge to tax on estate income

2354. This section applies the charge to corporation tax on income to estate income. It is based on sections 695(2) to (4), 696(3) and (6), 698(3) and 701(11) of ICTA. The corresponding rule for income tax is in section 649 of ITTOIA.

2355. The approach of Part 16 of ICTA is to deem sums to have been paid as income for all tax purposes. In the case of both UK and foreign estates, the income is not charged under a particular Schedule or Case and it is implicit that tax is charged on those sums. This section applies to both UK and foreign estates. And it has now been made explicit that the charge to tax applies to all estate income which is treated as arising under the Chapter from a deceased person's estate.

Section 935: Absolute, limited and discretionary interests

2356. This section defines the three types of interest in the whole or part of the residue of an estate. It is based on sections 698(1) and (3) and 701(2) and (3) of ICTA. The corresponding rule for income tax is in section 650 of ITTOIA.

2357. *Subsections (1)(b)* and *2(b)* reflect the fact that the amount of any residue, and the income from it, can only be an estimate until the residue has been ascertained.

2358. *Subsection (4)* covers the following four situations:

- where income/capital is properly payable directly to the person with the interest;
- where income/capital is properly payable to the person with the interest indirectly through a trustee or other person;
- where income/capital is properly payable for the benefit of the person with the interest, to another person, and that income/capital is paid directly to that other person; and
- where income/capital is properly payable to a person where that person is a personal representative and *subsection (5)* applies.

2359. Subsection (5) deals with the situation where personal representatives would have an absolute or limited interest in the residue of another deceased person's estate if a right they have as personal representatives were vested in them for their own benefit. In these circumstances they are treated as having that interest. The term "personal representatives" is defined in section 968. The definition corresponds with that in section 989 of ITA.

Section 936: Meaning of "UK estate" and "foreign estate"

2360. This section defines "UK estate" and "foreign estate" for the purposes of this Chapter. It is based on sections 699A(1B) and 701(9), (10) and (10A) of ICTA. The definitions in this section underpin the whole of this Chapter. The corresponding rule for income tax is in section 651 of ITTOIA.

Section 937: Absolute interests in residue

2361. This section sets out the basis on which estate income is treated as arising in an accounting period in the case of absolute interests in residue. It is based on section 696(3) and (5) of ICTA. The corresponding rule for income tax is in section 652 of ITTOIA.

2362. *Subsections (2)* and *(3)* set out the relevant conditions. A payment need not be made in the "final accounting period" because the net amount of estate income in that period is always equal to the assumed income entitlement for that period. Under section 696(5) of ICTA, taxing a company with an absolute interest in a residuary estate depends on whether the company receives payments and, in the final year of administration, on a fictional payment under that section. The same effect is achieved in this section by determining the liability by considering the assumed income entitlement in all accounting periods. Assumed income entitlement is dealt with in section 948.

Section 938: Meaning of "the administration period", "the final accounting period" and "the final tax year"

2363. This section defines "the administration period", "the final accounting period" and "the final tax year". It is based on sections 695(1), 701(13) and 702 of ICTA. The corresponding rule for income tax is in section 653 of ITTOIA.

2364. *Subsection (2)* defines when the administration of the estate is completed for Scotland. A full definition for Scotland is required because the completion of the administration of an estate would otherwise have no meaning under Scottish law (although the definition has been updated by replacing the archaic expression "for behoof of"). In contrast, there are cases under English law which have established that the administration is complete when the residue of the estate is ascertained and is ready for distribution. Case law explains what this means in particular circumstances (see, for example, R v

Special Commissioners ex parte Dr Barnardo's Homes (1921), 7 TC 646 HL, Daw v CIR (1928), 14 TC 58 HC and CIR v Sir Aubrey Smith (1930), 15 TC 661 CA).

Section 939: Limited interests in residue

2365. This section deals with estate income relating to limited interests. It is based on section 695(2) and (3) of ICTA. The corresponding rule for income tax is in section 654 of ITTOIA.

2366. The section sets out the basis on which estate income is treated as arising in an accounting period for limited interests in residue. The section reflects the need to deal with accounting periods before the final accounting period. Also, a limited interest might cease in an accounting period before the final accounting period and sums might be paid in respect of that interest in a later accounting period; so that situation has to be provided for.

Section 940: Discretionary interests in residue

2367. This section deals with estate income relating to discretionary interests in residue. It is based on section 698(3) of ICTA. The corresponding rule for income tax is in section 655 of ITTOIA.

Section 941: UK estates

2368. This section sets out the amount charged to tax under section 934 for income from UK estates. It is based on sections 695(2) to (4), 696(3) and (4) and 698(3) of ICTA. The corresponding rule for income tax is in section 656 of ITTOIA.

2369. As there are fundamental differences between the basis of charge for income from UK and foreign estates, the rules for foreign estates have been dealt with in a separate section (section 942).

2370. *Subsection (2)* provides that income from a UK estate is charged on the gross amount of the estate income arising for the accounting period. This is the basic amount of the income grossed up at the applicable rate. "Basic amount" is a new term. This avoids confusion with the term "net amount" since it is the "net amount" which is actually charged to tax in the case of a foreign estate (except where section 963 (income treated as bearing income tax) applies).

Section 942: Foreign estates

2371. This section sets out the amount charged to tax under section 934 for income from foreign estates. It is based on sections 695(4), 696(6) and 698(3) of ICTA. The corresponding rule for income tax is in section 657 of ITTOIA.

2372. *Subsection (5)* provides that, so far as the income is not within section 963, the charge is on the basic amount of that income. Where the income is within section 963, the charge is on the gross amount of the income calculated in accordance with section 946.

Section 943: Absolute interests

2373. This section explains how to calculate the basic amount of estate income for absolute interests. It is based on section 696(3) to (5) of ICTA. The corresponding rule for income tax is in section 660 of ITTOIA.

2374. This section removes all the deeming of amounts to have been paid in Part 16 of ICTA. Instead, it looks at either amounts actually paid or the assumed income entitlement. It then catches all previously untaxed income due to the absolute interest holder by taxing the assumed income entitlement in the final accounting period. This avoids the two stage process inherent in section 696(5) of ICTA.

2375. *Subsection (3)* introduces a new rule allowing excess estate deductions in the final year to be set off against the basic amount of estate income for the final accounting period. See *Change 69* in Annex 1.

Section 944: Limited interests

2376. This section explains how to calculate the basic amount of estate income for limited interests. It is based on section 695(2) to (4) of ICTA. The corresponding rule for income tax is in section 661 of ITTOIA.

Section 945: Discretionary interests

2377. This section identifies the basic amount of estate income relating to discretionary interests. It is based on sections 695(4) and 698(3) of ICTA. The corresponding rule for income tax is in section 662 of ITTOIA.

Section 946: Applicable rate for grossing up basic amounts of estate income

2378. This section provides for basic amounts of estate income to be grossed up, as appropriate, for the purposes of the sections charging income (section 941 for UK estates and section 942 for foreign estates) by reference to the rate at which tax is borne by the aggregate income of the estate. It is based on sections 699A and 701(3A) of ICTA. The aggregate income of the estate is defined in section 947. The corresponding rule for income tax is in section 663 of ITTOIA.

2379. *Subsection (5)* explains the interaction between "the relevant tax year" and "accounting period" for the purposes of this Chapter.

Section 947: Aggregate income of the estate

2380. This section explains what is meant by the "aggregate income of the estate" for a tax year. It is an important definition of general application. It is based on sections 701(5) and (8) and 702 of ICTA. The corresponding rule for income tax is in section 664 of ITTOIA.

2381. *Subsection (2)* defines the income and amounts within the aggregate income of the estate. Subsection (2)(b) brings in foreign source income and *subsection (4)* provides that such income takes account of any deductions which would have been available if it had been subject to United Kingdom income tax. So subsection (4) brings foreign source income into line with United Kingdom source income.

2382. *Subsection (5)* provides that two types of income are excluded from the aggregate income of the estate. The exclusion detailed in subsection (5)(a) concerning income to which any person may become entitled under a specific disposition is new to the definition of the aggregate income of the estate although it is similar to section 697(1)(b) of ICTA which deals with amounts which are deductible from the aggregate income in calculating the residuary income of the estate.

2383. It is not considered appropriate for income from specific dispositions or income from contingent interests to be treated as part of the aggregate income of the estate. See *Change 70* in Annex 1.

2384. Section 698(1) of ICTA in part deals with the position where the deceased person ("A"), whose estate is being administered by personal representatives, had an absolute or limited interest in the residue of the estate of another deceased person ("B"). Section 698(1) of ICTA deems the personal representatives to have the same interest as "A" "notwithstanding that that right is not vested in them for their own benefit". The substance of this is rewritten in section 935(5). Section 698(1) of ICTA also deems any income in respect of such an interest to be part of the aggregate income of A's estate. This part of the source legislation is not rewritten because such income will fall within the definition of the aggregate income of the estate anyway, once the personal

representatives are deemed to have the interest, because it will be the income of the deceased's personal representatives as such. It is immaterial for this purpose that that right in relation to the estate of another deceased person "is not vested in them for their own benefit".

2385. It is not necessary to expand on the two types of excluded income mentioned in subsection (5) of this section (with the exception of *subsection (6)* of this section) since it will be clear when such income arises. Consequently, section 701(6) and (7) of ICTA (which provide the meaning for "charges on residue") are not rewritten.

Section 948: Assumed income entitlement

2386. This section explains the new concept of the "assumed income entitlement". It is based on section 696(3A), (3B) and (5) of ICTA. The corresponding rule for income tax is in section 665 of ITTOIA.

2387. The concept of "assumed income entitlement" has been introduced as a tool for calculating the basic amount of estate income for absolute interests. It is similar to the "aggregated income entitlement" in section 696(3B) of ICTA but applies in a more straightforward way.

2388. Step 4 in *subsection (1)* deals also with situations where a beneficiary liable to corporation tax was, at some earlier point during the administration period, chargeable to income tax. It also deals with other situations where a non-UK resident beneficiary becomes UK resident, when the estate is a foreign estate.

Section 949: Residuary income of the estate

2389. This section explains how the residuary income of the estate is calculated. It is based on section 697(1) and (1A) of ICTA. The corresponding rule for income tax is in section 666 of ITTOIA.

2390. Beneficiaries with absolute interests need to know the residuary income of the estate for a tax year in order to work out their assumed income entitlement.

2391. *Subsection (2)* lists the "allowable estate deductions". This is a new label for the items which may be deducted from the aggregate income of the estate. Subsection (2)(a) refers to "all interest paid in that year by the personal representatives …". Section 697(1)(a) of ICTA refers to "the amount of any annual interest, annuity or other annual payment for that year which is a charge on residue …". The requirements that interest must be annual and also a charge on residue have not been reproduced. See *Change 71* in Annex 1.

2392. In practice, HMRC allow income from specific dispositions to be deducted from the aggregate income of the estate in calculating the residuary income of the estate in the year of assent and later years. But it is considered simpler for it merely to be excluded from what counts as the aggregate income and not be deducted from it. See *Change 70* in Annex 1.

2393. Subsection (2)(b) deals with annual payments. Because of the restricted meaning given to annual payments, much of the wide definition in sections 701(6) and 702(d) of ICTA is otiose. Any liabilities which are annual payments will now have to meet only the requirement that they are properly payable out of residue and this is also a requirement of section 701(6) of ICTA. Omitting the remainder of the definition removes unnecessary material. As a consequence of the change, section 701(7) of ICTA, which limits the meaning of "charges on residue" in relation to specific dispositions, does not need to be rewritten either.

2394. The section does not contain an ordering rule for allocating allowable estate deductions against different categories of income. It is implicit in this section that the taxpayer may choose whichever allocation is most advantageous.

Section 950: Shares of residuary income of estate

2395. This section explains the rules for determining the share of residuary income treated as arising from a company's absolute interest in the whole or part of the residue of an estate. It is based on section 696(2) and (8) of ICTA. The corresponding rule for income tax is in section 667 of ITTOIA.

Section 951: Reduction in share of residuary income of estate

2396. This section provides that the share of the residuary income of the estate of a company with an absolute interest is reduced at the end of the administration period in certain circumstances. It is based on section 697(2) and (3) of ICTA. The corresponding rule for income tax is in section 668 of ITTOIA.

2397. Until it was repealed by ITA 2007, section 4(1) of ICTA provided that sums paid during (or on completion of) the administration period were to be grossed up by reference to the basic rate for the tax year in which it was paid in the case of UK estates. *Subsection (5)* provides that, for the purposes of subsection (1)(b) the basic rate is used when grossing up these sums. See *Change 72* in Annex 1.

Section 952: Applicable rate for determining assumed income entitlement (UK estates)

2398. This section sets out the calculation of the applicable rate for the purposes of calculating income tax to be deducted from the residuary income at step 2 of section 948(1). The section is based on section 701(3A) of ICTA. The corresponding rule for income tax is in section 670 of ITTOIA.

Section 953: Introduction

2399. This section introduces the sections dealing with successive interests where two or more interests in the whole or part of the residue of an estate are held successively during the administration period by different persons. It is based on section 698(4) to (6) of ICTA. The income tax rules corresponding to *subsections (2)* and *(3)* are rewritten in section 671(7) and (8) of ITTOIA.

2400. Subsection (3) ensures that where a previous holder is not a company within the charge to corporation tax, that person's accounting periods (for the purposes of this section) correspond with tax years.

Section 954: Successive absolute interests

2401. This section explains the position where two or more absolute interests in the residue of an estate are held successively by different persons. It is based on sections 697(4) and (5), and 698(2) of ICTA. The corresponding rule for income tax is in section 671 of ITTOIA.

2402. *Subsection (3)* contains an ordering rule to ensure that all determinations under subsection (2) or section 955(2) are made in relation to the person with the earlier interest before the person with the later interest. This subsection has been inserted to make explicit what is already implicit in the source legislation.

2403. *Subsection (4)* provides a special rule where there are two or more absolute interests in the final accounting period. It is intended to ensure that it is the last absolute interest which is charged to tax on the assumed income entitlement, which will comprise all the residuary income, in the final accounting period. This is because the last absolute interest holder will receive the capital of the residue (and also all outstanding income in respect of it).

2404. *Subsections (5)* and *(6)* contain special rules where section 951 (reduction in share of residuary income of estate) applies and there are successive absolute interests. These

subsections provide that the calculation under section 951(1)(a) and (b) is to be made by reference to all the absolute interests taken together. Then, after applying the reduction to the last absolute interest under section 951(2) and (3), any remaining excess is applied to the previous absolute interest holders working backwards from the beginning of the last interest. See *Change 73* in Annex 1.

Section 955: Assumed income entitlement of holder of absolute interest following limited interest

2405. This section and section 956 explain the position of the absolute interest holder where successive limited and absolute interests in the residue of an estate are held by different persons. It is based on section 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 672 of ITTOIA.

2406. The section applies only where the later interests arise or are created on the cessation of the previous interest otherwise than by death. The position of limited interests which cease on the death of the holder before the final tax year are dealt with in section 654 of ITTOIA and section 939 of this Act. All sums paid or remaining payable in respect of that interest after the tax year of death are treated as estate income arising in the tax year of death.

2407. Examples of situations, in relation to limited interests, that are covered by the section include:

- the disclaiming of a life interest which accelerates an existing interest under the will; and
- an interest which is only held until marriage or attaining a certain age.

2408. *Subsections (3)* and *(4)* contain the two rules introduced by *subsection (2).* They deal with the limited interest which ceases otherwise than on death. They also explain how such an interest is brought into the calculation of whether the person with the absolute interest has an assumed income entitlement and, if so, its amount. The assumed income entitlement works on a cumulative basis, so the share of the residuary income of the absolute interest holder and the basic amounts of previous accounting periods are taken into account.

Section 956: Payments in respect of limited interests followed by absolute interests

2409. This section covers the position where the absolute interest holder is entitled to receive payments in respect of a preceding limited interest which has ceased otherwise than on death. It is based on section 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 673 of ITTOIA.

2410. *Subsection (2)* deals with such payments while the absolute interest holder still has the absolute interest. It provides that a payment made to the absolute interest holder in respect of the limited interest is treated as paid in respect of the absolute interest (and not the limited interest). Thus, such payments may form part of the basic amount of estate income in accounting periods before the final accounting period.

2411. *Subsection (3)* deals with the position where the holder's absolute interest has itself ceased (but the administration period continues). The approach here is to treat any such sum paid in these circumstances as a payment in respect of the earlier limited interest. The result is that such payments are treated as estate income under the limited interests provisions. But *subsection (6)* provides that the payments are treated as paid or payable in respect of the absolute interest for the purposes of section 951 (reduction in share of residuary income of estate).

2412. The taxation of successive interests in the residue of an estate is dealt with in section 698(1A) to (2) of ICTA. Section 698(1B) of ICTA deals with the case where there were successive interests in an estate which ceased otherwise than on death and

the earliest or one of the earlier interests was a limited interest (see section 698(1A) of ICTA).

2413. Section 698(1B)(a) of ICTA provides that Part 16 of ICTA applies as if all the interests were the same interest ("the deemed single interest"), so that none of them is to be treated as having ceased on being succeeded by any of the others. Section 698(1B)(b) of ICTA then determines who had the deemed single interest. It is either the person in respect of whose interest or previous interest the payment was made (section 698(1B)(b)(i) of ICTA) or a person who has or had an interest and is entitled to receive the payment (section 698(1B)(b)(ii) of ICTA). So a beneficiary who does not give up his or her entitlement to income which is unpaid at the time the interest ceases is taxable on the payment, rather than the person holding the successive interest at the time when the payment is made. However, section 698(1B)(b) of ICTA is made subject to section 698(1B)(c) of ICTA. Section 698(1B)(c)(i) of ICTA provides that, so far as a later interest is an absolute interest, it is to be treated as having always existed and the earlier interest or interests as having never existed for the purposes of the provisions dealing with absolute interests in section 696(3A) to (5) of ICTA.

2414. In rare circumstances the later absolute interest may itself have ceased at the time the payment is made. For example, A has a limited interest which is succeeded by absolute interests held first by B and then by C, and a payment is received by B in respect of A's earlier limited interest after B's own interest has ceased but before the end of the administration period. As a result of section 698(1B)(b)(ii) of ICTA, Part 16 of ICTA applies to the payment as if B had the deemed single interest. So section 696(3) of ICTA deems the sum to be paid to B as income in the accounting period in which it is actually paid. That is an accounting period in which C had the absolute interest. Under section 698(1B)(c)(i) of ICTA for the purposes of section 696(3A) to (5) of ICTA, Part 16 of ICTA is to apply as if the later interest of C had always existed and the earlier interests had never existed. Section 698(1B)(c)(ii) and (iii) of ICTA then provides that sums paid as income in respect of the earlier interests are deemed to be sums paid in respect of the later interest of C.

2415. The relationship between these particular provisions, where the later interest has itself ceased at the time the payment is made but the administration period continues, is difficult to work out. It would seem that the payment in the above example should be taxed on B because of section 696(3) of ICTA. The payment is then brought into account when the payments made in respect of C's interest are compared to its aggregated income entitlement (in making the final year calculation under section 696(5) of ICTA in respect of C's interest to determine whether any amount should be treated as having been paid to C immediately before the end of the administration period). So although section 698(1A) and (1B) of ICTA operate in a very convoluted way in the above circumstances, the end result appears to be that B, the person with the absolute interest who receives the payment, is taxed on it, but it does not affect B's aggregated income entitlement.

2416. In order to spell out how a payment made in these circumstances should be treated, subsections (3) and (4) of this section provide that where such a payment is made, this Chapter applies as if the earlier limited interest had continued to subsist while the later absolute interest subsisted and had been held by the holder of the later absolute interest. The result is that payments to that holder are treated as estate income under the provisions about limited interests.

2417. Sums to which that holder is entitled that remain payable at the end of the administration period are treated in the same way. They will be basic amounts arising from the limited interest in the accounting period in which the absolute interest ceases and are dealt with by sections 939 and 944. The effect of this on later absolute interests is then determined by the successive absolute interests provisions in section 954. Under subsection (6) of this section, however, these sums are to be treated as paid or payable in respect of

the absolute interest for the purposes of the provisions about the reduction in shares of residuary income under section 951.

Section 957: Holders of limited interests

2418. This section explains the position of a limited interest holder where successive interests in the residue of an estate are held by different persons and the earlier, or if there are more than two, the earliest of the interests is a limited interest. It is based on sections 695(2) and (3) and 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 674 of ITTOIA.

2419. The section only applies where the later interests arise or are created on the cessation of the previous interest otherwise than by death.

2420. *Subsections (3)* to *(5)* cover three sets of circumstances described as "cases" where the estate income in respect of successive limited interests is treated as arising. The cases are the equivalent for successive limited interests of the three cases for single limited interests in section 939. But the section recognises that there may be more than one limited interest in the chain of succession, so references are made to "one of the interests" and subsection (5) refers to "the last of the successive interests".

2421. There is also an additional sub-paragraph in each case providing that a limited holder (as defined) is entitled to receive the payment. This reflects the fact that the person who receives the payment in these circumstances is not always the person in respect of whose interest the payment is made. For example, on disclaiming a life interest, a beneficiary may also disclaim any entitlement to income accrued in respect of that interest but not yet paid.

2422. The section does not make it explicit that a new chain of succession begins with the first limited interest (and a previous absolute interest is ignored) for the purposes of this provision. Nor does the section make it explicit that two limited interests which are preceded by a limited interest which ceased on the death of the beneficiary are covered by the section. These conclusions are implicit in this section.

Section 958: Basic amount of estate income: successive limited interests

2423. This section explains how to calculate the net amount of estate income for successive limited interests. It is based on sections 695(2) to (4) and 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 675 of ITTOIA.

2424. The section is the equivalent provision to section 944 for limited interests that are not successive.

Section 959: Apportionments

2425. This section applies where successive interests apply to only part of the residue. In other words, the residuary estate is divided up and one or more of the successive interests provisions apply to a part or parts of that estate. It also applies where one of the interests covers the whole estate and the other interest covers part of it. It is new. The corresponding rule for income tax is in section 676 of ITTOIA. See *Change 74* in Annex 1.

2426. In such circumstances, it is possible that a subsequent interest may not cover exactly the same part of the residuary estate as the interest which preceded it. For example, limited interest holders may give up half their interest, thus accelerating the interest of the absolute interest holder. Only half the share of the residuary income and half the net amounts of the limited interest holder would be needed for the calculation of whether the absolute interest holder has an assumed income entitlement in accordance with section 955(2). The section provides for just and reasonable apportionments to be made in these circumstances.

Section 960: Relief in respect of tax relating to absolute interests

2427. This section provides for relief if income, which has borne United Kingdom tax, arises to a company with an absolute interest in the residue of a foreign estate. It is based on section 696(7) of ICTA. The corresponding rule for income tax is in section 677 of ITTOIA.

2428. *Subsection (2)* contains the formula for calculating the relief where a claim is made. The labels in section 696(7)(a) and (b) of ICTA – "the deemed income" and "the aggregate income" respectively – were added as explanatory aids in the course of the ICTA consolidation. These labels are not retained.

Section 961: Relief in respect of tax relating to limited or discretionary interests

2429. This section provides for relief if income, which has borne United Kingdom tax, arises to a company with a limited or discretionary interest in the residue of a foreign estate. The section is based on sections 695(5) and 698(3) of ICTA. The corresponding rule for income tax is in section 678 of ITTOIA.

2430. *Subsection (2)* provides for a reduction to be made from the tax charged on the company following a claim for relief. The tax is to be reduced by an amount equal to the appropriate fraction of that tax. The fraction here (based on section 695(5) of ICTA) is slightly different from the fraction used for absolute interests (based on section 696(7) of ICTA). The labels in section 695(5)(a) and (b) of ICTA – "the deemed income" and "the aggregate income" respectively – were added as explanatory aids in the course of the 1988 consolidation. These labels are not retained.

2431. Section 695(6) of ICTA is not rewritten. The meaning of this provision, which was introduced when surtax was still charged, is now obscure and it is difficult to see how it could operate in the context of Self Assessment for companies. See *Change 100* in Annex 1.

Section 962: Income from which basic amounts are treated as paid

2432. This section sets out the rules for determining from which part of the aggregate income of the estate a basic amount is treated as paid. It is based on sections 699A(2) and 701(3A) of ICTA. The corresponding rule for income tax is in section 679 of ITTOIA.

2433. Personal representatives may receive such income from a number of sources, and different rates of tax apply to different types of income. Some of the income is taxed in the hands of the personal representatives at "the applicable rate" (the basic rate or the dividend ordinary rate. See section 963).

2434. The basic amounts of estate income do not always correlate precisely to the income received by the personal representatives. It is therefore necessary to attribute payments out of the residuary estate in the form of basic amounts to particular types of income received by the personal representatives.

Section 963: Income treated as bearing income tax

2435. This section deals with income which is treated as bearing income tax. It is based on section 699A of ICTA. The corresponding rule for income tax is in section 680 of ITTOIA.

2436. Where such income forms part of the aggregate income of the estate (as a result of section 947(2)), this section treats the income as having borne tax at either the dividend ordinary rate or the basic rate (as appropriate) for certain provisions within the Chapter.

2437. Section 699A(1)(b) of ICTA is not rewritten in this Act. This provision provides that the sums to which section 699A(1)(a) of ICTA applies must be sums in respect of which

the personal representatives are not directly assessable to United Kingdom income tax. Of the income referred to in section 699A(1)(a) of ICTA to which section 699A(1)(b) of ICTA applies, none appears to be directly assessable. So section 699A(1)(b) of ICTA serves no useful purpose.

Section 964: Transfers of assets etc treated as payments

2438. This section is concerned with the appropriation of assets by personal representatives to themselves, any other transfer of assets and the set off or release of a debt. The section is based on section 701(12) of ICTA. The corresponding rule for income tax is in section 681 of ITTOIA.

Section 965: Assessments, adjustments and claims after the administration period

2439. This section deals with adjustments after the end of the administration period. It is based on section 700(1) to (3) of ICTA. The corresponding rule for income tax is in section 682 of ITTOIA.

Section 966: Power to obtain information from personal representatives and beneficiaries

2440. This section enables HMRC to obtain information for the purpose of this Chapter. It is based on section 700(4) of ICTA.

Section 967: Statements relating to estate income

2441. This section enables a company to request statements relating to a deceased person's estate. It is based on section 700(5) and (6) of ICTA.

2442. The last part of section 700(5) of ICTA that requires the statement to set out the matters in section 700(5)(a) to (b) separately for each part of estate income, in cases where different applicable rates apply, has not been rewritten. This requirement is considered unnecessary because the requirement to show amounts separately must occur in order for *subsection (1)(b)* of this section to be satisfied.

Section 968: Meaning of "personal representatives"

2443. This section provides the meaning of "personal representatives". It is based on section 701(4) of ICTA.

Chapter 4: Income from holding an office

Overview

2444. Section 9 of ICTA applies income tax law and practice to the charge and calculation of corporation tax and has been amended by ITEPA, ITTOIA and ITA in the course of the separation of corporation tax from income tax. (See the commentary on Chapter 1 of Part 2.)

2445. The only context in which the principle underlying section 9 of ICTA continues to be relevant is the charge to corporation tax on income from the holding of an office: this corporation tax charge still operates by reference to income tax.

Section 969: Charge to tax on income from holding an office

2446. This section applies "the charge to corporation tax on income" to income from an office. It is based on section 9 of ICTA. The charge on income is explained in section 2.

2447. Section 9(3)(b) of ICTA was amended by ITEPA and refers to employment, pension and social security income. Previously section 9(3) referred to "the like Schedules and Cases". As a company cannot be an employee and cannot receive pension and social

security income, these aspects of section 9(3)(b) have not been rewritten. Employment income however includes income from holding an office. A company can hold an office - a common example is as a company secretary - so this section rewrites that aspect of the source legislation.

2448. Under *subsection (2)* the amount of income from an office charged to tax is determined in accordance with income tax law and practice and under *subsection (4)* the provisions of ITEPA govern the calculation of the income from this source. The section uses "calculated" for "computed".

2449. *Subsection (3)* provides that subsection (2) is subject to provisions of the Corporation Tax Acts. The Corporation Tax Acts are defined in section 831(1)(a) of ICTA as "enactments relating to the taxation of the income and chargeable gains of companies and of company distributions (including provisions relating also to income tax)". In section 9(1) of ICTA the reference is to "the Tax Acts". The reference has been narrowed since the qualifications to subsection (2) of this section only occur in corporation tax enactments.

2450. Section 9(2A) of ICTA which provides that for corporation tax purposes no income shall be computed under ITTOIA is repealed.

2451. Section 9(4) of ICTA expands upon section 9(1). The part of this subsection that applies an exemption in an Income Tax Act (other than ITTOIA and ITA) has been rewritten in *subsection (4)(b)*, since it is not absolutely certain that exemptions are covered by subsections (1) to (3) of this section.

2452. The other part of section 9(4) that provides for any provision of the Income Tax Acts (again other than ITTOIA and ITA) which charges any amount to income tax to have like effect for corporation tax has not been rewritten since the determination of the charge is covered by subsections (1) to (2) of this section (and in the context of employment income in ITEPA free standing charges are not believed to be an issue).

2453. Section 9(5) of ICTA applies "where, by virtue of this section or otherwise" any enactment applies to both corporation tax and income tax. This provision is amended by this Act but is not repealed since it could have an application to an enactment that is not being rewritten.

2454. Section 9(6) of ICTA is repealed since it no longer serves a useful purpose.

2455. The interpretation of "office" in *subsection (6)* is based on section 5(3) of ITEPA. The ITEPA provision derives from the cases of Great Western Railway Company v Bater (1922), 8 TC 231 and Edwards v Clinch (1981), 56 TC 367. This accords with the application of income tax principles in subsection (2) based on section 9(1) of ICTA.

Section 970: Rule restricting deductions for bad debts

2456. This section deals with bad debts arising from the holding of an office. It is based on section 88D of ICTA.

2457. The corresponding rule about trade debts is in section 55.

2458. This section is needed because section 88D(4) of ICTA imports the extended meaning of "trade" in section 6(4) of ICTA. So the ICTA rule applies to a vocation and also to an office or employment. In this Act, for corporation tax purposes a company cannot carry on a vocation or be employed.

2459. *Subsection (1)* excludes from the rule any debts that are dealt with by the loan relationship rules in Parts 5 and 6 of the Act. Section 88D(1) of ICTA also excludes debts that are dealt with by the rules for derivative contracts and intangible fixed assets. Those rules are not relevant to an office-holder and so are not mentioned in the section.

Chapter 5: Distributions from unauthorised unit trusts

Overview

2460. This Chapter applies the charge to corporation tax on income to payments to companies from unauthorised unit trusts. It is based on section 469 of ICTA. The corresponding income tax provisions are in Chapter 10 of Part 4 of ITTOIA.

Section 971: Overview of Chapter

2461. This section sets out how relevant amounts are calculated and charged to corporation tax. It also points to particular provisions of ITA and of ICTA which deal with the position of a unit holder. It is new.

Section 972: Charge to tax under this Chapter

2462. This section applies the charge to corporation tax on income to amounts shown in the unit trust scheme's accounts as income available for payment to unit holders or for investment in the scheme. It is based on sections 9, 18 and 469 of ICTA. The corresponding charge for income tax is in section 547 of ITTOIA.

Section 973: Amount of income treated as received

2463. This section sets out the amount of income treated as received by a unit holder from an unauthorised unit trust scheme under section 972(2). It is based on section 469 of ICTA. The corresponding rule for income tax is in section 548 of ITTOIA.

2464. *Subsection (2)* contains a method statement setting out the steps to be taken to calculate the gross amount of income on which the unit holder is charged to tax.

Chapter 6: Sales of foreign dividend coupons

Overview

2465. This Chapter rewrites the charge to tax in section 18(3B) to (3E) of ICTA on the proceeds of the sale of coupons attached to foreign shares, where the sale is made through a bank in the United Kingdom or to a dealer in coupons in the United Kingdom.

2466. Although these provisions include coupons on both securities and shares, for corporation tax purposes the charge applies in effect to the sale of coupons on shares only.

2467. Chapter 2 of Part 4 of FA 1996 charges to tax all profits and gains arising to a company from its loan relationships. Profits and gains include (section 81(5) and 84(1) of that Act) payments payable in pursuance of any rights under a loan relationship. The sale of a coupon on a security is charged to tax in the same way as any sale in pursuance of a right under a loan relationship. Section 18(3B) of ICTA as it applies to coupons on securities is therefore unnecessary for corporation tax purposes and section 80(5) of FA 1996 applies to give the loan relationship provisions precedence in any event.

2468. Section 18(3B) of ICTA requires Schedule D Case IV in section 18(3) to be read as including proceeds of the sales of coupons for foreign dividends. Subsection (3B) does not explain how the charge is allocated between Schedule D Case IV and Case V. The obvious assumption is that where the coupon is issued in respect of a security out of the United Kingdom it falls within Case IV (which charges income from overseas securities) and otherwise within Case V (which charges income from possessions outside the United Kingdom).

2469. Section 18(3A) of ICTA requires "Case III" as set out in that subsection to be substituted for "Case IV" in section 18(3) of ICTA. The effect of this is to bring the extended meaning of Case IV required by section 18(3B) of ICTA into a Case III charge which

incorporates a charge under the loan relationships provisions which, as explained above, *already* charges to tax the sale of coupons in respect of securities.

2470. Whether or not it was intentional that a Case IV charge for corporation tax should remain within section 18(3B) to (3E) of ICTA to be brought within Case III by section 18(3A) of ICTA is unclear. Subsections (3B) to (3E) were introduced in FA 1996, the same Finance Act that introduced section 18(3A) of ICTA. Either way the effect of section 18(3B) to (3E) of ICTA is simply to bring within the loan relationships provisions the sale of coupons on securities even though they are already within the provisions on first principles.

2471. For these reasons section 18(3B) to (3E) of ICTA has been rewritten to exclude the sales of coupons on foreign securities.

Section 974: Charge to tax under this Chapter

2472. This section applies the charge to corporation tax to income which is treated as arising from foreign holdings where a dividend coupon attached to the holding is (a) sold or otherwise realised by a bank in the United Kingdom or (b) sold to a coupon dealer in the United Kingdom by someone other than a bank or a coupon dealer. It is based on section 18(3), (3B) and (3E) of ICTA. The corresponding rule for income tax is in section 570 of ITTOIA.

2473. *Subsection (3)* applies where the coupon is sold by the bank on behalf of another. See *Change 75* in Annex 1.

2474. *Subsection (4)* applies where a person who is neither a bank nor another coupon dealer sells the dividend coupons to a coupon dealer in the United Kingdom. Section 18(3B)(b) of ICTA refers to a dealer in coupons in the United Kingdom. See *Change 75* in Annex 1.

Section 975: Meaning of "foreign holdings" etc

2475. This section gives the meaning of "foreign holdings" and "dividend coupons". It is based on section 18(3B), (3C), (3D) and (3E) of ICTA. The corresponding rule for income tax is in section 571 of ITTOIA.

2476. For reasons given above the extended definition of "dividends" to include interest or other annual payments has been omitted as part of the exclusion of coupons in respect of securities. It is considered that "dividends" alone in section 18(3D) of ICTA is sufficient to refer to any income from shares.

2477. The definition in s*ubsection (1)* of "foreign holdings" as shares outside the United Kingdom which are issued by or on behalf of a non-UK resident body of persons reflects the wording of section 18(3C) of ICTA. Section 18(3B) states that the references in Schedule D Cases IV and V to income arising from securities or possessions out of the UK are to be taken *in the case of relevant foreign holdings* as including the various categories of proceeds detailed under paragraphs (a) and (b). This is construed as meaning that where the securities or possessions are out of the United Kingdom *and* are relevant foreign holdings references to income from them include the proceeds under those paragraphs (but not in other cases). In other words there is no assumption of a complete overlap between securities or possessions out of the United Kingdom *and* relevant foreign holdings. Whether a security or possession is within Cases IV and V as a security or possession out of the United Kingdom may depend on a number of factors (see Westminster Bank Executor and Trustee Co (Channel Islands) Ltd v National Bank of Greece SA (1970), 46 TC 472 HL).

Chapter 7: Annual payments not otherwise charged

Overview

2478. The Chapter sets out the charge to corporation tax on income on any annual payments that are not charged to tax by any other provision of this Act or any other legislation. It is based on the part of section 18 Schedule D Case III (b) of ICTA which deals with annual payments and the part of section 18 Schedule D Case V of ICTA which deals with foreign annual payments. The corresponding rules for income tax are in Chapter 7 of Part 5 of ITTOIA.

2479. Annuity payments made under purchased life annuities and distributions from unauthorised unit trusts (which in the source legislation are treated as annual payments) are generally regarded as investment income. A company which is the recipient of a payment under a purchased life annuity contract is deemed to be a party to a creditor relationship (see sections 561 and 562 of this Act). The application of the charge to corporation tax on income for distributions from unauthorised unit trusts is in section 972 of this Act. As the application of the charge to corporation tax on income for annual payments in this Chapter takes effect only if an amount is not otherwise charged to corporation tax, there is no overlap between the various provisions.

2480. The phrase "annual payment" is retained but is not defined in the Act or in the source legislation. Instead it derives its meaning from an extensive body of case law. That case law illustrates that the phrase has a meaning for tax purposes far different from its natural one. Replacing that phrase would risk breaking the link to case law without making the law any clearer or easier to understand.

Section 976: Overview of Chapter

2481. This section provides an overview of the Chapter and signposts other relevant provisions. It is new.

Section 977: Charge to tax on annual payments not otherwise charged

2482. This section applies the charge to corporation tax on income to annual payments not charged elsewhere. It is based on sections 9 and 18 of ICTA. The corresponding rule for income tax is in section 683 of ITTOIA.

2483. *Subsection (1)* applies the charge to corporation tax on income to residual annual payments. The charge to tax in the source legislation is in respect of "any annuity or other annual payment". The reference to "any annuity or other" is omitted because most annuities are charged to tax not under this Chapter but under Part 5 (loan relationships). Including a reference to annuities might therefore be misleading.

2484. The words "whether inside or outside the United Kingdom" in Schedule D Case III (b) are also omitted. The place of payment is only one of a number of factors derived from case law which may be taken into account in determining the source of annual payments.

2485. The source legislation excludes "any payment chargeable under Schedule A". It is not necessary to rewrite this as sections 209, 270, 277 and 280 apply the charge to corporation tax on income to property income.

2486. *Subsection (2)* ensures that any exemption resulting from the application of the charge to corporation tax on income to other income is not reversed by the application of that charge under this Chapter.

2487. *Subsection (3)* rewrites "or whether annually or at shorter or longer intervals".

Section 978: Exemption for payments by persons liable to pool betting duty

2488. This section gives an exemption from corporation tax for annual payments made by persons liable to pool betting duty. It is based on section 126 of FA 1990 and section 121 of FA 1991. The corresponding rule for income tax is in section 748 of ITTOIA.

2489. The exemption applies to payments made in consequence of a reduction in pool betting duty, whenever that reduction is made (see *subsection (2)*). Subsection (2) combines the conditions in FA 1990 and FA 1991. Although the source legislation is restricted to the 1990 and 1991 reductions in pool betting duty, the subsection applies to payments made "in consequence of" any reduction in the duty. See *Change 36* in Annex 1.

2490. *Subsection (3)* sets out a further condition which needs to be satisfied. The subsection does not specify that payments in consequence of the 1990 reduction in pool betting duty must be paid for football safety and comfort (see section 126(3) of FA 1990) or that payments in consequence of the 1991 reduction must be paid to the Foundation for Sport and the Arts (see section 121(3) of FA 1991). Instead the subsection applies to a payment in consequence of any reduction in pool betting duty for either purpose. See *Change 35* in Annex 1.

Chapter 8: Income not otherwise charged

Overview

2491. This Chapter applies the charge to corporation tax on income to any income that is not so charged by any other corporation tax provision. The corresponding income tax charge is in Chapter 8 of Part 5 of ITTOIA.

2492. The Chapter also includes exemptions from the charge applied under this Chapter.

2493. In the source legislation, Schedule D is the residual Schedule into which income falls for corporation tax purposes if neither ITEPA nor Schedule A applies to it. The Schedule is set out in section 18 of ICTA. Section 18(1)(a) of ICTA charges "annual profits or gains arising or accruing… from any kind of property whatever…". Section 18(1)(b) of ICTA charges "…other annual profits or gains not charged under Schedule A or under ITEPA 2003 as employment income, pension income or social security income, and not specially exempted from tax".

2494. Schedule D Case VI is itself the residual Case under that Schedule. Tax is charged under Case VI "in respect of annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of Schedule A or by virtue of ITEPA 2003 as employment income, pension income or social security income". Schedule D Case V includes an identical function for the income to which that Case applies. The scope of Case V is (subject to the override in section 18(3A) of ICTA giving priority to Schedule D Case III in respect of anything chargeable under Chapter 2 of Part 4 of FA 1996 as profits or gains from loan relationships) "income arising from possessions out of the United Kingdom not being employment income, pension income or social security income on which tax is charged under ITEPA 2003". Case law has established the comprehensive scope of Case V in relation to "income from possessions out of the United Kingdom". So far as any amount is "income from possessions out of the United Kingdom", Case V is the "last resort" charging provision, not Case VI. And a corollary to that rule is that income charged by Case VI (other than deemed income which is directed by provisions other than section 18 of ICTA to be taxed under Case VI) can only derive from a source in the United Kingdom.

2495. This Chapter brings together the "sweep up" functions of Schedule D Cases V and VI.

2496. The charge under this Chapter is restricted to amounts that are "income" on first principles. That is, in terms of the source legislation they are "annual profits or gains" under section 18(1) of ICTA, as that phrase has been interpreted by case law, and do

not include profits or gains of a capital nature even if such profits are directed to be charged to tax as income.

2497. Under section 396 of ICTA, Schedule D Case VI losses may be set against Case VI profits or gains. Although that relief is not rewritten in this Act, consequential amendments of ICTA in Schedule 1 to this Act ensure that the relief continues to work as before in respect of income within this Chapter despite the abolition by this Act of the Schedules and the Cases of Schedule D.

Section 979: Charge to tax on income not otherwise charged

2498. This section applies the charge to corporation tax on income to income not so charged elsewhere. It is based on sections 9(1), (2), (2B), (2C), (3) and (4) and 18(1) and (3) of ICTA. The corresponding rule for income tax is in section 687 of ITTOIA.

2499. Schedule D Case V charges tax in respect of *income* from possessions out of the United Kingdom. Schedule D Case VI charges tax in respect of *annual profits or gains*. The scope of both Cases is derived from section 18(1) of ICTA, which refers to "annual profits or gains". Case law does not indicate a difference, in the context of section 18 of ICTA, in the meaning of "annual profits or gains" and "income". The choice of term appears to be dictated (although not consistently) by the degree to which a calculation of profit or loss is relevant to the calculation of the income charged. The section uses *income* rather than *(annual) profits or gains*.

2500. *Subsection (2)* protects the effect of any exemption, whether provided by this Chapter or by Part 19 (general exemptions) of this Act or by other legislation.

2501. That subsection disapplies the charge to "deemed income". This term refers to amounts that are treated as income by a provision of the Corporation Tax Acts, so that the charge to corporation tax on income applies to that amount. The disapplication applies in the event that such deemed income would not fall within any other application of the charge to corporation tax on income.

Section 980: Exemption for commercial occupation of woodlands in UK

2502. This section exempts income arising from the occupation of commercial woodlands from any charge under this Chapter. It is based on paragraphs 2 and 3 of Schedule 6 to FA 1988. The corresponding rule for income tax is in section 768 of ITTOIA.

2503. A consequence of this exemption is that no loss relief is available under section 396 of ICTA (losses from miscellaneous transactions). A requirement of that section is that any profit on the transaction would be liable to corporation tax.

2504. This section is complemented by sections 37 and 208 of this Act. The combined effect of these three sections is that income from the occupation of commercial woodlands is ignored for corporation tax purposes.

2505. The interpretation of commercial occupation of woodlands in *subsection (2)* is supplemented by the definition of "woodlands" in section 1317(4) of this Act.

Section 981: Exemption for gains on financial futures

2506. This section removes gains on financial futures, traded options and financial options from the charge to corporation tax on income under this Chapter. It is based on section 128 of ICTA. The corresponding rule for income tax is in section 779 of ITTOIA.

2507. Because of this exemption, the gains in question (which do not include any gains falling within Part 3 (trading income)) are not charged to corporation tax as income but as chargeable gains (see section 143 of TCGA).

2508. In contrast to the equivalent income tax exemption (section 779 of ITTOIA), this exemption does not cover commodity futures. Commodity futures come within the scope of the derivative contracts regime rather than the chargeable gains rules (see Part 7 of this Act). To the extent that any of the futures or options to which this exemption would otherwise apply are also within the scope of that Part, this exemption will not apply. See the definition of a "derivative contract" in section 576.

2509. The section imports the definitions provided by section 143 of TCGA. The definition of "recognised futures exchange" is provided because, unlike the position in ITTOIA (see section 558(3) of that Act), there is no definition of the term elsewhere in this Act that applies here.

Chapter 9: Priority rules

Section 982: Provisions which must be given priority over this Part

2510. This section determines which Part takes priority in the event of an overlap of the charge on the profits of a trade or the profits of a UK property business and a charge under a Chapter of this Part. It is based on section 18(1), (2) and (3) of ICTA. The corresponding rules for income tax are in section 261 of ITTOIA.

2511. In the case of such an overlap, priority is given to the charge under Part 3 (trading income) or Part 4 (property income), as the case may be.

2512. *Subsection (1)* gives statutory effect to the Crown Option as regards the overlap between income charged under another Case of Schedule D and income of a United Kingdom trade charged under Schedule D Case I. See *Change 55* in Annex 1.

2513. *Subsection (2)* is based on the definition of the Cases of Schedule D in section 18 of ICTA so far as it gives priority to the charge under Schedule A.

Part 11: Relief for particular employee share acquisition schemes

Overview

2514. This Part and Part 12 give specific statutory deductions for various costs associated with setting up and operating employee share schemes. These are arrangements under which employers provide incentives for their employees in the form of shares. This Part gives relief for the provision of shares under an approved share incentive plan. It also gives relief for the cost of setting up particular types of approved share scheme. It is based on sections 84A and 85A of ICTA and Schedule 4AA to ICTA.

2515. Neither Part 11 nor Part 12 gives relief for the day to day costs of running a scheme. These must be considered according to the ordinary rules that apply to the calculation of business profits for corporation tax purposes. Those rules also apply if relief is not available under either of these Parts for the costs of setting up a scheme or providing the shares under the scheme.

2516. The rule in section 53 in Part 3 (trading income), that prevents a deduction for items of a capital nature, is subject to contrary provision. This avoids a conflict between that general rule and, in the context of this Part, the specific relief given by some sections of this Part. For example, the cost of setting up a SIP would normally be considered to be capital expenditure.

Chapter 1: Share incentive plans

Section 983: Overview of Chapter

2517. This section introduces the provisions within the Chapter. It is new.

2518. The Chapter gives a deduction for the costs of setting up an approved share incentive plan (SIP) and for the provision of shares under the SIP. The qualifying conditions for approval of the SIP itself are in Schedule 2 to ITEPA and this Chapter is treated as part of the SIP code. See section 984.

Section 984: Chapter to form part of SIP code etc

2519. This section provides that this Chapter forms part of the SIP code. The section also deals with the trustees' acquisition of forfeited shares. It is based on paragraphs 1 and 6 of Schedule 4AA to ICTA.

2520. S*ubsection (2)* makes clear that a consequence of treating the Chapter as part of the SIP code is that the definitions in Schedule 2 to ITEPA apply to the Chapter.

2521. *Subsection (4)* deals with the trustees' acquisition of forfeited shares. The plan rules may require an employee to forfeit his or her plan shares if the employee leaves the company. No further deduction is allowed to the company if the forfeited shares are re-awarded. See section 996 exclusion 5. But it may be necessary to identify whether these shares are included in a later award. See, for example, section 994(6)(b). Subsection (4) identifies when forfeited shares are acquired for this purpose.

Section 985: References to a deduction being allowed to a company

2522. This section explains how a deduction allowed by this Chapter is given to companies carrying on different types of business. It is based on paragraphs 1 and 13 of Schedule 4AA to ICTA.

2523. Paragraph 1(3) of Schedule 4AA to ICTA allows a deduction in calculating trade profits. Section 21A of ICTA applies this rule to the calculation of the profits of a property business. These deductions are dealt with in *subsection (2)*.

2524. A property business may also be an investment business. *Subsection (3)* makes specific provision for a company with investment business. The deduction is allowed as an expense of management (see Chapter 2 of Part 16).

2525. If the business is both a property business and an investment business subsection (3) gives priority to subsection (2). This priority is based on section 75(2) of ICTA which provides that a deduction as an expense of management is not given if the deduction is otherwise allowable.

Section 986: Treatment of receipts under Chapter

2526. This section explains how a withdrawal of relief is taxed. It is based on section 21A of, and paragraphs 10 to 13 of Schedule 4AA to, ICTA.

2527. If relief is withdrawn the company is treated as receiving an amount equal to the deduction. See, for example, section 990(4). This section sets out how this is taxed.

2528. *Subsection (3)* applies if the relief is recovered after the trade or property business has ceased. It makes clear that the recoveries are taxed as post-cessation receipts. In the source legislation the amounts are taxed as trading receipts. See *Change 76* in Annex 1. This change also affects sections 990(4) and (5), 992(4) and (6), 993(2) and (4) and 998(3) and (4).

2529. If the company is not carrying on a trade or property business or has not carried on a trade or property business the amount is one to which the charge to corporation tax on income is applied, see *subsection (4)*.

2530. This treatment is also applied to the recovery of relief given for contributions to a plan trust. In the source legislation paragraphs 10 and 12 of Schedule 4AA to ICTA charge these amounts as trade receipts. See *Change 76* in Annex 1.

2531. The amount charged by subsection (4) is included on the list of former Schedule D Case VI charges (in section 834A of ICTA as inserted by Part 1 of Schedule 1 to this Act). This does not mean that loss relief is available under section 396 of ICTA against the amount charged by subsection (4). This is because the amount charged by subsection (4) does not arise from a transaction as required by that section.

Section 987: Deduction for costs of setting up an approved share incentive plan

2532. This section gives a deduction for the costs setting up a SIP. It is based on paragraph 7 of Schedule 4AA to ICTA.

2533. *Subsection (4)* applies if there is a delay between the company incurring the costs and the SIP being approved. The deduction is given for the period of account in which the scheme is approved. This avoids the company having to amend its company tax return for the period in which the expenditure was incurred or in an extreme case being outside the time limit for amending that return.

Section 988: Deductions for running expenses of an approved share incentive plan

2534. This section prevents any prohibitive rule in this Chapter denying a deduction for the costs of running a SIP. It is based on paragraph 8 of Schedule 4AA to ICTA.

2535. The trustees of a SIP will incur costs related to the day to day running of the SIP. For example, they will have to operate a PAYE scheme to deal with the employees' income tax liabilities. They will also incur incidental costs in acquiring the shares. The employing company will have to meet these costs.

2536. The section does not itself give the company a deduction for payments made to the trustees to enable them to meet the running costs. It provides that none of the prohibitive rules in this Chapter, such as section 994(7), prevents a deduction being given for running expenses. As the SIP is run for the benefit of its employees the costs would usually be allowed as a normal deduction in calculating the company's taxable profits. Whether or not a deduction is allowed is considered on first principles.

2537. *Subsection (3)* makes clear that running expenses do not include the cost of acquiring the shares except for the incidental costs listed in *subsection (4)*. The reference to stamp duty reserve tax is new.

Section 989: Deduction for contribution to plan trust

2538. This section allows a deduction for a payment to the trustees which they use to buy shares for later award under the SIP. It is based on paragraphs 9 and 10 of Schedule 4AA to ICTA.

2539. In broad terms the purpose of this section is to give the company a deduction at the time when it funds the purchase of the shares and not when the shares are awarded to the employee. Without this section it could be difficult for companies to finance the purchase of shares in advance of them being awarded.

2540. The section applies to payments made on or after 6 April 2003. This commencement is preserved in Schedule 2 (transitionals and savings).

2541. "Plan trust" has the meaning given in paragraph 71(3) of Schedule 2 to ITEPA.

2542. *Subsection (2)* provides that at the end of the period of 12 months beginning when the trustees make the acquisition with the payment the trustees must hold at least 10% of the ordinary share capital of the company in which the shares are acquired. This total applies to all the shares held. There is no requirement that the total is made up of shares acquired using the payment.

2543. Under the SIP rules shares will be appropriated to an employee but the employee is required to leave the shares with the trustees. For example, paragraph 36(1) of

Schedule 2 to ITEPA requires free shares to remain in the hands of the trustees for a holding period of at least three years. *Subsection (3)* makes clear that these shares count towards the 10% total.

Section 990: Withdrawal of deduction under section 989

2544. This section withdraws the relief given by section 989 if the shares acquired with the payment are not awarded within specified time limits. It is based on paragraph 10 of Schedule 4AA to ICTA.

2545. *Subsection (4)* provides that the relief is withdrawn by treating the deduction as an amount received by the company. This amount is taxed in accordance with the rules in section 986.

2546. This section refers to a deduction being given under section 989. It is possible that the deduction may have been given under paragraph 9 of Schedule 4AA to ICTA if the relief was given in an accounting period before this Act took effect. The general continuity of law provisions in Schedule 1 to this Act provide that where necessary references to the new legislation should be read as applying also to the source legislation. So the recovery provisions still apply.

2547. This section contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on section 986.

Section 991: Another deduction to be allowed if all acquired shares are awarded

2548. This section allows a further deduction if the relief is withdrawn under section 990 but all the acquired shares are awarded at a later date. It is based on paragraph 10 of Schedule 4AA to ICTA.

Section 992: Award of shares to excluded employee

2549. This section withdraws a proportion of the relief given under sections 989 and 991 if shares are awarded to an excluded employee. It is based on paragraph 10 of Schedule 4AA to ICTA.

2550. The definition of excluded employee in *subsection (2)* is the same as that in paragraph 4(2) of Schedule 4AA to ICTA which is rewritten as Exclusion 1 in section 996.

2551. This section contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on section 986.

Section 993: Termination plan notice

2552. This section withdraws a proportion of the relief given by section 989 if the company terminates the SIP before all the shares have been awarded. It is based on paragraph 12 to Schedule 4AA to ICTA.

2553. This section contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on section 986.

Section 994: Deduction for providing free or matching shares

2554. This section gives a deduction for providing free or matching shares. It is based on paragraph 2 of Schedule 4AA to ICTA.

2555. A “free share” is defined in paragraph 2(1)(a) of Schedule 2 to ITEPA. It means a share appropriated to the employee without payment.

2556. A "matching share" is defined in paragraph 3(1) of Schedule 2 to ITEPA. It means a share appropriated to the employee without payment in proportion to the partnership shares acquired by the employee.

2557. A "group plan" is defined in paragraph 4 of Schedule 2 to ITEPA. It means a SIP established by a parent company in which the companies it controls are allowed to participate.

Section 995: Deduction for additional expense in providing partnership shares

2558. This section gives a deduction for any contribution the company makes towards the acquisition of partnership shares. It is based on paragraph 3 of Schedule 4AA to ICTA.

2559. A "partnership share" is defined in paragraph 2(1)(a) of Schedule 2 to ITEPA. It means a share acquired by the trustees on behalf of an employee out of sums deducted from the employee's salary.

2560. This section is concerned with the case to which paragraph 52 of Schedule 2 to ITEPA applies. Partnership shares are acquired by the trustees with funds provided by the employee. The rules of the SIP may require the employee to make payments to the trustees over an accumulation period which cannot last longer than twelve months. Paragraph 52(3) of Schedule 2 to ITEPA provides the number of partnership shares awarded to the employee is calculated at the end of the accumulation period by reference to the lower of:

- the market value of the shares at the beginning of the period; or
- the market value of the shares on the date on which they are to be acquired.

2561. If the market value of the shares at the end of the period is greater than the value at the beginning the company will make up the difference. This section gives the company a deduction for the excess.

Section 996: Shares excluded from sections 994 and 995

2562. This section identifies the shares that do not qualify for relief if they are awarded as free, matching or partnership shares. It is based on paragraphs 4, 6 and 9 of Schedule 4AA to ICTA.

2563. *Exclusion 1* is similar to the exclusion in section 992(2). It requires the employee to whom the shares are awarded to be within the charge to income tax on any earnings from the employment in respect of which the shares were awarded. Generally, it has the effect of excluding any shares awarded to non-UK resident employees.

2564. *Exclusion 2* is intended to protect the employee by acting as a disincentive to the award of shares that are intended to reduce in value.

2565. *Exclusion 3* applies if the company or an associated company operates another share scheme, including another SIP, and has already had a deduction for the cost of providing the shares for use by that scheme. As shares are not identifiable individually, rules are needed to identify when the shares included in an award were acquired. *Subsection (6)(b)* identifies whether shares included in an award have already had relief under another SIP or share scheme.

Section 997: No deduction for expenses in providing dividend shares

2566. This section provides that no deduction is allowed for the cost of providing dividend shares. It is based on paragraph 5 of Schedule 4AA to ICTA.

2567. The expression "dividend shares" is defined in paragraph 62(3)(b) of Schedule 2 to ITEPA. They are shares acquired by the trustees reinvesting cash dividends declared on plan shares the trustees hold on behalf of employees participating in the SIP.

Section 998: Withdrawal of deductions if approval for share incentive plan withdrawn

2568. This section withdraws any deduction given under this Chapter if approval for the SIP is withdrawn. It is based on paragraph 11 of Schedule 4AA to ICTA.

2569. Paragraph 83 of Schedule 2 to ITEPA allows an officer of Revenue and Customs to issue a notice to the company withdrawing approval of a SIP. If approval is withdrawn a separate notice must be issued under *subsection (2)* of this section to recover any relief given under this Chapter.

2570. The relief is withdrawn by treating the company as receiving an amount equal to the amount of the deduction. Section 986 sets out how this amount is taxed.

2571. This section contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on section 986.

Chapter 2: SAYE option schemes, Company share option schemes and Employee share options trusts

Section 999: Deduction for costs of setting up SAYE option scheme or CSOP scheme

2572. This section allows a deduction for the costs of setting up an approved "save as you earn" (SAYE) option scheme or an approved "company share option plan" (CSOP) scheme. It is based on sections 21A, 75 and 84A of ICTA.

2573. A CSOP scheme is commonly known as a company share option plan.

2574. The section is very similar to sections 987 and 1000. The deduction is given in calculating the trade or property business profits, *subsection (3)*, or as an expense of managing an investment business, *subsection (4)*. If the business is both an investment business and a property business subsection (4) gives priority to the property business. This order of priority is based on section 75(2) of ICTA which provides that a deduction as an expense of management is not given if the deduction is otherwise allowable.

2575. *Subsection (6)* applies if there is a delay between the company incurring the costs and the scheme being approved. The deduction is given for the period of account in which the scheme is approved. This avoids the company having to amend its company tax return for the period in which the expenditure is incurred or in an extreme case being outside the time limit for amending that return.

2576. Relief for providing the shares under the schemes is given by Part 12, which rewrites Schedule 23 to FA 2003.

2577. A CSOP can be set up by a non-UK resident company which trades in the United Kingdom otherwise than through a permanent establishment. Such a non-UK resident company would be subject to income tax, rather than corporation tax.

Section 1000: Deduction for costs of setting up employee share ownership trust

2578. This section gives relief for the costs of setting up a qualifying employee share ownership trust (QUEST). It is based on sections 21A, 75 and 85A of ICTA.

2579. In practice it is unlikely that a QUEST would be set up in an accounting period to which this Act applies. Section 67 of FA 1989 gave relief for employers' contributions to QUESTs. That relief was withdrawn by section 142 of FA 2003 with effect for contributions made in accounting periods beginning on or after 1 January 2003. Relief for the provision of shares through a QUEST is given now by Schedule 23 to FA 2003, rewritten in Part 12 of this Act.

2580. The relief given by section 85A of ICTA for the setting up costs was not withdrawn and is still available in the event that a company did set up a new QUEST. The section is very similar to section 999.

2581. This Act does not rewrite section 85 of ICTA (payments to trustees of approved profit sharing schemes). Approved profit sharing schemes were phased out by section 49 of FA 2000, and the deduction in section 85 of ICTA was phased out by section 50 of FA 2000. This Act accordingly does not rewrite section 85 of ICTA (or section 50 of FA 2000).

Part 12: Other relief for employee share acquisitions

Overview

2582. This Part and Part 11 give specific statutory deductions for various costs associated with setting up and operating employee share schemes. These are arrangements under which employers provide incentives for their employees in the form of shares. This Part is based on Schedule 23 to FA 2003.

2583. The relief given is available to companies carrying on all types of business. There are no requirements as to how the company funds or structures the arrangements. It applies to shares that are newly issued, acquired in the market or acquired by private purchase. It applies to formal plans operated through trusts and to informal arrangements.

2584. Although the Part gives relief to a company, usually the employing company, in calculating its corporation tax profits the availability and the amount of the relief are closely related to the income tax position of the employee. Because of the links to employment income this Part makes frequent reference to provisions in ITEPA.

Chapter 1: Introduction

Section 1001: Overview of Part

2585. This section gives an overview of the Part. It is new.

Section 1002: "Employment"

2586. This section gives the meaning of "employment" for the purposes of the Part. It is based on paragraph 26 of Schedule 23 to FA 2003.

Section 1003: "Shares" etc

2587. This section gives the meaning of "shares" for the purposes of the Part. It is based on paragraphs 10, 17, 22, 22D and 30 of Schedule 23 to FA 2003.

2588. The test in *subsection (2)*, which determines when the shares are acquired, is identical to that in section 477(4) of ITEPA. This correlation is important as that section determines the income tax position of the employee for the purposes of section 1017.

Section 1004: Groups, consortiums and commercial associations of companies

2589. This section gives various definitions that apply when considering employee share acquisitions within a group of companies. It is based on paragraphs 23, 28 and 29 of Schedule 23 to FA 2003.

2590. Any group company that owns shares in the consortium company is treated as a member of the consortium. But a member of a group of companies is not part of the consortium simply because another member of the group holds shares in the consortium company.

Section 1005: Other definitions

2591. This section gives various definitions used for the purposes of the Part. It is based on paragraph 30 of Schedule 23 to FA 2003.

2592. "Convertible securities" has the same meaning as that in section 436 of ITEPA.

2593. "Restricted shares" means shares that are restricted securities or a restricted interest in securities for the purposes of Chapter 2 of Part 7 of ITEPA. These terms are defined in section 423 of ITEPA.

Chapter 2: Relief if shares acquired by employee or other person

Overview

2594. This Chapter gives relief for an acquisition of shares. It is based on Part 2 of Schedule 23 to FA 2003. The source legislation describes the process by which the shares are acquired as an award of the shares. For the purposes of Schedule 23 it means any acquisition of shares that does not require the exercise of a right to make the acquisition. Relief for shares acquired through the exercise of an option is given by Part 3 of Schedule 23 to FA 2003, rewritten as Chapter 3 of this Part.

2595. This Chapter refers merely to shares being acquired by the employee or another person. The boundary between this Chapter and Chapter 3 is created by section 1007(1)(e). This prevents relief being given under both Chapters and gives priority to Chapter 3.

2596. This Chapter applies to the acquisition of all types of shares including restricted shares and convertible shares. This is a different structure from that in the source legislation. In the source legislation the application of Part 2 of Schedule 23 is modified to deal with restricted shares and convertible shares. In this Chapter, and Chapter 3, the conditions to qualify for relief and the amount of the relief are set out in full. Chapters 4 and 5 then give additional relief for future events that affect restricted shares and convertible shares after they have been acquired.

Section 1006: Overview of Chapter

2597. This section gives an overview of the Chapter. It is new.

Section 1007: Basic requirements for relief under Chapter 2

2598. This section sets out the basic requirements for relief under this Chapter. It is based on paragraphs 1 and 3 of Schedule 23 to FA 2003.

Section 1008: Conditions relating to shares acquired

2599. This section identifies the type of shares that have to be acquired. It is based on paragraphs 4 and 6 of Schedule 23 to FA 2003.

Section 1009: Conditions relating to employee's income tax position

2600. This section gives the conditions that must be met in relation to the employee's income tax position. It is based on paragraphs 7 and 20 of Schedule 23 to FA 2003.

2601. The "employee" is the person defined in section 1007(1)(a) as the person in respect of whose employment the shares are acquired.

2602. *Subsection (1)* deals with the acquisition of shares other than restricted shares. So it applies to the acquisition of convertible shares. The acquisition of the shares has to result in an income tax charge on the employee.

2603. Relief is not given if section 446UA of ITEPA applies to the shares. That provision applies to shares acquired for less than their market value under arrangements that seek

to avoid the income tax charge or the national insurance contribution on the employment income.

2604. *Subsection (2)* applies if the shares are restricted shares.

2605. Relief will be available in two circumstances.

2606. First, if as a result of the acquisition there is an employment income tax charge on earnings as defined in Chapter 1 of Part 3 of ITEPA. This is a charge on the money's worth of the shares. The test is met at the time of acquisition.

2607. Second, if on acquisition there is no immediate employment income tax charge, but there will be such a charge if there occurs later a chargeable event in respect of the shares. The test is met at the time of acquisition. The company does not have to suspend its claim until that later event actually occurs. It is sufficient that on acquisition the circumstances are such that it appears that the employee will become subject to a charge under section 426 of ITEPA. One reason why there may be no immediate income tax charge is if the shares are forfeitable and the exemption in section 425(2) of ITEPA applies.

2608. The events that trigger a later charge are listed in section 427(3) of ITEPA. They include, for example, a lifting of the restrictions at a time when the recipient of the shares or an associated person still owns the shares. (The definition of associated person for the purposes of section 427 of ITEPA is in section 421C(1) of ITEPA and includes the person who acquired the shares.)

2609. This section does not rewrite paragraph 20(3) of Schedule 23 to FA 2003. Paragraph 20(3) provides that the test in paragraph 20(2)(a)(ii) of Schedule 23 to FA 2003 is applied on the assumption that section 426 of ITEPA continues to apply after the employee dies. Paragraph 20(2)(a)(ii) of Schedule 23 to FA 2003 is rewritten as subsection (2)(b).

2610. Paragraph 20(3) of Schedule 23 to FA 2003 is not necessary where the employee dies after acquiring shares but before becoming subject to a charge. This is because the test in paragraph 20(2)(a)(ii) of Schedule 23 to FA 2003 is applied to the circumstances existing on acquisition. It does not apply on the subsequent chargeable event (for example, the lifting of the restriction). Since the test has already been met on acquisition, it is not necessary to rely on paragraph 20(3) to provide for the case in which section 426 of ITEPA ceases to apply because of some future event. The fact that the employee dies before the restriction is lifted and the section 426 charge does not materialise is irrelevant for the purposes of the test in paragraph 20(2)(a)(ii).

2611. Paragraph 20(3) of Schedule 23 to FA 2003 cannot be relevant to a company's entitlement to relief under this Part where the employee dies before acquiring shares. If while alive the employee possesses a right to acquire shares then the employee possesses an option and corporation tax relief will be available under Chapter 3 of this Part. If while alive the employee does not enjoy a right to acquire shares and no shares are acquired by a person before the employee's death, but after the employee's death shares are acquired by a person, then for both practical and technical reasons corporation tax relief under this Part is not available. See also the commentary on section 1025.

Section 1010: Calculation of relief if shares are neither restricted nor convertible

2612. This section gives the amount of the relief if the shares are neither restricted nor convertible. It is based on paragraph 8 of Schedule 23 to FA 2003.

Section 1011: Calculation of relief if shares are restricted or convertible

2613. This section gives the amount of relief if the shares are restricted or convertible. It is based on paragraphs 21 and 22C of Schedule 23 to FA 2003.

2614. *Subsections (2)* and *(3)* give the basic rule that the relief is equal to the amount that counts as earnings of the employee from the employment in respect of which the shares were acquired. This is the money's worth charge in Chapter 1 of Part 3 of ITEPA. It will be equal to the market value of the shares.

2615. If the shares are restricted shares the valuation takes account of the restriction unless the employer and employee have made a joint election under section 431 of ITEPA that the shares are valued as if they were not restricted shares (section 431(1)), or as if particular restrictions did not apply (section 431(2)). Either election will give the employee a higher employment income charge on acquisition which is mirrored in greater relief being given to the employer. If an election under section 431(1) is made there will be no later employment income charge if the restrictions are lifted and no additional relief will be available to the employer under Chapter 4 of this Part.

2616. If the shares are convertible shares the basis of valuation in section 437(1) of ITEPA applies. The shares are valued as if they are not convertible. Instead of referring the reader to section 437(1), and rewriting the disapplication of section 437(2) in paragraph 22C(4A) of Schedule 23 to FA 2003, the full out words in subsection (3) state the valuation rule in section 437(1).

2617. There is a difference between subsections (2) and (3) which is not apparent from the text. This is that the calculation under subsection (2) is made by reference to Chapter 2 of Part 7 of ITEPA, while the calculation under subsection (3) is made by reference to Chapter 3 of that Part. In effect, different rules apply to the calculation under these two subsections. It is therefore possible that the calculations under these two subsections will yield different amounts.

2618. *Subsection (5)* rewrites the comparison in paragraphs 21(5) and 22C(5) of Schedule 23 to FA 2003 if the shares are both restricted and convertible. The company may claim relief for the higher figure (as yielded by subsection (2) or (3)) even if the employee has or will be chargeable to tax on a different amount in respect of the shares acquired.

Section 1012: Reduction in amount of relief

2619. This section restricts the relief if the shares are given partly for employment in a qualifying business and partly for employment in a business that does not qualify. It is based on paragraphs 8, 21 and 22C of Schedule 23 to FA 2003.

Section 1013: How the relief is given

2620. This section explains how the relief is given. It is based on paragraphs 9, 10, 22 and 22D of Schedule 23 to FA 2003.

Chapter 3: Relief if employee or other person obtains option to acquire shares

Overview

2621. The Chapter gives relief for the acquisition of shares "pursuant to an option". It is based on Part 3 of Schedule 23 to FA 2003. "Option" is defined in section 1005 to include "any right to acquire shares". This definition is based on the definition of "securities option" in section 420(8) of ITEPA. Using a similar definition of "option" relates the relief given to the employing company to the income tax charge on the employee.

2622. The definition is wider than the normal meaning of option as the shares may be acquired without the need to exercise any right. The Chapter follows the source legislation in describing this as the acquisition of shares "pursuant to an option". This is also to align the language in this Chapter with that used in ITEPA. See, for example, section 477(3)(a) of ITEPA.

2623. Like Chapter 2 this Chapter gives relief for the acquisition of all types of share including restricted shares and convertible shares. The Chapter has rules to deal with a change

in circumstances between the grant of the option and the acquisition of the shares (for example, the death of the employee or original option holder or a take-over of the employing company).

Section 1014: Overview of Chapter

2624. This section gives an overview of the Chapter. It is new.

Section 1015: Basic requirements for relief under Chapter 3

2625. This section sets out the basic requirements for relief under this Chapter. It is based on paragraphs 1, 3 and 27 of Schedule 23 to FA 2003.

2626. The requirements are very similar to those which apply to relief under Chapter 2. See section 1007.

Section 1016: Conditions relating to shares acquired

2627. This section identifies the type of shares that have to be acquired. It is based on paragraphs 4 and 12 of Schedule 23 to FA 2003.

Section 1017: Condition relating to employee's income tax position

2628. This section gives the conditions that must be met in relation to the employee's income tax position. It is based on paragraphs 14 and 27 of Schedule 23 to FA 2003.

2629. *Subsection (1)* gives the basic rule that the acquisition must be a chargeable event for the purposes of section 476 of ITEPA. Section 476(2) of ITEPA provides that "chargeable event" has the meaning given by section 477 of ITEPA. The list of chargeable events is given in section 477(3) of ITEPA.

2630. The only event relevant to this Chapter is section 477(3)(a) which applies to "the acquisition of securities pursuant to the employment-related securities option by an associated person". (The definition of "associated person" for the purposes of section 477 of ITEPA, in section 472(1) of ITEPA, includes the person who acquired the option.)

2631. The income tax condition is satisfied whether or not an amount counts as employment income as a result of the chargeable event. This covers the case in which the shares are acquired under an approved share option scheme under which there is no charge on the acquisition. For example, section 519 of ITEPA provides that no liability to income tax arises on the exercise of an option under an approved SAYE option scheme.

Section 1018: Calculation of relief if shares are neither restricted nor convertible

2632. This section gives the amount of the relief if the shares are neither restricted nor convertible. It is based on paragraph 15 of Schedule 23 to FA 2003.

Section 1019: Calculation of relief if shares are restricted or convertible

2633. This section gives the amount of the relief if the shares are restricted or convertible, where they are acquired pursuant to an option. It is based on paragraphs 21 and 22C of Schedule 23 to FA 2003.

2634. *Subsections (2)(a)* and *(3)(a)* give the basic rule. The relief is equal to the amount that counts as employment income under section 476 of ITEPA when the shares are acquired. The chargeable amount is given in section 478 of ITEPA. In broad terms it is the market value of the shares at the time they are acquired (section 479 of ITEPA) less any consideration given for the shares and any expenses incurred on the acquisition (section 480 of ITEPA).

2635. *Subsections (2)(b)* and *(3)(b)* modify the basic rule if the option is a qualifying option under the EMI (Enterprise Management Incentives) code. The effect of that code is ignored in calculating the amount of the relief. The EMI code is defined in section 527(3) of ITEPA. A qualifying option is defined in section 527(4) of ITEPA.

2636. This modification is needed to deal with the interaction between sections 476 and 531 of ITEPA. Section 531 of ITEPA sets out how to calculate the amount that counts as employment income under section 476 of ITEPA if the option allows the shares to be acquired at a discount to their market value at the date the option is granted. The amount that counts as employment income is that market value less any consideration given for the option and any consideration given for the shares. This limits the employment income charge on the employee to the amount of the discount.

2637. Subsections (2)(b) and (3)(b) ensure that the company gets a deduction for the market value of the shares at the date they are acquired under the option less any consideration given for the shares and any expenses incurred on the acquisition.

2638. The full out words at the end of subsection (3) are similar to the full out words at the end of section 1011(3). If the shares are convertible shares they are valued on the basis that they are not convertible. This is the normal method of valuation that section 437(1) of ITEPA applies to such shares.

2639. There is a difference between subsections (2) and (3) which is not apparent from the text. This is that the calculation under subsection (2) is made by reference to Chapter 2 of Part 7 of ITEPA, while the calculation under subsection (3) is made by reference to Chapter 3 of that Part. In effect, different rules apply to the calculation under these two subsections. It is therefore possible that the calculations under these two subsections will yield different amounts.

2640. *Subsection (4)(a)* states the rule that, in calculating the amount of relief given to the company, no deduction is made for the relief given to the employee by sections 481 and 482 of ITEPA. These sections reduce the employment income charge by the amount of certain national insurance contributions paid by the employee.

2641. *Subsection (5)* rewrites the comparison in paragraphs 21(5) and 22C(5) of Schedule 23 to FA 2003 if the shares are both restricted and convertible. The company may claim relief for the higher figure (as yielded by subsection (2) or (3)) even if the employee has or will be chargeable to tax on a different amount in respect of the shares acquired.

2642. *Subsection (6)* deals with the case in which the employee dies before the shares are acquired so there is no employment income charge on which to calculate the relief. It is based on paragraph 27(1) of Schedule 23 to FA 2003.

2643. Strictly speaking paragraph 27(1) of Schedule 23 to FA 2003 deems the employee to be alive only for the purposes of the income tax condition in paragraph 14 of Schedule 23 to FA 2003. Subsection (6) extends that treatment to the calculation of the relief.

Section 1020: Reduction in amount of relief

2644. This section restricts the relief if the shares are given partly for employment in a qualifying business and partly for employment in a business that does not qualify. It is based on paragraphs 15, 21 and 22C of Schedule 23 to FA 2003.

2645. Its effect is identical to section 1012.

Section 1021: How the relief is given

2646. This section explains how the relief is given. It is based on paragraph 16 of Schedule 23 to FA 2003 and is identical to section 1013.

Section 1022: Takeover of company whose shares are subject to option

2647. This section gives relief if the company whose shares are to be acquired is taken over and the original option is exchanged for an option over shares in the new company. It is based on paragraph 13 of Schedule 23 to FA 2003.

Section 1023: Supplementary provision for purposes of section 1022

2648. This section gives the definitions needed for the purposes of section 1022. It is based on paragraph 13 of Schedule 23 to FA 2003.

2649. *Subsection (3)* defines a takeover in terms of one company acquiring control of another. The definition of "control" in section 840 of ICTA applies for this purpose. See section 1316.

Section 1024: Transfer of qualifying business by group transfers

2650. This section gives relief to a new employing company if the business carried on by the original employing company is transferred within a group of companies. It is based on paragraph 23 of Schedule 23 to FA 2003.

2651. The definition of group transfer is in section 1004(3).

2652. Paragraph 23(1)(a) of Schedule 23 to FA 2003 applies the rule rewritten in this section to an award of shares. The rule for relief given by Chapter 2 of this Part is not rewritten here as that Chapter gives no scope for a transfer of the business before the shares are acquired.

Chapter 4: Additional relief in cases involving restricted shares

Overview

2653. This Chapter applies if the shares acquired, either directly or pursuant to an option, are restricted shares. It gives the company further relief if an employment income charge arises after the shares have been acquired or if the employee dies. It is based on Part 4 of Schedule 23 to FA 2003.

2654. Schedule 2 (transitionals and savings) provides that the special rules for restricted shares in this Part do not apply to shares acquired before 16 April 2003. If shares acquired before that date are forfeitable shares as defined in paragraph 19 of Schedule 23 to FA 2003 (as originally enacted) that Schedule continues to apply.

Section 1025: Additional relief available if shares acquired are restricted shares

2655. This section sets out the basic conditions for the relief to apply and identifies the company to which the relief is given. It is based on paragraph 21 of Schedule 23 to FA 2003.

2656. *Subsection (1)* gives the two basic conditions for the relief to apply.

2657. First, subsection (1)(a), the company must have been entitled to relief under either Chapter 2 or Chapter 3 in relation to restricted shares which have been acquired either directly or through an option. This condition will still be met if the amount of the relief is nil possibly because section 425(1) of ITEPA has applied to an acquisition of forfeitable shares. See the commentary on section 1009(2).

2658. For a number of years after this Act takes effect initial relief on the acquisition of the shares will have been given not under Chapters 2 and 3 of this Part but under Schedule 23 to FA 2003. In that case the continuity of law provisions in Schedule 2 (transitionals and savings), apply to treat references to Chapters 2 and 3 as if they were references to the equivalent provisions in the source legislation. Schedule 2 gives a signpost to those provisions and states their effect.

2659. Second, subsection (1)(b), after the shares have been acquired either section 426 of ITEPA applies (so giving the employee an amount of employment income) or the employee dies.

2660. The chargeable events that can give rise to a post-acquisition employment income charge under section 426 of ITEPA are listed in section 427(3) of ITEPA.

2661. The definition of "associated person" in section 421C(1) of ITEPA includes the person who acquired the shares.

2662. There will be no employment income charge if the employee dies before any of the events listed in section 427(3) of ITEPA occurs. Section 421B(4) and (6) of ITEPA provides that Chapter 2 of Part 7 of ITEPA ceases to apply to the securities immediately before the death of the employee.

2663. Subsection (1) treats the death as a chargeable event and gives the relief that would have been given if there had been an actual chargeable event at the date of death. No further relief is available under subsection (1) as the death of the employee prevents any further charge arising under section 426 of ITEPA.

2664. This section does not give relief if the employee has died before the shares are acquired. First, the deeming provision in paragraph 20(3) of Schedule 23 to FA 2003 (see the commentary on section 1009) is not expressed to apply to paragraph 21 of Schedule 23. Second, paragraph 21(2)(c) of Schedule 23, when read with paragraph 21(7) of Schedule 23, can work sensibly only if the employee dies after the shares are acquired. Third, the inclusion of paragraph 21(2)(c) of Schedule 23 itself indicates that paragraph 21(2)(b) of Schedule 23 applies only while the employee is alive.

Section 1026: Relief available on occurrence of chargeable event

2665. This section gives the relief available if there is a chargeable event as defined in section 427(3) of ITEPA. It is based on paragraphs 21 and 22 of Schedule 23 to FA 2003.

2666. Various reliefs are available in calculating the amount that counts as employment income but these reliefs are not deducted from the relief given to the company (see *subsection (4)*).

Section 1027: Relief available on death of employee

2667. This section gives the relief available on the death of the employee. It is based on paragraphs 21 and 22 of Schedule 23 to FA 2003.

2668. The amount of the relief is calculated by deeming the shares to be sold to an unconnected person immediately before the death of the employee (see *subsection (3)*). This deemed sale is a chargeable event within section 427(3) of ITEPA.

Section 1028: Supplementary provision for purposes of sections 1026 and 1027

2669. This section explains how relief is given under the Chapter. It is based on paragraphs 9, 16 and 21 of Schedule 23 to FA 2003.

2670. The section does not repeat the rules but cross-refers to the equivalent provisions in Chapters 2 and 3.

Section 1029: Transfer of qualifying business by group transfers

2671. This section gives relief to the successor company if the business carried on by the employing company is transferred before a chargeable event or the death of the employee. It is based on paragraph 23 of Schedule 23 to FA 2003.

2672. The section is very similar to section 1024 which gives relief to a successor company if the business is transferred some time between the grant of the option and the acquisition of shares pursuant to the option. Section 1024 identifies this time-frame as the "option period".

2673. *Subsection (6)* provides that the "interim period" for this section starts when the shares or option are acquired. If the original relief has been given under Chapter 3 this means the "interim period" will include the period before the shares are acquired. This rule is needed to give relief to the successor company if there is a group transfer before the shares are acquired.

2674. Section 1024 will give relief under Chapter 3 and section 1029 will give relief under this Chapter. Section 1029 would apply also if there was a further transfer after the shares had been acquired but before a chargeable event or the death of the employee.

Chapter 5: Additional relief in cases involving convertible securities

Overview

2675. This Chapter provides relief if the shares acquired, either directly or pursuant to an option, are convertible shares. It gives additional relief if a further employment income charge arises or the employee dies after the shares have been acquired and it also applies if there is an acquisition of convertible securities which are converted into qualifying shares. It is based on Part 4A of Schedule 23 to FA 2003.

Section 1030: Application of Chapter

2676. This section gives the conditions for the Chapter to apply. It is based on paragraphs 22B and 22C of Schedule 23 to FA 2003.

2677. As with relief under Chapter 4 the continuity of law provisions will apply if the shares or securities were acquired when Schedule 23 to FA 2003 was still in force. See the commentary on section 1025.

2678. *Subsection (5)* applies if the original recipient of an option dies and as a result the shares or securities are acquired by a different person. Relief under Chapter 3 on the acquisition of the shares is given by section 1015(3) which treats the shares as acquired by the original recipient of the option. Subsection (5) does the same for relief under this Chapter.

2679. *Subsection (6)* applies if there has been a takeover of the company whose shares were to be acquired and the options have been exchanged for options in a new company. Section 1022 gives relief under Chapter 3. Subsection (6) does the same for relief under this Chapter.

Section 1031: Additional relief available if shares acquired are convertible shares etc

2680. This section governs the events upon which and the timing on which relief is available. It is based on paragraphs 22C and 22D of Schedule 23 to FA 2003.

2681. *Subsection (2)* applies if the employee has died and there is a chargeable event that would have given rise to an employment income charge if the employee had been alive. Paragraph 22C(2)(c) of Schedule 23 to FA 2003 refers to relief being available on the death of the employee. In fact the availability of the relief is not triggered by the death of the employee but by the occurrence of a later chargeable event after the death. This sequence is reflected in *subsection (3)*.

Section 1032: Meaning of "chargeable event"

2682. This section gives the meaning of "chargeable event". It is based on paragraph 22C of Schedule 23 to FA 2003.

Section 1033: Relief available on occurrence of chargeable event

2683. This section identifies the amount and timing of relief available on a chargeable event. It is based on paragraphs 22C and 22D of Schedule 23 to FA 2003.

Section 1034: Relief available following death of employee

2684. This section identifies the amount of the relief available if the employee dies. It is based on paragraphs 22C and 22D of Schedule 23 to FA 2003.

2685. *Subsections (3)* and *(4)* provide relief which is similar to that given by section 1027 for restricted shares in that it is the amount that would count as employment income if the employee were still alive. But, under *subsection (2)*, unlike section 1027, relief is given for the accounting period in which the event occurs, not the period in which the employee dies.

Section 1035: Supplementary provision for purposes of sections 1033 and 1034

2686. This section explains how relief is given under the Chapter. It is based on paragraphs 9, 16 and 22C of Schedule 23 to FA 2003.

2687. The section does not repeat the rules but cross-refers to the equivalent provisions in Chapters 2 and 3.

Section 1036: Transfer of qualifying business by group transfers

2688. This section gives relief to the successor company if the business carried on by the employing company is transferred before a chargeable event or the death of the employee. It is based on paragraph 23 of Schedule 23 to FA 2003.

2689. The section performs the same function for convertible shares that section 1029 performs for restricted shares.

Chapter 6 Relationship between relief under this Part and other reliefs

Section 1037: Priority of Chapter 1 of Part 11

2690. This section gives priority to any deduction available under Chapter 1 of Part 11 of this Act. It is based on paragraph 24 to Schedule 23 to FA 2003.

2691. Chapter 1 of Part 11 of this Act gives relief for SIP schemes.

Section 1038: Exclusion of other deductions

2692. This section provides that no other deduction is available for the provision of shares if relief is, or could be, given under this Part. It is based on paragraph 25 of Schedule 23 to FA 2003.

Part 13: Additional relief for expenditure on research and development

Overview

2693. This Part gives additional relief for expenditure by a company on research and development including research and development into certain vaccines. It is based on Schedule 20 to FA 2000 and Schedules 12 and 13 to FA 2002.

2694. The relief is given in addition to any deduction allowed in calculating the company's trade profits. For example, section 87 in Part 3 (trading income) provides a deduction for expenditure on research and development.

2695. References to research and development are abbreviated to R&D when used in a longer phrase or a long section title. See, for example, "R&D threshold" in section 1050.

2696. In this Part, the rates at which the various reliefs are stated to be available apply only if the expenditure was incurred on or after 1 August 2008. Schedule 2 (transitionals and savings) preserves this commencement rule by providing that, in relation to expenditure incurred before that date, the reliefs are available at the rates previously applicable.

Chapter 1: Introduction

Section 1039: Overview of Part

2697. This section gives an overview of the Part. It is new.

2698. The source legislation refers to "tax relief" given to companies in calculating their trade profits. *Subsection (1)* makes clear that the relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1. This change affects the following sections in this Part: sections 1044, 1045, 1063, 1068, 1074, 1087 and 1092.

2699. The reference to Part 9A of Schedule 18 to FA 1998 in *subsection (10)* is to that Part as amended by this Act (see Schedule 1). As this Act brings all the additional reliefs for research and development together, it repeals Parts 9BA and 9C of Schedule 18 to FA 1998.

2700. Chapters 2 to 4 and 7 of this Part provide for relief in the case of companies which are small or medium-sized enterprises as defined for the purposes of European Union rules on state aid. Section 1120 modifies the basic definition of "small or medium-sized enterprise" in section 1119 by increasing the limits above which a company ceases to be a small or medium-sized enterprise. Schedule 2 (transitionals and savings) contains provision excluding that modified definition in relation to expenditure incurred before 1 August 2008.

Section 1040: Relief may be available under more than one Chapter of Part

2701. This section confirms that "double relief" may be available in certain circumstances. It is based on paragraphs 7 and 10A of Schedule 12 to FA 2002 and paragraph 1 of Schedule 13 to FA 2002.

Section 1041: "Research and development"

2702. This section applies the definition of "research and development" in section 837A of ICTA to this Part. It is based on paragraph 25 of Schedule 20 to FA 2000, paragraph 19 of Schedule 12 and paragraph 27 of Schedule 13 to FA 2002.

2703. This phrase is used because it has a specific meaning in guidelines published by the Department for Business, Enterprise and Regulatory Reform (formerly, the Department of Trade and Industry). Details can be found on the website www.businesslink.gov.uk.

Section 1042: "Relevant research and development"

2704. This section defines "relevant research and development". It is based on paragraph 4 of Schedule 20 to FA 2000, paragraph 17 of Schedule 12 and paragraph 5 of Schedule 13 to FA 2002.

2705. "Relevant research and development" is a key concept. All of the reliefs given in this Part include a condition that the expenditure is incurred on relevant research and development in relation to the company.

Chapter 2: Relief for SMEs: cost of R&D incurred by SME

Overview

2706. This Chapter sets out some rules that apply to a "small or medium sized enterprise" ("SME"). An SME is defined in section 1119.

Section 1043: Overview of Chapter

2707. This section summarises the contents of this Chapter. It is new.

2708. This Chapter rewrites the reliefs given by Schedule 20 to FA 2000 if a small or medium-sized enterprise incurs expenditure on in-house direct research and development or research and development that is sub-contracted out by it.

Section 1044: Additional deduction in calculating profits of trade

2709. This section allows the company to claim the relief, gives the conditions that have to be met and the amount of the relief. It is based on paragraphs 1 and 13 of Schedule 20 to FA 2000.

2710. Relief under this Chapter is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (5)* and *(7)*). The amount of the deduction is increased by 75% (see *subsection (8)*).

2711. The relief has to be claimed (see *subsection (6)*). The procedure for making the claim is in Part 9A of Schedule 18 to FA 1998.

2712. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

Section 1045: Alternative treatment for pre-trading expenditure: deemed trading loss

2713. This section allows a small or medium-sized enterprise to claim immediate relief for qualifying research and development expenditure incurred in a pre-trading period. It is based on paragraphs 1 and 14 of Schedule 20 to FA 2000.

2714. The usual treatment of expenditure incurred before a company starts trading is given by section 61 in Part 3 (trading income). Expenditure incurred up to seven years before the day the company starts to trade is treated as incurred on that day if it would have been deductible had the company been trading when the expenditure was incurred.

2715. This section allows the company to elect for pre-trading expenditure to create a deemed trade loss for the accounting period in which it was actually incurred. Subject to the restrictions in sections 1048 and 1049 the loss can be used in the same way as other trade losses. It can be set off against other profits under section 393A of ICTA or surrendered as group relief. Any part of the loss not used is carried forward. See the commentary on section 1048.

2716. If the company is entitled to relief because it has made an election under this section, *subsection (8)* provides that the expenditure is not allowed again under the ordinary rules in section 61 for dealing with pre-trading expenditure.

2717. The company has to meet the other qualifying conditions for the relief. In particular the pre-trading expenditure must exceed the threshold for relief (see *subsection (3)*) See the commentary on section 1050(5)(b) for more details on the treatment of pre-trading expenditure for the purposes of the threshold test.

2718. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

Section 1046: Relief only available where company is going concern

2719. This section sets out a precondition for relief under sections 1044 and 1045. It is based on paragraph 18A of Schedule 20 to FA 2000.

Section 1047: Elections under section 1045

2720. This section sets out the procedure for making an election under section 1045. It is based on paragraph 14 of Schedule 20 to FA 2000.

Section 1048: Treatment of deemed trading loss under section 1045

2721. This section imposes a restriction on the use of a deemed trade loss and explains how any unused loss is to be dealt with. It is based on paragraph 23 of Schedule 20 to FA 2000.

2722. It is not a condition of section 1045 that the pre-trading research and development leads to the establishment of a trade. But if it does any of the loss created by the section 1045 election that is unused when the trade starts is treated as a trade loss brought forward (see *subsections (3)* and *(4)*).

Section 1049: Restriction on consortium relief

2723. This section prevents a loss created by relief given under this Chapter being surrendered as consortium relief unless the claimant company is also a small or medium-sized enterprise. It is based on paragraph 22 of Schedule 20 to FA 2000.

Section 1050: R&D threshold

2724. This section gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 20 to FA 2000.

2725. *Subsection (2)* reduces this limit proportionately if the accounting period is less than 12 months. The source legislation does not explicitly state how the reduction is done. Subsection (2) eliminates uncertainty by prescribing the arithmetic formula to be used where an accounting period is less than 12 months. The formula adopted has been widely used in the rewrite Acts. It incorporates a denominator of 365 days, regardless of the length of the calendar year. In this case, it makes a small change adverse to the taxpayer. See *Change 78* in Annex 1. This Change also affects sections 1064, 1075, 1097 (see paragraphs 27672767, 28042804 and 28492849).

2726. S*ubsection (5)(b)* deals with pre-trading expenditure by deeming the company to be carrying on a trade for the purpose of deciding whether the expenditure would be deductible. In the absence of any special tax rule to the contrary pre-trading expenditure is allocated to periods of account in accordance with generally accepted accounting practice.

2727. Subsection (5)(b) is needed for the purposes of section 1045. That section allows a company to elect to create a trade loss out of its pre-trading expenditure on qualifying research and development. Section 1045(3) requires the company to meet the threshold test in the period covered by the election.

2728. Section 1137 may also be relevant in this regard. It applies to a company that incurs qualifying Chapter 2 or 7 expenditure at a time when it does not have an accounting period. In practice this must be pre-trading expenditure. The section deems the company to have the accounting periods it would have had if it had been trading when it incurred the expenditure.

2729. *Subsections (7)* and *(8)* deal with expenditure that qualifies under Chapters 3 and 4 of this Part. The basic rule applies. The expenditure must be deductible in calculating the

trade profits for the accounting period. In this case the ordinary operation of section 61 is not suspended.

2730. There is no requirement in this section that the expenditure is incurred in the same trade or pre-trading activity. So qualifying expenditure on one trade can be used to meet the threshold required to make a claim under section 1045 in respect of pre-trading expenditure on a separate activity.

2731. There have been a number of changes to the threshold since the relief was introduced by Schedule 20 to FA 2000. Most of these are not relevant to the accounting periods affected by this Act. But Schedule 2 (transitionals and savings), provides that expenditure incurred before 1 April 2002 is ignored for the purposes of subsection (3)(b) and (c), and that section 61 (which provides for up to 7 years' worth of pre-trading expenses to be treated as incurred on the start date of the trade) is ignored in applying this rule.

2732. In relation to qualifying Chapter 3 expenditure the transitional rule preserves the effect of paragraph 2(2) of Schedule 15 to FA 2002. That provision extended the threshold test to include expenditure that qualifies under Part 2 of Schedule 12 to FA 2002, rewritten in Chapter 3 of this Part.

2733. Paragraph 2(2) of Schedule 15 to FA 2002 provides that the extension does not apply to expenditure incurred before 1 April 2002 and that for this purpose no account is taken of section 401 of ICTA.

2734. In relation to qualifying Chapter 4 expenditure the transitional preserves the effect of paragraph 3(2) of Schedule 31 to FA 2003. That provision extended the threshold test to include qualifying additional SME expenditure as defined in paragraph 10B of Schedule 12 to FA 2002, rewritten in this Part in Chapter 4.

2735. Paragraph 10B(a) of Schedule 12 to FA 2002 provides that:

> "qualifying additional expenditure" is any expenditure which had the SME been a large company throughout the accounting period in question, would have been qualifying R&D expenditure of that company

2736. This brings into play the commencement provision in paragraph 20(1) of Schedule 12 to FA 2002, which provides that Schedule 12 does not apply to expenditure incurred before 1 April 2002 and that "for this purpose no account shall be taken of section 401 of ICTA".

2737. There are very limited circumstances in which the transitional applies. This Act has effect for accounting periods ending after 31 March 2009. The earliest date on which an accounting period covered by the Act could start is 2 April 2008. For the transitional rule to apply the expenditure would have to be incurred in the period between 2 April 2001 and 31 March 2002.

Section 1051: Qualifying Chapter 2 expenditure

2738. This section identifies the expenditure that qualifies for relief under this Chapter. It is new.

Section 1052: Qualifying expenditure on in-house direct R&D

2739. The section defines "qualifying expenditure on in-house direct research and development". It is based on paragraph 3 of Schedule 20 to FA 2000.

2740. The broad aim of Schedule 20 to FA 2000 is to give relief to the company that incurs the expenditure on the research and development. Paragraph 3(3) of Schedule 20 to FA 2000 describes that as research and development directly undertaken "by the company" or "on its behalf". A common set of conditions is used to decide whether expenditure on either type of research and development qualifies for relief.

2741. This Act uses the labels "in-house direct research and development" and "contracted out research and development" to describe the two types of research and development. It also rewrites the conditions that apply to each type of research and development separately. In part this is because the two types of activity are quite distinct and in part because the rules on sub-contractor payments apply only to contracted out research and development.

2742. The term "in-house direct research and development" is merely a label. It is not a condition of the relief that the research and development is incurred "in-house". The condition that the research and development is directly undertaken by the company is rewritten in s*ubsection (3).* This requires that the research and development is undertaken "by the company itself".

2743. The expression "in-house direct research and development" is used because it has a specific meaning in the Department for Business, Enterprise and Regulatory Reform guidelines on the meaning of research and development for tax purposes. See paragraph 27022702. But the definition of what constitutes "direct research and development" in paragraph 3 of Schedule 12 and paragraph 3 of Schedule 13 to FA 2002 is identical in all material aspects to that in paragraph 3 of Schedule 20 to FA 2000. So referring to "in-house *direct* research and development" in this section does not introduce a new condition into the rewrite of paragraph 3 of Schedule 20.

2744. The section does not reproduce the condition in paragraph 3(2) of Schedule 20 to FA 2000 that the expenditure is not of a capital nature. This condition is unnecessary because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Section 1053: Qualifying expenditure on contracted out R&D

2745. This section defines what is meant by "qualifying expenditure on contracted out research and development". It is based on paragraph 3 of Schedule 20 to FA 2000.

2746. The section does not reproduce the condition in paragraph 3(2) of Schedule 20 to FA 2000 that the expenditure is not of a capital nature. This condition is unnecessary because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Section 1054: Entitlement to and payment of tax credit

2747. This section allows a small or medium-sized enterprise to claim an R&D tax credit. It is based on paragraphs 15 and 18 of Schedule 20 to FA 2000.

2748. Sections 1054 to 1062 rewrite the paragraphs of Schedule 20 to FA 2000 that allow a small or medium-sized enterprise to surrender a loss, created as a result of the relief, in return for a cash payment described as an "R&D tax credit".

2749. The section clarifies that a company may make part claims (*subsection (2)*).

2750. This Act does not rewrite paragraph 24 of Schedule 20 to FA 2000. This provision is no longer required, since the rule allowing the Commissioners for HMRC to deduct money for tax credits before paying their receipts into the Consolidated Fund is set out in sufficiently general terms in section 44 of CRCA (see subsections (1) and (3)(d) of that section). It is worth noting that paragraph 25 of Schedule 13 to FA 2002, which made similar provision to that made by paragraph 24 of Schedule 20 to FA 2000, was repealed by paragraph 96 of Schedule 4 to CRCA.

Section 1055: Meaning of "Chapter 2 surrenderable loss"

2751. This section defines "Chapter 2 surrenderable loss". It is based on paragraph 15 of Schedule 20 to FA 2000.

Section 1056: Amount of trading loss which is "unrelieved"

2752. This section identifies the amount of a trading loss that is "unrelieved" It is based on paragraph 15 of Schedule 20 to FA 2000.

Section 1057: Tax credit only available where company is going concern

2753. This section sets out a precondition for relief under section 1054. It is based on paragraph 18A of Schedule 20 to FA 2000.

Section 1058: Amount of tax credit

2754. This section gives the amount of the R&D tax credit. It is based on paragraph 16 of Schedule 20 to FA 2000.

Section 1059: Total amount of company's PAYE and NIC liabilities

2755. This section explains how to calculate the total amount of a company's PAYE and NIC liabilities. It is based on paragraph 17 of Schedule 20 to FA 2000.

2756. In *subsection (4)*, amount B includes both primary and secondary Class 1 NIC liabilities. But amount B does not include Class 1 contributions where under paragraph 3B of Schedule 1 to the Social Security Contributions and Benefits Act 1992, the company and the employee have jointly elected to transfer liability to the employee.

2757. "National insurance contributions" is defined in section 1319. This definition is based on paragraph 25 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

Section 1060: Payment of tax credit

2758. This section explains the circumstances in which the payment of an R&D tax credit can be withheld or set against arrears of corporation tax. It is based on paragraph 18 of Schedule 20 to FA 2000.

2759. In *subsection (7)(a)*, the words "PAYE regulations" are to be interpreted in accordance with section 684(8) of ITEPA.

Section 1061: Tax credit payment not income of company

2760. This section makes clear that a payment of an R&D tax credit is not income of the company for tax purposes. It is based on paragraph 20 of Schedule 20 to FA 2000.

Section 1062: Restriction on losses carried forward where tax credit claimed

2761. This section provides that any losses that are surrendered in return for an R&D tax credit are not available for carry forward. It is based on paragraph 19 of Schedule 20 to FA 2000.

Chapter 3: Relief for SMEs: R&D sub-contracted to SME

Overview

2762. This Chapter allows a company which is a small or medium-sized enterprise to claim relief for research and development sub-contracted to it. It is based on Part 2 of Schedule 12 to FA 2002.

2763. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).

Section 1063: Additional deduction in calculating profits of trade

2764. This section allows a small or medium-sized enterprise to claim relief for expenditure on research and development contracted out to it. It is based on paragraph 11 of Schedule 12 to FA 2002.

2765. As with relief under Chapter 2, relief under this Chapter is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (4)* and *(6)*). The amount of the deduction is increased by 30% (see *subsection (7)*).

2766. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

Section 1064: R&D threshold

2767. This section gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 7 of Schedule 12 to FA 2002.

2768. The rules are very similar to those in section 1050. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in section 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

2769. A significant difference to section 1050 is the treatment of pre-trading expenditure.

2770. Under *subsection (5)*, unlike section 1050, the normal rules in section 61 for dealing with pre-trading expenditure are not suspended. Pre-trading expenditure is bunched into the accounting period in which the trade starts and counts towards the threshold for that period. This includes expenditure that qualifies under Chapter 2 of this Part. For the purposes of claiming relief under Chapter 2 itself section 61 is suspended (see section 1050(6)).

Section 1065: Qualifying Chapter 3 expenditure

2771. This section identifies the expenditure that qualifies for relief under this Chapter. It is based on paragraph 8 of Schedule 12 to FA 2002.

2772. Relief is given to companies that undertake the research and development themselves (section 1066), and to companies that commission the research and development from certain other persons (section 1067). This section prevents more than one company claiming the relief and the relief leaking out into the income tax sector.

2773. If a large company commissions the research and development that company will not be able to claim relief under Chapter 5 of this Part. This is because that Chapter requires the company to carry out the research and development itself. If the research and development is contracted out to a small or medium-sized enterprise the effect of s*ubsection (2)* is to allow that small or medium-sized enterprise company to claim relief under this Chapter.

2774. If the research and development is contracted out by another small or medium-sized enterprise that company will be able to claim relief itself under Chapter 2. Subsection (2) prevents relief being given to the sub-contractor company under this Chapter.

2775. The relief given by this Part is restricted to corporation tax payers. Subsection (2) prevents a sub-contractor company getting relief if the work has been contracted out by a person, other than a large company, who could get a deduction for the payment in calculating its trade profits. This prevents the sub-contractor passing on some of the benefit of the relief to an income tax payer by charging lower prices.

Section 1066: Expenditure on sub-contracted R&D undertaken in-house

2776. This section identifies the expenditure which qualifies for relief if the company undertakes the research and development itself. It is based on paragraph 9 of Schedule 12 to FA 2002.

2777. As in section 1052, this section uses the label "in-house" to describe research and development that the source legislation describes as being "directly undertaken" by the company.

2778. The section does not reproduce the condition in paragraph 9(4) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This condition is unnecessary because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Section 1067: Expenditure on sub-contracted R&D not undertaken in-house

2779. This section identifies the expenditure which qualifies for relief if the company commissions another person to do the research and development. It is based on paragraph 10 to Schedule 12 to FA 2002.

2780. The section does not reproduce the condition in paragraph 10(4) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This condition is unnecessary because section 53 in Part 3, the trading income Part, already prohibits a deduction for capital expenditure.

Chapter 4: Relief for SMEs: subsidised and capped expenditure on R&D

Overview

2781. This Chapter allows small or medium-sized enterprises to claim relief for expenditure on research and development that is subsidised on the same basis as provided for large companies (see Chapter 5 of this Part). It is based on Part 2A of Schedule 12 to FA 2002.

2782. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).

Section 1068: Additional deduction in calculating profits of trade

2783. This section allows a small or medium-sized enterprise to claim relief for expenditure on research and development that is subsidised. It is based on paragraph 11 of Schedule 12 to FA 2002.

2784. As with relief under Chapters 2 and 3, relief under Chapter 4 is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (4)* and *(7)*). The amount of the deduction is increased by 30% (see *subsection (8)*).

2785. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

Section 1069: R&D threshold

2786. This section gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 10A of Schedule 12 to FA 2002.

Section 1070: Qualifying Chapter 4 expenditure

2787. This section identifies the two categories of expenditure that qualify for relief under this Chapter. It is based on paragraph 10B of Schedule 12 to FA 2002.

2788. This Act takes a different approach to identifying the qualifying conditions from that taken in the source legislation. Paragraph 10B of Schedule 12 to FA 2002 defines what it calls "qualifying additional SME expenditure" by providing first that the expenditure would qualify for relief under Part 1 of Schedule 12 to FA 2002. It then superimposes the qualifying conditions in Schedule 20 to FA 2000. But it removes the condition that the expenditure must not be subsidised.

2789. In this Chapter the qualifying conditions are set out in full to avoid the reader having to make these modifications.

Section 1071: Subsidised qualifying expenditure on in-house direct R&D

2790. This section defines what is meant by "subsidised qualifying expenditure on in-house direct research and development". It is based on paragraph 10B of Schedule 12 to FA 2002.

2791. The section does not rewrite the condition in paragraph 10B(c) of Schedule 12 to FA 2002 that the expenditure "is not qualifying sub-contracted R&D expenditure for the purposes of this Schedule". It is unnecessary.

2792. To qualify under Part 2A of Schedule 12 to FA 2002 the expenditure must qualify for relief under Schedule 20 to FA 2000 but for the fact it is subsidised. Expenditure would not qualify under Schedule 20 to FA 2000 if it were paid in respect of activities sub-contracted to the company. Condition E in *subsection (6)*, which reproduces condition D in section 1052, is all that is required.

2793. This section does not reproduce the condition that the expenditure must not be capital in nature. This condition is unnecessary because section 53 in Part 3, the trading income Part, already prohibits a deduction for capital expenditure.

Section 1072: Subsidised qualifying expenditure on contracted out R&D

2794. This section defines what is meant by "subsidised qualifying expenditure on contracted out research and development". It is based on paragraph 10B of Schedule 12 to FA 2002.

2795. The section does not allow a small or medium-sized enterprise to claim relief for a subsidised contribution to independent research and development. A large company can claim relief for such expenditure (see section 1079). But a small or medium-sized enterprise cannot and therefore the condition in paragraph 10B(b) of Schedule 12 to FA 2002 would not be satisfied.

2796. This section does not reproduce the condition that the expenditure must not be capital in nature. This condition is unnecessary because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Section 1073: Capped R&D expenditure

2797. This section defines what is meant by "capped R&D expenditure". It is based on paragraph 10C of Schedule 12 to FA 2002.

Chapter 5: Relief for large companies

Overview

2798. This Chapter gives relief for expenditure on direct research and development undertaken by a large company itself and for research and development that is contracted out to it. It is based on Part 1 of Schedule 12 to FA 2002.

2799. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).

2800. A "large company" is any company which is not a small or medium-sized enterprise (see section 1122).

Section 1074: Additional deduction in calculating profits of trade

2801. This section allows a large company to claim an additional deduction for qualifying expenditure on research and development. It is based on paragraph 11 of Schedule 12 to FA 2002.

2802. As with the reliefs given to small or medium-sized enterprises, relief under Chapter 5 is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsection (6)*). The amount of the deduction is increased by 30% (see *subsection (7)*).

2803. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

Section 1075: R&D threshold

2804. This section gives the minimum amount of expenditure that a company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 12 to FA 2002.

2805. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in section 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

2806. The normal operation of section 61 is not suspended. So pre-trading expenditure that is bunched into the accounting period in which the trade starts counts towards the threshold (see *subsection (4)*).

Section 1076: Qualifying Chapter 5 expenditure

2807. This section identifies the three categories of expenditure that qualify for relief under this Chapter. It is based on paragraph 3 of Schedule 12 to FA 2002.

Section 1077: Qualifying expenditure on in-house direct R&D

2808. This section defines "qualifying expenditure on in-house direct research and development". It is based on paragraph 4 of Schedule 12 to FA 2002.

2809. "In-house direct research and development" is the term this Act uses to describe research and development that is undertaken directly by the company.

2810. The section does not reproduce the condition in paragraph 4(5) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

2811. Condition C in *subsection (4)* identifies the expenditure that qualifies if the research and development is contracted out to the company. It prevents more than one company claiming the relief and the benefit of the relief leaking into the income tax sector.

2812. If a large company commissions the research and development the company will not be able to claim relief under this Chapter. This is because that Chapter requires the company to carry out the research and development itself. So subsection (4) allows a

large company to which the research and development is sub-contracted to claim the relief.

2813. If the research and development is contracted out by a small or medium-sized enterprise that company will be able to claim relief itself under Chapter 2 of this Part. The effect of subsection (4) is to prevent relief also being given to the sub-contractor large company.

2814. The relief given by this Part is restricted to corporation tax payers. Subsection (4) prevents a sub-contractor company getting relief if the work has been contracted out by a person, other than a large company, who could get a deduction for the payment in calculating its trade profits. This prevents the sub-contractor passing on some of the benefit of the relief to an income tax payer by charging lower prices.

Section 1078: Qualifying expenditure on contracted out R&D

2815. This section defines "qualifying expenditure on contracted out research and development". It is based on paragraph 5 of Schedule 12 to FA 2002.

2816. The section does not reproduce the condition in paragraph 5(5) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Section 1079: Qualifying expenditure on contributions to independent R&D

2817. This section defines "qualifying expenditure on contributions to independent research and development". It is based on paragraph 6 of Schedule 12 to FA 2002.

2818. The main purpose of this section is to support research and development carried out by universities and other non-taxpaying research institutions.

Section 1080: Entitlement to relief: I minus E basis

2819. This section describes the way a claim for R&D relief is given effect in the case of a company carrying on life assurance business. It is based on paragraph 13 of Schedule 12 to FA 2002.

Chapter 6: Chapters 2 to 5: further provision

Section 1081: Insurance companies treated as large companies

2820. This section provides that a company which carries on life assurance business in an accounting period and which qualifies as a small or medium-sized enterprise (see section 1119) is to be treated as a large company (see section 1122) for the purposes of Chapters 2 to 5. It is based on paragraph 12 of Schedule 12 to FA 2002.

Section 1082: R&D expenditure of group companies

2821. This section deals with the case where the research and development in a group of companies is undertaken by particular members of the group on behalf of other group companies. It is based on paragraph 14 of Schedule 12 to FA 2002.

2822. *Subsection (3)* extends the scope of the provisions to cover work contracted out to third parties.

Section 1083: Refunds of expenditure treated as income chargeable to tax

2823. This section applies the charge to tax under Chapter 2 of Part 3 if the company gets a refund of expenditure for which it has received certain of the reliefs given by this Part. It is based on paragraph 15 of Schedule 12 to FA 2002.

Section 1084: Artificially inflated claims for relief or tax credit

2824. This section denies relief for transactions that are intended to increase artificially the amount of relief or R&D tax credit. It is based on paragraph 21 of Schedule 20 to FA 2000 and paragraph 16 of Schedule 12 to FA 2002.

Chapter 7: Relief for SMEs and large companies: vaccine research etc

Overview

2825. This Chapter provides relief for research into certain vaccines and medicines. It is based on Schedule 13 to FA 2002.

2826. The Chapter applies only to expenditure incurred on or after 22 April 2003. See paragraph 28(1) of Schedule 13 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).

Section 1085: Overview of Chapter

2827. This section describes the contents of the Chapter. It is new.

Section 1086: Meaning of "qualifying R&D activity"

2828. This section defines "qualifying R&D activity" for the purposes of the relief available for vaccine research. It is based on paragraph 4 of Schedule 13 to FA 2002.

2829. The relief is intended to encourage research into vaccines that protect against diseases that are particularly prevalent in the developing world. This is reflected in the scope of *subsections (1)* and *(2)*. A clade is a type of genetic grouping. Subsection (2) limits relief to research into the varieties of HIV that are most common in the developing world.

Section 1087: Deduction in calculating profits of trade

2830. This section allows the company to claim relief as a trade deduction for qualifying expenditure on vaccine research. It is based on paragraphs 14 and 21 of Schedule 13 to FA 2002.

2831. The section combines the qualifying conditions that apply to small or medium-sized enterprises in paragraph 14 and to large companies in paragraph 21 of Schedule 13 to FA 2002. The amount of the relief is then given separately for each type of company in the following sections. Also, section 1092 allows a small or medium-sized enterprise to elect to create a trade loss in respect of pre-trading expenditure.

2832. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

Section 1088: Large companies: declaration about effect of relief

2833. This section requires that a claim for relief under section 1087 be accompanied by a declaration. It is based on paragraph 21 of Schedule 13 to FA 2002.

Section 1089: SMEs: amount of deduction

2834. This section gives the amount of the deduction if a small or medium-sized enterprise claims relief as a trade deduction. It is based on paragraph 14 of Schedule 13 to FA 2002.

2835. The normal operation of section 61 in Part 3 is suspended when allocating qualifying expenditure to an accounting period (see section 1099(2)). Pre-trading expenditure is allocated to periods of account in accordance with generally accepted accounting practice and is not treated as incurred when the company starts to trade.

2836. The company may be carrying on one trade and incur pre-trading expenditure in respect of another activity. *Subsections (5)* and *(6)* make clear that relief can be claimed on the pre-trading activity and given as a deduction in calculating the profits of the existing trade. This follows from paragraph 14(1)(b) of Schedule 13 to FA 2002, which requires only that the company be carrying on *a* trade. There is no requirement that the relief is given in calculating the profits of *the* trade for which the relief is given.

Section 1090: Modification of section 1089 for larger SMEs

2837. This section modifies section 1089. It is based on paragraphs 13, 14 and 15A of Schedule 13.

2838. The purpose of this modification is to keep the deduction in section 1089 within the European Union limit on state aid. "Larger SME" is defined in section 1121. Schedule 2 (transitionals and savings) disapplies the "larger SME" category of company in relation to expenditure incurred before 1 August 2008. This preserves the commencement rule in section 50(7) of FA 2007.

Section 1091: Large companies: amount of deduction

2839. This section gives the amount of the deduction if a large company claims relief as a trade deduction. It is based on paragraph 21 of Schedule 13 to FA 2002.

Section 1092: SMEs: deemed trading loss for pre-trading expenditure

2840. This section allows a small or medium-sized enterprise to claim immediate relief for qualifying expenditure incurred in a pre-trading period. It is based on paragraph 15 of Schedule 13 to FA 2002.

2841. The section is very similar to section 1045. A small or medium-sized enterprise can elect to create a trading loss in respect of pre-trading expenditure that qualifies for relief under this Chapter.

2842. Section 1099(1)(b) has an important role to play in the operation of this section. It determines how pre-trading expenditure is allocated to accounting periods. This determines whether the threshold test in *subsection (3)* is met and the amount on which relief is given.

2843. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

Section 1093: Modification of section 1092 for larger SMEs

2844. This section modifies section 1092. It is based on paragraphs 13, 14 and 15A of Schedule 13. The purpose of this modification is to keep the deduction in section 1092 within the European Union limit on state aid. "Larger SME" is defined in section 1121.

Section 1094: Relief only available to SME where company is going concern

2845. This section sets out a precondition for relief under sections 1087 and 1092. It is based on paragraph 18A of Schedule 13 to FA 2002.

Section 1095: Elections under section 1092

2846. This section gives the procedure for making an election under section 1092. It is based on paragraph 15 of Schedule 13 to FA 2002.

Section 1096: Treatment of deemed trading loss under section 1092

2847. This section imposes a restriction on the use of the trade loss and explains how any unused loss is to be dealt with. It is based on paragraph 15 of Schedule 13 to FA 2002.

2848. The section is identical in effect to section 1048.

Section 1097: R&D threshold

2849. This section gives the minimum amount of expenditure that a company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 13 to FA 2002.

2850. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in section 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

Section 1098: Meaning of "qualifying Chapter 7 expenditure"

2851. This section identifies the three categories of expenditure which qualify for relief. It is based on paragraph 2 of Schedule 13 to FA 2002.

Section 1099: SMEs: qualifying expenditure "for" an accounting period

2852. This section explains how qualifying expenditure is allocated to the accounting periods of a small or medium-sized enterprise. It is based on paragraph 2 of Schedule 13 to FA 2002.

2853. *Subsection (2)* suspends the normal operation of section 61 in Part 3 for pre-trading expenditure. Pre-trading expenditure is not treated as incurred on the first day of trading. Instead s*ubsection (1)(b)* treats the expenditure as incurred for an accounting period if it would have been deductible in calculating the trade profits for that period if the company had been trading.

2854. Relief is available for pre-trading expenditure not just under section 1092 but also under the main rule in section 1089 if it can be deducted in calculating the profits of a trade.

Section 1100: Large companies: qualifying expenditure "for" an accounting period

2855. This section explains how qualifying expenditure is allocated to the accounting periods of a large company. It is based on paragraph 2 of Schedule 13 to FA 2002.

2856. *Subsection (1)* deals with in-house direct research and development and contracted out research and development. Expenditure is incurred for an accounting period if it is deductible in calculating the trade profits for that period. Unlike small or medium-sized enterprises the normal rules for pre-trading expenditure in section 61 in Part 3 apply (see *subsection (2)*). Any pre-trading expenditure will be treated as incurred the day the company starts trading.

Section 1101: Qualifying expenditure on in-house direct R&D

2857. This section defines "qualifying expenditure on in-house direct research and development". It is based on paragraph 3 of Schedule 13 to FA 2002.

2858. "In-house direct research and development" is the term this Act uses to describe research and development that is undertaken directly by the company.

2859. *Subsections (2)* and *(3)* rewrite sub-paragraphs (2) and (3) of paragraph 3 of Schedule 13 to FA 2002 which refer to the expenditure being *on* qualifying R&D activity. This section refers to the expenditure being *attributable* to qualifying R&D activity in order to align the language with that in Chapters 2 to 5 of this Part.

2860. Paragraph 3(3) of Schedule 20 to FA 2000 and paragraphs 4(4) and 9(3) of Schedule 12 to FA 2002 all require that the qualifying expenditure is attributable to relevant research and development. The provisions that define particular classes of expenditure have rules for determining if the expenditure is attributable to relevant research and development.

2861. Paragraph 3(3) of Schedule 13 to FA 2002 requires that the "qualifying R&D activity on which the expenditure is incurred is relevant research and development in relation to the company". This test is the same as requiring the expenditure to be attributable to relevant research and development and the section adopts the language of the earlier Chapters.

2862. The section does not reproduce the condition in paragraph 3(4) of Schedule 13 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Section 1102: Qualifying expenditure on contracted out R&D

2863. This section defines "qualifying expenditure on contracted out research and development". It is based on paragraphs 6 and 7 of Schedule 13 to FA 2002.

2864. The section covers payments to a sub-contractor. The conditions in the section have to be satisfied but it also necessary to isolate the sub-contractor element of the payment. This is described in sections 1134 to 1136.

2865. *Subsections (3)* and *(4)* also refer to the expenditure being attributable to qualifying R&D activity. See the commentary on section 1101.

2866. The section does not reproduce the condition in paragraph 7(5) of Schedule 13 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Section 1103: Entitlement to and payment of tax credit

2867. This section allows a small or medium-sized enterprise to claim an R&D tax credit. It is based on paragraphs 16 and 18 of Schedule 13 to FA 2002.

2868. The section clarifies that a company may make part claims (*subsection (2)*).

Section 1104: Meaning of "Chapter 7 surrenderable loss"

2869. This section defines "Chapter 7 surrenderable loss". It is based on paragraph 16 of Schedule 13 to FA 2002.

2870. The section follows the same pattern as section 1055 (meaning of "Chapter 2 surrenderable loss") but the restriction in *subsection (2)* if the claim is made by a trading company is slightly different.

2871. Section 1055(2)(b) gives relief both for the additional deduction and for the underlying expenditure. Subsection (2) denies relief for the underlying expenditure. This is because if the company has had relief under Chapter 2 it will already have had relief for the underlying expenditure in making an R&D tax credit claim under section 1055.

Section 1105: Amount of trading loss which is "unrelieved"

2872. This section lists the other ways in which a company may get relief for the loss. It is based on paragraph 16 of Schedule 13.

Section 1106: Tax credit only available where company is going concern

2873. This section sets out a precondition for relief under section 1103. It is based on paragraph 18A of Schedule 13 to FA 2002.

Section 1107: Amount of tax credit

2874. This section gives the amount of the R&D tax credit. It is based on paragraph 17 of Schedule 13 to FA 2002.

Section 1108: Total amount of company's PAYE and NIC liabilities

2875. This section explains how to calculate the total amount of a company's PAYE and NIC liabilities. It is based on paragraph 17 of Schedule 13 to FA 2002.

Section 1109: Payment of tax credit

2876. This section explains the circumstances in which the payment of an R&D tax credit can be withheld or set against arrears of corporation tax. It is based on paragraph 18 of Schedule 13 to FA 2002.

Section 1110: Tax credit payment not income of company

2877. This section makes clear that a payment of an R&D tax credit is not income of the company for tax purposes. It is based on paragraph 20 of Schedule 13 to FA 2002.

Section 1111: Restriction on losses carried forward where tax credit claimed

2878. This section provides that any losses that are surrendered in return for an R&D tax credit are not available for carry forward. It is based on paragraph 19 of Schedule 13 to FA 2002.

Section 1112: Artificially inflated claims for relief or tax credit

2879. This section denies relief for transactions that are intended to increase artificially the amount of relief or R&D tax credit. It is based on paragraph 24 of Schedule 13 to FA 2002.

Chapter 8: Cap on aid for R&D

Overview

2880. This Chapter sets out the rules for calculating the cap on R&D aid for the purposes of Chapters 2 and 7. It sets out the formula for the calculation of the cap, and brings together the definitions of terms that constitute that formula.

2881. Schedule 2 (transitionals and savings) preserves the transitional provision in paragraph 7 of Schedule 10 to FA 2008. This provides that no account is to be taken, for the purpose of calculating "total R&D aid" in accordance with section 1089, of any relief or tax credit under Chapter 2 or 7 of Part 13 in respect of expenditure incurred before 1 August 2008.

Section 1113: Cap on R&D aid under Chapter 2 or 7

2882. This section imposes a cap on the total amount of R&D aid which may be claimed in respect of a project. It is based on section 29 of, and paragraph 6 of Schedule 10 to, FA 2008.

Section 1114: Total R&D aid

2883. This section sets out the rules for calculating the cap on R&D aid for a project. It is based on paragraph 1 of Schedule 10 to FA 2008.

Section 1115: "The tax credits"

2884. This section defines "the tax credits" for the purposes of the formula prescribed in section 1114. It is based on paragraph 2 of Schedule 10 to FA 2008.

Section 1116: "The actual reduction in tax liability"

2885. This section defines "the actual reduction in tax liability" for the purposes of the formula prescribed in section 1114. It is based on paragraph 3 of Schedule 10 to FA 2008.

Section 1117: "The potential relief"

2886. This section defines "the potential relief" for the purposes of the formula prescribed in section 1114. It is based on paragraph 4 of Schedule 10 to FA 2008.

Section 1118: "The notional relief"

2887. This section defines "the notional relief" for the purposes of the formula prescribed in section 1114. It is based on paragraph 5 of Schedule 10 to FA 2008.

Chapter 9: Supplementary

Overview

2888. This Chapter brings together the definitions of terms that apply to each of the earlier Chapters. Most of these definitions are given in Schedule 20 to FA 2000 but they are applied to Schedules 12 and 13 to FA 2002 by the respective paragraphs 17 and 5 of those Schedules. In such cases the commentary refers only to the Schedule 20 provision on which the definition is based.

Section 1119: "Small or medium-sized enterprise"

2889. This section defines "small or medium-sized enterprise". It is based on paragraph 2 of Schedule 20 to FA 2000, paragraph 2 of Schedule 12 and paragraph 5 of Schedule 13 to FA 2002.

Section 1120: Qualifications to section 1119

2890. This section makes two qualifications to the European Union definition of small or medium-sized enterprise. It is based on paragraph 2 of Schedule 20 to FA 2000, paragraph 2 of Schedule 12 to FA 2002 and 5 of Schedule 13 to FA 2002.

2891. The European Union definition is in the Annex to Commission Recommendation 2003/361/EC of 6 May 2003, as incorporated by reference in section 1119(1). Article 3 of the Annex requires a company to include figures from a partner or linked enterprise in determining whether it breaches the qualifying thresholds (aggregation). This is called "aggregation".

2892. Article 4(2) of the Annex gives the company a period of grace if the inclusion of those figures means it ceases to be a small or medium-sized enterprise. The company will cease to be a small or medium-sized enterprise within the European Union definition only if the limits are exceeded in two consecutive accounting periods.

2893. The purpose of Qualification 2 in this section is to remove that period of grace for the purposes of this Part, so that the company ceases to be a small or medium-sized enterprise in the second accounting period. The effect of Qualification 2 in this section is to disapply Article 4(2) of the Annex so that Article 2 of the Annex applies instead. Article 2 of the Annex provides: "In respect of any year, you must use the year end accounts for that year to classify the company, according to these criteria."

Section 1121: "Larger SME"

2894. This section defines "larger SME". It provides a convenient label for companies falling within Qualification 1 of section 1120. It is based on paragraphs 15A and 16A of Schedule 13 to FA 2002.

Section 1122: "Large company"

2895. This section defines "large company". It is based on paragraph 2 of Schedule 12 to FA 2002.

Section 1123: "Staffing costs"

2896. This section defines "staffing costs". It is based on paragraph 5 of Schedule 20 to FA 2000.

2897. Paragraph 5(1)(a) of Schedule 20 to FA 2000 refers to "emoluments paid by the company … including all salaries, wages, perquisites and profits whatsoever other than benefits in kind". This is based on the definition of emoluments that section 131 of ICTA applied for Schedule E before that Schedule was rewritten by ITEPA.

2898. None of the definitions of "earnings" in ITEPA is appropriate, because none matches the scope of the definition in paragraph 5(1)(a) of Schedule 20 to FA 2000.

2899. In rewriting Schedule 20 to FA 2000 the language has been modernised and the definition has been adapted so that it applies more clearly from the position of the company making the payment, rather than the employee receiving it. This is achieved by referring to money earnings and reimbursed expenses. When interpreting these definitions, it should be borne in mind that this Part does not create a new class of deduction. It merely enhances an existing staffing costs deduction, the scope of which is determined on ordinary principles. Before an expense can be considered for the purposes of this Part, it must first be deductible on ordinary principles. See for example section 1050(5).

2900. *Subsection (2)* rewrites the reference to salaries and wages by reference to money earnings. "Earnings" takes its ordinary meaning. The statutory definitions of "earnings" in ITEPA are not relevant to the scope of "earnings" in this subsection. See *Change 79* in Annex 1.

2901. *Subsection (3)* rewrites the reference to perquisites or profits whatsoever by reference to reimbursed expenses but making clear that it does not include benefits in kind. See *Change 79* in Annex 1.

2902. In subsections (2) and (3), the phrase "because of employment" is used instead of the ITEPA phrase "by reason of employment". The effect is that interpretations developed in relation to ITEPA, which might not be appropriate to this section, cannot simply be read across into this section.

2903. ITEPA amended paragraph 5 of Schedule 20 to FA 2000 so that it referred to earnings which constitute employment income. In doing so it inadvertently expanded the definition to include benefits in kind. This change was reversed by paragraph 7 of Schedule 17 to FA 2004, which reinstated the original wording. Schedule 2 (transitionals and savings) preserves the wider definition inserted by ITEPA for the brief window in which it applies to accounting periods covered by this Act. It is relevant only to expenditure incurred before 1 April 2004.

Section 1124: Staffing costs: attributable expenditure

2904. This section identifies when staffing costs are attributable to relevant research and development. It is based on paragraph 5 of Schedule 20 to FA 2000.

2905. In *subsection (4)* and in sections 1126(4) and 1132(4) the phrase "appropriate proportion" is used, while in sections 1129(7), 1134(6) and 1138(4) the concept of a just and reasonable apportionment is used. The two phrases have different meanings and are used in different circumstances. "Appropriate proportion" is used where the quantities or qualities to be determined are objectively measurable. "Just and reasonable" is

used where the quantities to be determined are not objectively measurable and the apportionment exercise requires a measure of subjectivity.

2906. When the legislation was introduced the test was that 80% of the director or employee's working time had to be spent on relevant research and development. Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Act applies. It is relevant only to expenditure incurred before 9 April 2003 (Chapters 3 and 5) and 27 September 2003 (Chapters 2 and 7).

Section 1125: "Software or consumable items"

2907. This section defines "software or consumable items". It is based on paragraph 6 of Schedule 20 to FA 2000.

2908. When the legislation was introduced relief under all the Chapters in this Part was given for expenditure on "consumable stores". Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Act applies. It is relevant only to expenditure incurred before 1 April 2004.

Section 1126: Software or consumable items: attributable expenditure

2909. This section identifies when expenditure on software or consumable items is attributable to relevant research and development. It is based on paragraph 6 of Schedule 20 to FA 2000.

Section 1127: "Qualifying expenditure on externally provided workers"

2910. This section defines "qualifying expenditure on externally provided workers". It is based on paragraph 8A of Schedule 20 to FA 2000.

2911. This section is the first of six sections that deal with the relief given in relation to expenditure on externally provided workers. Sections 1129 to 1131 explain how to calculate this amount. These sections focus on the subject matter of the expenditure. Section 1132 then identifies whether that expenditure is incurred on relevant research and development.

2912. The relief applies only to expenditure incurred on or after 9 April 2003 (Chapters 3 and 5) or 27 September 2003 (Chapters 2, 4 and 7). Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Act applies.

Section 1128: "Externally provided worker"

2913. This section defines "externally provided worker". It is based on paragraph 8B of Schedule 20 to FA 2000.

Section 1129: Qualifying expenditure on externally provided workers: connected persons

2914. This section gives the amount of the qualifying expenditure if the company and the staff provider are connected. It is based on paragraph 8C of Schedule 20 to FA 2000.

2915. The definition of connected persons in section 839 of ICTA (applied by section 1316(1)) applies.

2916. *Subsection (3)* defines "relevant expenditure". It provides for the exclusion for expenditure of a capital nature that is omitted in the rewrite of other provisions of the source legislation for this Part. Section 53 in Part 3 (trading income), which denies a deduction for capital expenditure, applies to determine if the expenditure would

be deductible in calculating the trading profits. It would not apply to exclude capital expenditure from the staff provider's actual relevant expenditure.

2917. The definition of "agency workers' remuneration" in *subsection (6)* omits the reference to section 134 of ICTA in paragraph 8C(4)(b) of Schedule 20 to FA 2000. The ICTA provision was repealed by ITEPA and the cross-reference is no longer required.

Section 1130: Election for connected persons treatment

2918. This section allows a company and a staff provider who are not connected to elect for connected persons treatment. It is based on paragraph 8D of Schedule 20 to FA 2000.

2919. The word "other" in *subsection (2)* does not appear in paragraph 8D(2) of Schedule 20 to FA 2000 (the source for this subsection). It does appear in a similar context in paragraph 11(2) of Schedule 20 (the source for section 1131(2)). The inclusion of the word in subsection (2) of this section promotes consistency without changing the meaning of the law.

Section 1131: Qualifying expenditure on externally provided workers: other cases

2920. This section identifies the amount of the qualifying expenditure if the company and staff provider are not connected and have not made an election under section 1130. It is based on paragraph 8E of Schedule 20 to FA 2000.

Section 1132: External workers: attributable expenditure

2921. This section identifies when qualifying expenditure on externally provided workers is attributable to relevant R&D. It is based on paragraph 8A of Schedule 20 to FA 2000.

2922. The section follows the pattern of section 1124 which performs a similar function for staffing costs.

Section 1133: "Sub-contractor" and "sub-contractor payment"

2923. This section defines "sub-contractor" and "sub-contractor payment". It is based on paragraph 9 of Schedule 20 to FA 2000 and paragraph 6 of Schedule 13 to FA 2002.

2924. This section is the first of a group of sections that apply to sub-contractor payments. The sections are very similar to those that apply to qualifying expenditure on externally provided workers.

Section 1134: Qualifying element of sub-contractor payment: connected persons

2925. This section identifies the qualifying element of a sub-contractor payment if the company and the sub-contractor are connected persons. It is based on paragraph 10 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 8 of Schedule 13 to FA 2002.

2926. The definition of connected persons in section 839 of ICTA (applied by section 1316(1)) applies.

2927. *Subsection (3)* defines "relevant expenditure". It provides for the exclusion for expenditure of a capital nature that is omitted in the rewrite of other provisions of the source legislation for this Part. See the commentary on section 1129(3) for an explanation of this.

Section 1135: Election for connected persons treatment

2928. This section allows a company and a sub-contractor which are not connected to elect to be treated as if they were connected. It is based on paragraph 11 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 10 of Schedule 13 to FA 2002.

2929. Subsection (4) provides for a time limit in which the election must be made. This time limit does not apply in certain circumstances in the case of companies affected by the repeal of paragraph 6(3) of Schedule 13 to FA 2002 (100% relief where the subcontractor is a charity etc). Schedule 2 (transitionals and savings) provides that where the notice is given before 31 July 2009, the time limit does not apply.

Section 1136: Qualifying element of sub-contractor payment: other cases

2930. This section identifies the qualifying element of a sub-contractor payment if the company and the sub-contractor are not connected persons. It is based on paragraph 12 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 11 of Schedule 13 to FA 2002.

Section 1137: Accounting periods: company not within charge to corporation tax

2931. This section treats a company as having an accounting period if it incurs qualifying Chapter 2 or 7 expenditure at a time when it is not within the charge to corporation tax. It is based on paragraph 25 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

2932. An accounting period is the basis for the determination of tax liability. If a company does not have an accounting period, or is not deemed to have one, then that company will not be able to perform the calculations which are necessary for it to take advantage of the provisions in sections 1045 and 1092. Those sections allow a company to elect to create a loss in respect of pre-trading expenditure. A company that is not yet trading may not have an accounting period. Sections 1045 and 1092 operate by reference to accounting periods. This section treats the company as having the accounting periods it would have had if it had been trading when it incurred the expenditure.

Section 1138: "Subsidised expenditure"

2933. This section defines "subsidised expenditure". It is based on paragraph 8 of Schedule 20 to FA 2000.

Section 1139: "Intellectual property"

2934. This section defines "intellectual property". It is based on paragraph 7 of Schedule 20 to FA 2000.

Section 1140: "Relevant payments to the subjects of a clinical trial"

2935. This section defines "relevant payments to the subjects of a clinical trial". It is based on paragraph 6A of Schedule 20 to FA 2000.

2936. Schedule 2 (transitionals and savings) excludes the application of this Part in relation to this category of expenditure if the expenditure was incurred before 1 August 2008 (for the purposes of Chapters 2, 3 and 7) or 1 April 2006 (for the purposes of Chapters 4 and 5). This preserves the commencement set out in section 28 of FA 2006.

Section 1141: "Payment period"

2937. This section defines "payment period". It is based on paragraph 17 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

Section 1142: "Qualifying body"

2938. This section defines "qualifying body". It is based on paragraph 18 of Schedule 12 to FA 2002.

Part 14: Remediation of contaminated land

Overview

2939. This Part allows a company to claim relief for qualifying expenditure it incurs on the remediation of contaminated land. It is based on Schedule 22 to FA 2001.

2940. Relief under the Part is given as a deduction in calculating the company's trade profits or the profits of a UK property business carried on by the company.

Chapter 1: Introduction

Section 1143: Overview of Part

2941. This section gives an overview of the Part. It is new.

Section 1144: "Qualifying land remediation expenditure"

2942. This section sets out the conditions that expenditure on land remediation must satisfy to qualify for relief under this Part. It is based on paragraph 2 of Schedule 22 to FA 2001.

Section 1145: Land "in a contaminated state"

2943. This section sets out when land is "in a contaminated state" for the purposes of this Part. It is based on paragraph 3 of Schedule 22 to FA 2001.

Section 1146: "Relevant land remediation"

2944. This section identifies the activities that make up "relevant land remediation". It is based on paragraph 4 of Schedule 22 to FA 2001.

2945. "Relevant land remediation" can either be the remediation activity itself or activities in preparation for the remediation activity, see *subsection (1)*. "Relevant preparatory activity" comes within the definition of "relevant land remediation" only if it leads to remediation activity being carried out, see *subsection (4)(b)*.

Chapter 2: Reliefs for expenditure on contaminated land

Section 1147: Deduction for capital expenditure

2946. This section gives the company a deduction for capital expenditure included in qualifying land remediation expenditure subject to certain conditions. It is based on paragraph 1 of Schedule 22 to FA 2001.

2947. The company must elect to make the deduction. The procedure for making the election is in section 1148.

2948. Capital expenditure is not defined. It is expenditure for which a deduction would normally be denied by section 53. But this section permits a deduction for capital expenditure in calculating the profits of a trade or UK property business of a company in spite of the rule in section 53.

2949. The existence of section 53 means it is not necessary to rewrite paragraph 1(4)(a) of Schedule 22 to FA 2001. That provision denies relief for expenditure that has already been allowed as a deduction in calculating the profits of a trade or of a UK property business carried on by the company. It is not needed if there is already a specific rule preventing a deduction for such expenditure.

2950. *Subsection (7)* is a similar provision to section 61. It treats capital expenditure incurred on contaminated land that will be used for the purposes of a trade or UK property business as incurred on the day the trade or business starts. Unlike section 61 there is

no time limit on how far in advance of the trade or business starting the expenditure must be incurred.

Section 1148: Election under section 1147

2951. This section sets out the requirements for making an election. It is based on paragraph 1 of Schedule 22 to FA 2001.

Section 1149: Additional deduction for qualifying land remediation expenditure

2952. This section entitles a company to make a claim increasing the deduction given in calculating its trade or UK property business profits if certain conditions are met. It is based on paragraphs 12 and 13 of Schedule 22 to FA 2001.

2953. *Subsection (1)* is a further example of *Change 77* in Annex 1 where it is made clear that the additional relief applies only for corporation tax.

2954. This section applies to expenditure that is allowed as a deduction in computing taxable profits either as a normal revenue deduction or through the operation of section 1147. The relief increases the amount of the deduction by 50%.

2955. The additional deduction has to be claimed. There is no special procedure for making the claim. The ordinary rules in Part 7 of Schedule 18 to FA 1998 apply.

Section 1150: No relief if company responsible for contamination

2956. This section denies relief if the company or a person connected with it was responsible for any part of the contamination. It is based on paragraphs 1 and 12 of Schedule 22 to FA 2001.

Chapter 3: Land remediation tax credit

Section 1151: Entitlement to and payment of tax credit

2957. This section allows a company to claim a land remediation tax credit if it has a "qualifying land remediation loss". It is based on paragraphs 14 and 16 of Schedule 22 to FA 2001.

2958. The section clarifies that a company may make part claims (*subsection (2)*). This is in line with current HMRC policy and is supported by paragraph 17(5)(b) of Schedule 22 to FA 2001.

Section 1152: Meaning of "qualifying land remediation loss"

2959. This section defines "qualifying land remediation loss". It is based on paragraph 14 of Schedule 22 to FA 2001.

2960. *Subsection (2)* limits the amount of the qualifying land remediation loss to the lesser of two amounts.

Section 1153: Amount of a loss which is "unrelieved"

2961. This section explains what is meant by the amount of a UK property business loss or trading loss that is "unrelieved". It is based on paragraph 14 of Schedule 22 to FA 2001.

Section 1154: Amount of tax credit

2962. This section gives the amount of the cash payment the company will receive. It is based on paragraph 15 of Schedule 22 to FA 2001.

Section 1155: Payment of tax credit

2963. This section gives a number of administrative rules that affect the payment of a land remediation tax credit. It is based on paragraph 16 of Schedule 22 to FA 2001.

Section 1156: Tax credit payment not income of company

2964. This section states that the payment of a land remediation tax credit is not income of the company for any tax purposes. It is based on paragraph 18 of Schedule 22 to FA 2001.

Section 1157: Exclusion for capital gains purposes of certain expenditure

2965. This section prevents any expenditure for which a land remediation tax credit has been claimed from also being deducted in the calculation of any chargeable gain on the disposal of the land. It is based on paragraph 19 of Schedule 22 to FA 2001.

2966. Section 39 of TCGA prevents expenditure that is allowable as a deduction in calculating income tax profits from being deducted again in the calculation of the chargeable gain. Section 8(3) and (4) of TCGA applies this principle to the calculation of a company's income and chargeable gains.

2967. The ordinary operation of section 39 of TCGA will prevent a double deduction for expenditure which attracts relief under sections 1147 and 1149. Amounts allowed under those sections are deducted in calculating the company's profits charged to corporation tax. But it is arguable that a loss surrendered in return for the payment of a land remediation tax credit falls outside this rule as the loss is not used in the ordinary calculation of the company's profits.

2968. This section makes clear that expenditure that contributed to the surrendered qualifying land remediation loss is not deductible in calculating the chargeable gain or allowable loss on the disposal of the land. It is not necessary to apply the rule to the 50% additional deduction itself as it is a notional figure and not an amount of actual expenditure.

Section 1158: Restriction on losses carried forward where tax credit claimed

2969. This section ensures that the amount of any qualifying land remediation loss surrendered in return for the payment of a land remediation tax credit is not available for carry forward for set-off against future profits. It is based on paragraph 17 of Schedule 22 to FA 2001.

Chapter 4: Special provision for life assurance business

Section 1159: Limitation on relief under Chapter 2

2970. This section provides that the deductions allowed in Chapter 2 do not apply to the calculation of the profits of a company's life assurance business where the calculation is made in accordance with the provisions of Part 3 (trading income). It is based on paragraph 20 of Schedule 22 to FA 2001.

Section 1160: Provision in respect of I minus E basis

2971. This section provides that the provisions of this Chapter apply where the profits of an insurance company are charged to tax under the I minus E basis in respect of its life assurance business. It is based on paragraph 21 to Schedule 22 to FA 2001.

Section 1161: Relief in respect of I minus E basis: enhanced expenses payable

2972. This section sets out the three conditions that companies with life assurance business must satisfy in order to claim relief for expenditure on the remediation of contaminated land. It also sets out the relief that is available (*subsection (6)*). It is based on paragraphs 22 and 23 of Schedule 22 to FA 2001.

2973. The relief takes the form of an enhancement in the expenses payable which the company may bring into account at Step 1 of section 76(7) of ICTA.

Section 1162: Meaning of "qualifying Chapter 4 expenditure"

2974. This section defines a company's "qualifying Chapter 4 expenditure" as the amount of its qualifying land remediation expenditure reduced by any amount not attributable to basic life assurance and general annuity business (BLAGAB). It is based on paragraph 22 of Schedule 22 to FA 2001.

2975. Qualifying Chapter 4 expenditure may include expenditure of a capital nature.

Section 1163: No relief if company responsible for contamination

2976. This section denies relief if the company or a person connected with it was responsible for any part of the contamination. It is the life assurance company equivalent of section 1150. It is based on paragraph 22 of Schedule 22 to FA 2001.

Section 1164: Entitlement to tax credit

2977. This section allows a company to claim a life assurance company tax credit if it has a "qualifying life assurance business loss". It is the life assurance company equivalent of section 1151 and is based on paragraph 24 of Schedule 22 to FA 2001.

Section 1165: Meaning of "qualifying life assurance business loss"

2978. This section defines "qualifying life assurance business loss". It is the life assurance company equivalent of section 1152. It is based on paragraph 24 of Schedule 22 to FA 2001.

Section 1166: Amount of tax credit

2979. This section gives the amount of the cash payment the company carrying on life assurance business will receive. It is the life assurance company equivalent of section 1154 and is based on paragraph 25 of Schedule 22 to FA 2001.

Section 1167: Payment of tax credit etc

2980. This section applies various provisions contained in Chapter 3 (namely sections 1151(4), 1155, 1156 and 1157) with appropriate modifications for companies carrying on life assurance business. Those provisions include provision relating to the payment of a life assurance company tax credit. It is based on paragraphs 26 and 28 of Schedule 22 to FA 2001.

Section 1168: Restriction on carrying forward expenses payable where tax credit claimed

2981. This section ensures that the amount of any qualifying life assurance business loss that is surrendered in return for the payment of a life assurance company tax credit is not available for carry forward. It is the life assurance company equivalent of section 1158. It is based on paragraph 27 of Schedule 22 to FA 2001.

Chapter 5: Tax avoidance

Section 1169: Artificially inflated claims for relief or tax credit

2982. This section restricts the amount of relief or tax credit available under the Part if there are arrangements that artificially increase the amount of that relief or tax credit. It is based on paragraph 29 of Schedule 22 to FA 2001.

Chapter 6: Supplementary

Section 1170: "Staffing costs"

2983. This section gives the meaning of staffing costs. It is based on paragraph 5 of Schedule 22 to FA 2001. That paragraph uses the term "employee costs", but in rewriting the source legislation it was felt that the term "staffing costs", which is the term used for the equivalent purpose in Part 13 of the Act, was more appropriate.

2984. Paragraph 5(1)(a) of Schedule 22 to FA 2001 refers to "emoluments paid by the company … including all salaries, wages, perquisites and profits whatsoever other than benefits in kind". This is based on the definition of emoluments that section 131 of ICTA applied for Schedule E before that Schedule was rewritten by ITEPA.

2985. ITEPA amended paragraph 5 of Schedule 20 to FA 2000 so that it referred to earnings which constitute employment income. In doing so it inadvertently expanded the definition to include benefits in kind. This change was reversed by paragraph 7 of Schedule 17 to FA 2004, which reinstated the original wording.

2986. In rewriting Schedule 22 to FA 2001 it was decided that the language and format of the definition should be adapted so that the definition applies more clearly from the position of the company making the payment rather than the employee receiving it. Hence the reference to money earnings and reimbursed expenses.

2987. *Subsection (2)* rewrites the reference to salaries and wages by reference to money earnings. *Subsection (3)* rewrites the reference to perquisites and profits by reference to reimbursed expenses. See *Change 79* in Annex 1.

2988. Paragraph 5(1)(c) of Schedule 22 to FA 2001 refers to "contributions paid by the company to any pension fund (within the meaning of section 231A(4) of [ICTA])". Section 231A of ICTA was repealed by F(No 2)A 1997 with effect for distributions made on or after 6 April 1999. But a consequential amendment was not made to paragraph 5 of Schedule 22 so as to set out in full the definition of "pension fund".

2989. The parallel definition in paragraph 5(1)(c) of Schedule 20 to FA 2000 also used to refer to section 231A(4) of ICTA. It was amended by paragraph 3 of Schedule 15 to FA 2002. The wording of the definition is the same but it is now free-standing. *Subsection (6)* provides a freestanding definition of "pension fund" that reflects the definition used in paragraph 5(1A) of Schedule 20 to FA 2000.

Section 1171: Staffing costs attributable to relevant land remediation

2990. This section identifies when staffing costs are attributable to relevant land remediation. It is based on paragraph 5 of Schedule 22 to FA 2001.

Section 1172: Expenditure on materials

2991. This section outlines whether expenditure on materials is attributable to land remediation. It is based on paragraph 6 of Schedule 22 to FA 2001.

Section 1173: Expenditure incurred because of contamination

2992. This section identifies two specific circumstances in which condition B in section 1144 – the condition that expenditure on contaminated land would not have been incurred if the land had not been in a contaminated state - is treated as met. It is based on paragraph 7 of Schedule 22 to FA 2001.

Section 1174: Sub-contractor payments

2993. This section defines "sub-contractor payment" and is the first of three sections that deal with such payments. It is based on paragraph 9 of Schedule 22 to FA 2001.

Section 1175: "Qualifying expenditure on sub-contracted land remediation": connected persons

2994. This section identifies the amount of qualifying expenditure on sub-contracted land remediation if the parties are connected. It is based on paragraph 10 of Schedule 22 to FA 2001.

Section 1176: "Qualifying expenditure on sub-contracted land remediation": other cases

2995. This section identifies the amount of qualifying expenditure on sub-contracted land remediation if the parties are not connected. It is based on paragraph 11 of Schedule 22 to FA 2001.

Section 1177: "Subsidised expenditure"

2996. This section defines "subsidised expenditure". It is based on paragraph 8 of Schedule 22 to FA 2001.

Section 1178: Persons having a "relevant connection" to a company

2997. This section sets out when a person has a "relevant connection" to a company for the purposes of the Part. It is based on paragraph 31 of Schedule 22 to FA 2001.

Section 1179: Other definitions

2998. This section provides definitions and is based on paragraph 31 of Schedule 22 to FA 2001.

2999. "National insurance contributions" is defined in section 1319.

3000. This Act does not rewrite paragraph 30 of Schedule 22 to FA 2001. This provision is no longer required, since the rule allowing the Commissioners for HMRC to deduct money for tax credits before paying their receipts into the Consolidated Fund is set out in sufficiently general terms in section 44 of CRCA (see subsections (1) and (3)(d) of that section). Paragraph 26 of Schedule 13 to FA 2002, which made similar provision to that made by paragraph 30 of Schedule 22 to FA 2001, was repealed by paragraph 96 of Schedule 4 to CRCA.

Part 15: Film production

Overview

3001. This Part treats certain film production and exploitation activity by certain companies as separate film trades for corporation tax. It is based on Chapter 3 of Part 3 of, and Schedules 4 and 5 to, FA 2006 (films and sound recordings).

3002. In relation to some separate film trades, this Part also provides for:

- additional trading deductions; and
- payments for the surrender of losses.

3003. This Part deals solely with film production companies. Provisions about the corporation tax treatment of sound recordings are dealt with in Chapter 9 of Part 3 (trade profits: other specific trades).

Chapter 1: Introduction

Section 1180: Overview of Part

3004. This section gives an overview of the Part. It is new.

Section 1181: "Film" etc

3005. This section provides for the meaning of "film" in this Part, when a series of films is treated as a single film and when a film is completed. It is based on section 31 of FA 2006.

3006. The definitions are the same as those in paragraph 1 of Schedule 1 to the Films Act 1985 (certification of British films for purposes of film tax relief) which was substituted by paragraph 17 of Schedule 5 to FA 2006.

Section 1182: "Film production company"

3007. This section defines "film production company" for this Part. It is based on section 32 of FA 2006.

3008. There can be at most one company that fits the description of "film production company" in relation to a particular film. There may be no such company. A company might be a film production company in relation to some of the films that it is involved with but not in relation to others.

3009. If a company is the film production company in relation to a particular film its production and exploitation activities in relation to the film are, for corporation tax purposes, treated as a separate trade (see Chapter 2: taxation of activities of film production company). A film production company may, but need not, be entitled to additional reliefs in relation to the film concerned (see Chapter 3: film tax relief).

3010. *Subsection (7)* provides for a company to elect that it is not to be treated as a film production company in relation to films. Such an election is likely to be helpful to companies that are not entitled to additional reliefs in relation to films that they are involved with.

Section 1183: "Film-making activities" etc

3011. This section gives the meaning of "film-making activities" for this Part and gives the Treasury power to make regulations that alter the meaning. It is based on section 33 of FA 2006.

3012. The activities mentioned in *subsection (1)* are not further defined. Those activities are however well understood in the film industry.

3013. *Subsection (2)* ensures that principal photography has an appropriate meaning in cases where images for a film are generated by computer.

Section 1184: "Production expenditure", "core expenditure" and "limited-budget film"

3014. This section defines the terms "production expenditure", "core expenditure" and "limited-budget film". It is based on section 34 of FA 2006.

3015. Limited-budget films are eligible for more generous reliefs than other films (see sections 1200(3) and 1202(3)). To reduce the risk of exploitation by arrangements involving connected parties, *subsection (3)* substitutes, in certain cases, (greater) arms length prices in determining whether a film is a limited-budget film.

Section 1185: "UK expenditure" etc

3016. This section gives the meaning of "UK expenditure" in this Part and gives the Treasury power to make regulations that alter the meaning. It is based on section 35 of FA 2006.

3017. *Subsection (2)* provides that any apportionment of expenditure be made on a "just and reasonable basis". The source legislation refers to "fair and reasonable". The

formulation used in this section has generally been adopted in ITTOIA and ITA. See *Change 12* in Annex 1.

Section 1186: "Qualifying co-production" and "co-producer"

3018. This section defines "qualifying co-production" and "co-producer" for this Part. It is based on section 36 of FA 2006.

Section 1187: "Company tax return"

3019. This section defines "company tax return". It is based on section 32(10) of FA 2006.

3020. Whilst the definition in section 32(10) of FA 2006 is not explicitly applied to instances where the term "company tax return" appears in Schedules 4 and 5 to FA 2006, it is considered that the same meaning applies in those instances. So the definition in this section applies to the whole Part.

Chapter 2: Taxation of activities of film production company

Section 1188: Activities of film production company treated as a separate trade

3021. This section treats a film production company's activities in relation to the film as a separate trade for corporation tax purposes and provides for when that trade is treated as starting. It is based on section 37 of, and paragraphs 2 and 3 of Schedule 4 to, FA 2006.

3022. *Subsection (3)* introduces the label "the separate film trade" in this Chapter as a means of avoiding cumbersome references such as "the separate trade that a film production company is treated as carrying on in relation to the film in respect of which it is the film production company".

Section 1189: Calculation of profits or losses of separate film trade

3023. This section provides rules for bringing into account income from the film (as defined) and costs of the film (as defined) in calculating the profit or loss of the separate film trade for a period of account. It is based on paragraph 7 of Schedule 4 to FA 2006.

Section 1190: Income from the film

3024. This section gives the meaning in this Chapter of the term "income from the film". It is based on paragraph 6 of Schedule 4 to FA 2006.

3025. *Subsection (3)* provides that capital receipts are treated as having a revenue nature for this purpose. So, for instance, all receipts from the sale of the film will be treated as income for the purposes of this section.

Section 1191: Costs of the film

3026. This section gives the meaning in this Chapter of the term "costs of the film". It is based on paragraph 5 of Schedule 4 to FA 2006.

3027. *Subsection (3)* prevents expenditure being treated as capital purely because it is on the creation of the film. It does not therefore apply to, say, capital expenditure on plant and machinery since that would be capital regardless of the creation of the film.

Section 1192: When costs are taken to be incurred

3028. This section makes provision about when costs are taken to be incurred. It is based on paragraph 9 of Schedule 4 to FA 2006.

3029. To prevent avoidance costs are, for instance, not to be treated as incurred before they are the subject of an unconditional obligation and are reflected in the state of completion of the work in progress.

Section 1193: Pre-trading expenditure

3030. This section allows expenditure incurred on development of the film, but before the separate film trade starts, to be treated as incurred immediately after the separate film trade starts. It is based on paragraph 4 of Schedule 4 to FA 2006.

3031. If pre-trading expenditure is treated in this fashion, the company must amend any company tax returns that have previously taken account of the same expenditure.

Section 1194: Estimates

3032. This section provides that estimates for the purposes of this Chapter are to be made at the balance sheet date and on a just and reasonable basis. It is based on paragraph 8 of Schedule 4 to FA 2006.

3033. The section provides that any estimate is to be made on a "just and reasonable basis". The source legislation refers to "fair and reasonable". The formulation used in this section has generally been adopted in ITTOIA and ITA. See *Change 12* in Annex 1.

Chapter 3: Film tax relief

Section 1195: Availability and overview of film tax relief

3034. This section gives an overview of the Chapter and gives signposts to film tax relief and to the three conditions that must be satisfied in order for the relief to be available. It is new.

Section 1196: Intended theatrical release

3035. This section sets out the condition about intended theatrical release. It is based on section 39 of FA 2006.

Section 1197: British film

3036. This section sets out the condition about certification as a British film. It is based on section 40 of FA 2006.

Section 1198: UK expenditure

3037. This section sets out conditions about the minimum percentage of core expenditure that must be UK expenditure and gives the Treasury power to alter that percentage. It is based on section 41 of FA 2006.

Section 1199: Additional deduction for qualifying expenditure

3038. This section allows a company, entitled to film tax relief, to claim additional trading deductions in respect of core expenditure on the film and gives the Treasury powers in relation to such additional deductions. It is based on paragraphs 1 to 3 of Schedule 5 to FA 2006.

Section 1200: Amount of additional deduction

3039. This section sets out the amount of additional deduction for which a claim may be made under section 1199 and gives the Treasury power to alter the percentages in subsections (1) and (2). It is based on paragraphs 4 and 5 of Schedule 5 to FA 2006.

3040. *Subsection (3)* provides for a higher rate of enhancement if the film is a limited-budget film.

Section 1201: Film tax credit claimable if company has surrenderable loss

3041. This section allows a company, entitled to film tax relief, to surrender a tax loss for a payment if it has a surrenderable loss for the accounting period concerned. It is based on paragraph 6 of Schedule 5 to FA 2006.

Section 1202: Surrendering of loss and amount of film tax credit

3042. This section allows a company to claim a film tax credit for only part of its surrenderable loss and quantifies the film tax credit. It is based on paragraphs 7, 8 and 11 of Schedule 5 to FA 2006.

3043. *Subsection (3)* provides for a higher payable credit rate if the film is a limited-budget film.

3044. *Subsection (4)* provides that the company's loss is reduced by the amount for which it claims a film tax credit.

Section 1203: Payment in respect of film tax credit

3045. This section requires the Commissioners for HMRC to pay to the company any film tax credit to which it is entitled and for which a claim has been made. It is based on paragraphs 9, 10 and 14 of Schedule 5 to FA 2006.

3046. Various circumstances in which a payment need not be made are set out. These include cases where the company has not yet made certain payments that it is required to make.

3047. *Subsection (5)* provides that a payment in respect of film tax credit does not count as income of the company.

Section 1204: No account to be taken of amount if unpaid

3048. This section requires costs that remain unpaid four months after the end of a period of account to be treated, for the purposes of this Chapter, as if they had not been incurred by the end of that period. It is based on paragraph 12 of Schedule 5 to FA 2006.

3049. The restriction in this section is additional to that in section 1192. Section 1192 is concerned with whether, and when, a trading deduction may be made in respect of expenditure in calculating the profit or loss of the single film trade. The further restriction in this section applies in deciding whether (and, if so, how much of) an additional trading deduction may be claimed or a trading loss may be surrendered for payment.

Section 1205: Artificially inflated claims for additional deduction or film tax credit

3050. This section requires transactions to be ignored for film tax relief purposes if they are attributable to arrangements whose sole or main purpose is obtaining, or increasing, entitlement to that relief. It is based on paragraph 13 of Schedule 5 to FA 2006.

Section 1206: Confidentiality of information

3051. This section permits disclosure of information by HMRC for the purpose of the Secretary of State's functions relating to certification of films, but prevents the recipient of such information making further disclosure except in specified cases. It is based on paragraph 24 of Schedule 5 to FA 2006.

Section 1207: Wrongful disclosure

3052. This section makes it an offence to disclose information in contravention of section 1206(3) if the disclosure reveals, or one can deduce, the identity of the person to whom the information relates. It is based on paragraph 25 of Schedule 5 to FA 2006.

3053. *Subsection (6)(b)* does not reproduce the reference to "Scotland" in paragraph 25(7) of Schedule 5 to FA 2006. That is because section 45(1) of the Criminal Proceedings etc (Reform) (Scotland) Act 2007 (ASP 6) (brought into force on 10 December 2007) has the effect that the 12 month limit in paragraph 25(4)(b) of Schedule 5 to FA 2006 applies in Scotland.

Chapter 4: Film losses

Section 1208: Application of sections 1209 and 1210

3054. This section introduces, and provides defined terms for, the next two sections dealing with losses of separate film trades. It is based on section 43(3) and 44(5) of FA 2006.

Section 1209: Restriction on use of losses while film in production

3055. This section restricts the offset of single film trade losses arising in accounting periods ending before the film is completed or abandoned ("pre-completion periods"). It is based on section 43(1) and (2) of FA 2006.

3056. The profits against which pre-completion period single film trade losses can be offset are restricted to those provided for by section 393(1) of ICTA (carry forward against trading profits of the same trade). But this restriction may effectively cease to apply in respect of some, or all, of those single film trade losses from the accounting period in which the film is completed or abandoned (see section 1210).

Section 1210: Use of losses in later periods

3057. This section modifies, for accounting periods from that in which the film is completed or abandoned ("the completion period"), the rules on trade losses and their offset against other profits. It is based on section 44(1) to (4) and (6) of FA 2006.

3058. *Subsection (1)(b)* refers to the separate film trade continuing in accounting periods after the completion period. This deals with the possibility that a film production company might decide to exploit the completed film, rather than sell it. In such a case the separate film trade may continue after the completion period.

3059. *Subsections (2)* and *(3)* allow part (or all) of single film trade losses brought forward to the completion period to be treated as if they were single film trade losses of the completion period. Single film trade losses of the completion period are not subject to the restrictions in section 1209. Any brought forward losses that are attributable to film tax relief (see *subsection (6)*) will not be "freed-up" in this manner. Nor will losses be "freed-up" if they are brought forward because of section 1211 (terminal losses) (see *subsection (7)*).

3060. *Subsections (4)* and *(5)* prevent single film trade losses being offset against other profits to the extent that such losses are attributable to film tax relief (see subsection (6)).

Section 1211: Terminal losses

3061. This section allows certain single film trade losses, attributable to a trade that ceases, to be treated as if they were brought forward losses of certain other single film trades and it allows the Treasury to make regulations appropriate to the operation of the section. It is based on section 45 of FA 2006.

3062. The normal rule is that trade losses do not survive the cessation of the trade in which the losses were made. This section operates if the trade that ceases (trade A) is a single film trade that qualifies for film tax relief and, at the time of cessation, there is another single film trade (trade B) carried on which also qualifies for film tax relief. Subject to conditions being met, the losses of trade A that would otherwise have been available for carry forward under section 393(1) of ICTA may be treated as if they were losses of trade B that are carried forward under section 393(1) of ICTA.

3063. Trade B may be carried on either by the film production company that had carried on trade A or by another member of the same group (for group relief) as that film production company.

3064. The Corporation Tax (Surrender of Terminal Losses on Films and Claims for Relief) Regulations 2007 (SI 2007/678) have been made under section 45(5) of FA 2006.

Chapter 5: Provisional entitlement to relief

Overview

3065. It may not be established that a film qualifies for film tax relief, or transfer of terminal losses, until the accounting period in which the film is completed or abandoned ("the final accounting period"). This Chapter provides for film tax relief to be obtained, or terminal losses transferred, for earlier accounting periods ("interim accounting periods") on the basis of provisional assumptions and for later adjustments where those assumptions are wrong.

Section 1212: Introduction

3066. This section defines terms used in the Chapter and requires the appropriate company tax return of the film production company to state that the film has been completed or abandoned. It is based on paragraph 30 of Schedule 5 to FA 2006.

3067. The term "special film relief" covers both film tax relief (which requires that the film in question satisfy the requirements listed in section 1195(2)) and the transfer of terminal losses (which requires that both of the films in question satisfy those requirements).

Section 1213: Certification as a British film

3068. This section relates to the requirement that a film must be certified as a British film in order for there to be entitlement to special film relief. It is based on paragraph 31 of Schedule 5 to FA 2006.

3069. Special film relief cannot be claimed for an interim accounting period unless the company tax return is accompanied by an interim certificate. For the final accounting period the company tax return must be accompanied by a final certificate or, if the film was abandoned rather than completed, an interim certificate. Special film relief previously obtained is withdrawn if the conditions in this section are not met.

Section 1214: The UK expenditure condition

3070. This section relates to the requirement that a film must meet the UK expenditure condition in order for there to be entitlement to special film relief. It is based on paragraph 32 of Schedule 5 to FA 2006.

3071. Special film relief cannot be claimed for an interim accounting period unless the company tax return indicates that the UK expenditure condition will be met. For the final accounting period the company tax return must show that the UK expenditure condition is met. Special film relief previously obtained is withdrawn if the conditions in this section are not met.

3072. *Subsection (3)* does not rewrite the requirement, in paragraph 32(3)(a)(i) of Schedule 5 to FA 2006, that the company's tax return for the final accounting period state that the film has been completed or abandoned. That is because it duplicates the requirement in paragraph 30(2) of Schedule 5 to FA 2006 (rewritten in section 1212(2)).

Section 1215: Film tax relief on basis that film is limited-budget film

3073. This section relates to the requirement that a film must be a limited-budget film in order for there to be entitlement to film tax relief at the enhanced rates in sections 1200(3)(a) and 1202(3)(a). It is based on paragraph 33 of Schedule 5 to FA 2006.

3074. Film tax relief at an enhanced rate cannot be claimed for an interim accounting period unless the company tax return indicates that the film will be a limited-budget film. For the final accounting period the company tax return must show that the film is, or if it had been completed would have been, a limited-budget film. Film tax relief previously obtained at an enhanced rate tax relief is reduced if the conditions in this section are not met.

3075. *Subsection (3)* does not rewrite the requirement, in paragraph 33(3)(a)(i) of Schedule 5 to FA 2006, that the company's tax return for the final accounting period state that the film has been completed or abandoned. That is because it duplicates the requirement in paragraph 30(2) of Schedule 5 to FA 2006 (rewritten in section 1212(2)).

Section 1216: Time limit for amendments and assessments

3076. This section allows an amendment or assessment, required by this Chapter, to be made even if it would otherwise be out of time to do so. It is based on paragraph 34 of Schedule 5 to FA 2006.

Part 16: Companies with investment business

Overview

3077. Expenses of management (generally known as "management expenses") are designed to give relief for the cost of managing an investment business on broadly the same basis as relief for trading expenses or expenses of a property business.

3078. Originally relief was given for expenses "disbursed" but changes in 2004 brought the relief (and the recovery of relief) more closely into line with the treatment of the corresponding items in a company's accounts. So, for instance, sections 1225 and 1231 rely on the concept of "generally accepted accounting practice".

Chapter 1: Introduction

Section 1217: Overview of Part

3079. This section introduces the Part. It is new.

3080. This Act does not rewrite section 76 of ICTA (expenses of insurance companies). Instead, it inserts sections 76ZA to 76ZO into ICTA, to provide a version of the trading income rules adapted to insurance companies to which section 76 of ICTA applies. For companies carrying on life assurance business, but not charged in accordance with the trading income rules, this Part does not apply. Instead, the rules in section 76 apply.

Section 1218: "Company with investment business" and "investment business"

3081. This section sets out which companies are within the rules in this Part of the Act. It is based on sections 75 and 130 of ICTA.

3082. *Subsection (2)* is the rule that a credit union is not a company with investment business.

3083. The rule applies for the purposes of this Part of the Act. So there is no possibility of a charge on a credit union under section 1254 on a FISMA repayment. See *Change 80* in Annex 1.

3084. *Subsection (3)* is a signpost to section 1219(2) which restricts the application of this Part of the Act to the part of the company's business which is an investment business.

But that restriction does not affect the basic definition of a "company with investment business".

3085. Schedule 1 to this Act amends section 18 of CAA so that "managing the investments of a company with investment business" in section 15(1)(g) of CAA is defined by reference to sections 1218 and 1219 of this Act. So there is no need for a separate rule to the effect that a credit union is not a company with investment business for the purposes of CAA.

Chapter 2: Management expenses

Section 1219: Expenses of management of a company's investment business

3086. This section sets out what are "expenses of management". It is based on section 75 of ICTA.

3087. There is no explicit definition of "expenses of management" either in the source legislation or in this Act. Instead, the limits of the expression are set by:

- case law, in which the expression (retained in this Act) has been considered;
- general exclusions set out in this section;
- specific reliefs set out in Chapter 3 of this Part; and
- specific restrictions set out in Chapter 4 of this Part.

3088. *Subsection (1)* ties the expenses to the management of the company's investment business (defined in section 1218), and to the accounting period to which the expenses are "referable" (see section 1224).

3089. The section provides that the expenses are allowed as a deduction, echoing the words of Part 3 (trading income). HMRC guidance (see paragraph 8580 of the Company Taxation Manual) suggests that the deduction of management expenses is mandatory. But this amounts to the same thing.

3090. Both restrictions in *subsection (2)* apply for the purposes of this Part (see section 1218).

3091. *Subsection (3)* excludes capital expenditure, in terms that follow closely the trading income rule. It also prevents a deduction as management expenses for anything that is otherwise allowable for tax purposes.

Section 1220: Meaning of "unallowable purpose"

3092. This section explains "unallowable purpose", an expression used in section 1219(2)(b). It is based on section 75 of ICTA.

3093. *Subsection (1)* is the basic rule that explains the ordinary meaning of "unallowable purpose".

3094. *Subsection (2)* extends "unallowable purpose" to include investments held in connection with arrangements to secure a tax advantage.

Section 1221: Amounts treated as expenses of management

3095. This section makes clear the relationship between two of the rules in section 1219 and rules elsewhere in this Part. It is based on section 75 of ICTA.

3096. The rule in section 1219(3)(a) which excludes capital expenditure is not applied to a rule that treats an amount as an expense of management.

3097. Similarly, the rule in section 1219(2) that expenses must be "in respect of" the company's investment business is not applied to a rule that makes an amount deductible as an expense of management. See *Change 81* in Annex 1.

Section 1222: Income from a source not charged to tax

3098. This section requires non-taxable income to be set off against management expenses. It is based on section 75 of ICTA.

Section 1223: Carrying forward expenses of management and other amounts

3099. This section allows excess management expenses to be carried forward. It is based on section 75 of ICTA.

Section 1224: Accounting period to which expenses are referable

3100. This section introduces the timing rules for management expenses. It is based on section 75A of ICTA.

3101. *Subsection (2)* makes clear that the general rules in this Chapter may be overridden by a specific timing rule elsewhere.

Section 1225: Accounts conforming with GAAP

3102. This section gives the timing rule in the two most common cases. It is based on section 75A of ICTA.

3103. *Subsection (1)* deals with the first most common case. The management expenses are "referable to" the accounting period for which accounts are drawn up in accordance with generally accepted accounting practice ("GAAP"). GAAP is defined in section 50(1) of FA 2004.

3104. UK generally accepted accounting practice is defined in section 50(4) of FA 2004.

3105. *Subsection (2)* deals with the second most common case. GAAP accounts are drawn up. But the period of the accounts does not coincide with the company's accounting period. The expenses are apportioned.

3106. *Subsection (3)* sets out the basis of apportionment. It retains the words "it appears that" because they may make the test easier to meet than an apparently objective test ("if the method would work unreasonably …"). But the second "appears" in section 75A(5) of ICTA ("such other method … as appears just and reasonable") is dropped as it adds nothing. So the wording here is consistent with other "just and reasonable" apportionments in the Act. The same point arises in connection with section 1229(6).

Section 1226: Accounts not conforming with GAAP

3107. This section gives the timing rule if accounts are not GAAP compliant. It is based on section 75A of ICTA.

Section 1227: Accounts not drawn up

3108. This section gives the timing rule if there are no accounts. It is based on section 75A(7) and (8) of ICTA.

3109. The rule is that the management expenses are "referable to" the accounting period into which they would have fallen if GAAP accounts had been drawn up.

3110. There are alternative definitions of GAAP in section 50 of FA 2004. International standards apply if the company "prepares accounts in accordance with international accounting standards". In any other case (including the case where no accounts are prepared), the United Kingdom standard (UK GAAP) applies.

3111. The combined effect of section 50(1) and (4) of FA 2004 is that in section 75A(8) GAAP means UK GAAP. A similar point arises in section 1231. In each case the section specifies UK GAAP.

Section 1228: Credits that reverse debits

3112. This section explains that the credits in accounts with which sections 1229 and 1230 are concerned include repayments and amounts never paid. It is based on section 75B of ICTA.

Section 1229: Claw back of relief

3113. This section applies the corporation tax charge to credits in accounts that reverse management expenses. It is based on section 75B of ICTA.

3114. *Subsection (5)* provides for any necessary apportionment of the company's accounts to accounting periods.

3115. *Subsection (6)* sets out the basis of apportionment. It retains the words "it appears that" because they may make the test easier to meet than an apparently objective test ("if the method would work unreasonably …"). But the second "appears" in section 75B(6) of ICTA ("such other method … as appears just and reasonable") is dropped as it adds nothing. So the wording here is consistent with other "just and reasonable" apportionments in the Act. The same point arises in connection with section 1225(3).

Section 1230: Meaning of "reversal amount"

3116. This section calculates the reversal amount. It is based on section 75B of ICTA.

3117. The calculation is set out in a method statement that excludes from the credit in the accounts:

- anything that does not relate to management expenses previously allowed; and
- anything that has already been taxed.

Section 1231: Absence of accounts

3118. This section sets out what happens if there are no accounts. It is based on sections 75B and 578A of ICTA.

3119. The reversal amount is the amount that would have been credited to GAAP accounts for the company's accounting period.

3120. There are alternative definitions of GAAP in section 50 of FA 2004. International standards apply if the company "prepares accounts in accordance with international accounting standards". In any other case (including the case where no accounts are prepared), UK GAAP applies.

3121. The combined effect of section 50(1) and (4) of FA 2004 is that in section 75B(10) GAAP means UK GAAP. A similar point arises in section 1227. In each case the section specifies UK GAAP.

Chapter 3: Amounts treated as expenses of management

Section 1232: Chapter applies to amounts not otherwise relieved

3122. This section is a priority rule. It is based on section 75 of ICTA.

3123. If an expense falls within the general rule for management expenses in section 1219(1) that section takes priority over the rules in this Chapter. And if an expense is otherwise deductible for tax purposes the rules in this Chapter do not apply to it.

Section 1233: Excess capital allowances

3124. This section gives a deduction for some capital allowances. It is based on section 75 of ICTA.

3125. A company with an investment business carries on a "qualifying activity" (see section 15(1)(g) of CAA). The rule in section 253 of CAA is that capital allowances are to be deducted in calculating the profits of the business. But, if there is an excess of allowances, the excess is treated as management expenses and can be set against profits generally.

Sections 1234 to 1246

Overview

3126. The following 13 sections are equivalent to trading income sections.

3127. Generally there are no timing rules in the sections. So a deduction is made in the accounting period to which it is "referable" in accordance with section 1224. There are two exceptions: sections 1240(4) and 1242(4) require the deduction for a redundancy payment to be made in the final accounting period of the business if the payment is made after the business has ceased.

Section 1234: Payments for restrictive undertakings

3128. This section allows a company to deduct certain amounts paid to employees for restrictive undertakings. It is based on section 73 of FA 1988. The corresponding rule for trading income is in section 69.

Section 1235: Employees seconded to charities and educational establishments

3129. This section allows a company carrying on investment business to deduct the cost of an employee seconded to a charity or educational establishment. It is based on section 86 of ICTA. The corresponding rule for trading income is in section 70.

3130. The rule in section 86 of ICTA is that the cost of the employee "shall continue to be deductible in the manner and to the like extent" as if the employee continued to work in the employer's business. This section allows the employer to deduct *all* costs attributable to the seconded employee during the period of the secondment, regardless of whether those costs would have been allowed if the employee had not been seconded. See *Change 14* in Annex 1.

Section 1236: Payroll deduction schemes

3131. This section allows an employer a deduction for expenses incurred in operating the payroll deduction scheme. It is based on section 86A of ICTA. The corresponding rule for trading income is in section 72.

Section 1237: Counselling and other outplacement services

3132. This section gives a deduction for certain expenses of counselling provided for employees. It is based on section 589A of ICTA. The corresponding rule for trading income is in section 73.

Section 1238: Retraining courses

3133. This section gives a deduction for certain expenses of retraining provided for employees. It is based on section 588 of ICTA. The corresponding rule for trading income is in section 74.

3134. The section does not rewrite section 588(3)(b) of ICTA. That provision makes a deduction as a management expense conditional on the employee's exemption under section 311 of ITEPA in respect of the expenditure in question. This condition is not consistent with the similar provision in section 1237 and does not serve any material purpose. See *Change 16* in Annex 1.

Sections 1239 to 1243: Redundancy payments etc

3135. These five sections are based on sections 90, 579 and 580 of ICTA. The parts of the rules that deal with the employee's liability are in section 309 of ITEPA. The corresponding rules for trading income are in sections 76 to 81.

Timing

3136. In sections 1240(4) and 1242(4) there is a special timing rule for management expenses. For trading income the Act adopts a "person-based" approach. So the corresponding trading income rules refer to a "payment … made after the employer has permanently ceased to carry on the trade [or part of the trade]".

3137. In these sections the rules refer to a payment "referable to … an accounting period beginning after the business [or the part of the business] has [permanently] ceased to be carried on". This produces the same result as the trading income sections, without the need to explain the rule for businesses carried on in partnership.

3138. If an investment business ceases, the closing words of the second sentence of section 90(1) and section 579(3A) of ICTA make the payments referable to the "accounting period ending on the last day on which the … business was carried on". These sections specify instead "the last accounting period in which the business was carried on". See *Change 82* in Annex 1.

Just and reasonable apportionment

3139. Section 1241(2) requires a "just and reasonable" apportionment. Section 579(5) of ICTA does not specify the basis of apportionment. See *Change 12* in Annex 1.

Part of a business

3140. Section 1242 applies to payments in connection with the cessation of *part* of a business in the same way as it applies to payments in connection with the cessation of a whole business. See *Change 17* in Annex 1.

Devolution

3141. Section 1243(2)(b) reflects the effect of the devolution settlements. See *Change 15* in Annex 1.

Section 1244: Contributions to local enterprise organisations or urban regeneration companies

3142. This section allows deductions for contributions to local enterprise agencies, training and enterprise councils, local enterprise companies in Scotland, business links and urban regeneration companies. It is based on sections 79, 79A and 79B of ICTA. The corresponding rule for trading income is in section 82.

3143. *Subsection (3)* is an anti-avoidance rule. It prevents a company using the section to obtain a deduction for non-commercial expenditure, such as funding the training of a member of a shareholder's family, by passing funds through one of these bodies. The source legislation disallows any deduction if there is a benefit to the company (or a connected person). This section merely restricts the deduction by the value of the benefit. See *Change 18* in Annex 1.

3144. *Subsection (6)* of this section invokes the supporting sections 83 and 86.

3145. If a disqualifying benefit is later received it is charged to tax by section 1253.

Section 1245: Payments to Export Credits Guarantee Department

3146. This section allows a company to deduct the cost of certain payments to the Export Credits Guarantee Department. It is based on section 88 of ICTA. The corresponding rule for trading income is in section 91.

Section 1246: Levies under FISMA 2000

3147. This section allows a deduction for certain payments arising from FISMA. It is based on section 76B of ICTA. The corresponding rule for trading income is in section 92.

3148. A company carrying on investment business may be called upon to make payments in connection with FISMA. The payments are of two sorts:

- a "levy" to meet the running costs of the schemes set up by FISMA; and
- "costs" which may be awarded at the conclusion of a hearing of a complaint.

3149. Section 76B of ICTA allows as a management expense both sorts of payment. But there is a difficulty with one sort of levy. So some changes are made in this section and in the trading income section to ensure that all the payments under FISMA qualify for a deduction. Schedule 1 to this Act makes a corresponding relaxation in section 155 of ITTOIA. See *Change 22* in Annex 1.

Chapter 4: Rules restricting deductions

Section 1247: Introduction

3150. This section introduces the Chapter. It is new.

3151. *Subsection (2)* lists rules outside this Part that affect the calculation of management expenses. All these rules in the source legislation are drafted in wide terms (for instance, "for the purpose of calculating profits or other income charged to corporation tax"). The rules apply to the calculation of management expenses because that is part of the calculation of profits charged to corporation tax.

3152. In some cases the application of the rewritten rules is restricted so that they do not apply in calculating the profits of a trade or property business. That is because there is an equivalent rule in Part 3 (trading income) which is also applied to property income by section 210.

3153. The permissive rules for management expenses in Chapter 3 of this Part say that expenses are "treated for the purposes of Chapter 2 as expenses of management". The restrictive rules in this Chapter "restrict the deduction of expenses of management under section 1219" (which is in Chapter 2). So it is clear that the restrictive rules have priority.

3154. This is the reverse of the position for trading income, where the general rule in section 51 is that the permissive rules have priority. But, in the unusual cases where it is possible for the rules to overlap, the result is the same.

3155. *Subsection (3)* draws attention to section 196A of FA 2004. This rule about pension scheme contributions does not itself restrict management expenses. But it gives HMRC power to make regulations that may make such a restriction.

Section 1248: Expenses in connection with arrangements for securing a tax advantage

3156. This section disallows expenses incurred in connection with arrangements to secure a tax advantage. It is based on section 75 of ICTA.

3157. *Subsections (1)* and *(2)* are the basic rule that the expenses are not allowed as management expenses. The wording of the subsections echoes that of section 1220,

which treats investments held in connection with arrangements to secure a tax advantage as held for a disallowable purpose.

3158. *Subsection (3)* establishes an order of priority for "disallowable purposes" rules.

- If the investments concerned are held for an unallowable purpose, the expenses are not expenses of management of the company's investment business (section 1219(2)(b)).
- Otherwise, if a manufactured payment is made in pursuance of arrangements that have an unallowable purpose, relief may be denied for the payment by paragraph 7A of Schedule 23A to ICTA.
- If neither of these applies, this section may apply.

Section 1249: Unpaid remuneration

3159. This section delays a deduction for employees' (or an office-holder's) pay if it is paid late. The section is based on section 44 of FA 1989. The corresponding rule for other businesses (based on section 43 of FA 1989) is in section 1288.

Section 1250: Unpaid remuneration: supplementary

3160. This section provides definitions and further explanation of the main rule in section 1249. It is based on section 44 of FA 1989. The corresponding rule for other businesses (based on section 43 of FA 1989) is in section 1289.

3161. *Subsection (1)* applies section 1249 to provisions made in the accounts for amounts that may become employees' remuneration.

3162. *Subsection (3)* deals with the case in which the company submits its tax return before the end of the nine month limit in section 1249(2) and all or any of the remuneration is unpaid. The company must assume the remuneration will remain unpaid. If, subsequently, the remuneration is paid within the time limit the calculation can be adjusted and the return amended. See *Change 68* in Annex 1.

Section 1251: Car or motor cycle hire

3163. This section restricts the amount that a company can deduct in respect of the cost of hiring certain cars or motor cycles with a retail price (when new) of more than £12,000. The section is based on sections 578A and 578B of ICTA. The corresponding rule for trading income is in section 56.

3164. Under section 75B(3) of ICTA any recovery of the hire charge is restricted to the reversal of "so much of the debit as represents the expenses of management." *Subsection (4)* makes this restriction explicit and mirrors the trading income rule in section 56(4). See *Change 83* in Annex 1.

3165. *Subsection (7)* of the section invokes the supporting sections 57 and 58. So the definition of "qualifying hire car or motor cycle" includes a car or motor cycle where ownership passes without the exercise of an option to purchase. See the commentary on section 57 and *Change 10* in Annex 1.

Chapter 5: Companies with investment business: receipts

Section 1252: Industrial development grants

3166. This section deals with the treatment of certain grants under the Industrial Development Act 1982 or the corresponding provision in Northern Ireland. It is based on section 93 of ICTA. The corresponding rule for trading income is in section 102.

3167. Under section 93(1) of ICTA the payment of a grant is "taken into account as a receipt in computing [the company's] profits under Case VI of Schedule D". Under section 70(1) of ICTA the basis of assessment for Schedule D is the "profits gains or income arising" in an accounting period. But there is no explicit rule to say into which accounting period the grant falls.

Section 1253: Contributions to local enterprise organisations or urban regeneration companies: disqualifying benefits

3168. This section sets out what happens if a company (or a connected person) receives a benefit in connection with a contribution to a local enterprise organisation or urban regeneration company (see section 1244). It is based on sections 79, 79A and 79B of ICTA. The corresponding rule for trading income is in section 82.

3169. Section 79(9) of ICTA refers to relief having been given "under subsection (1) above". Strictly, relief for management expenses is given under subsection (2) by reference to a "deduction under subsection (1)". But it is clear in the context of the section that the recovery under subsection (9) is intended to apply to management expenses as it applies to a trading deduction. The same analysis applies to the corresponding provisions in sections 79A and 79B of ICTA. This section clarifies the position.

3170. The charge is restricted to the amount of the "disqualifying benefit". That expression is explained in section 1244(5). See the commentary on that section and *Change 18* in Annex 1.

Section 1254: Repayments under FISMA 2000

3171. This section charges tax on a repayment made to a company under FISMA. It is based on section 76B of ICTA. The corresponding rule for trading income is in section 92.

3172. Under section 76B(2) of ICTA the repayment is "charged to tax under Case VI of Schedule D". Under section 70(1) of ICTA the basis of assessment for Schedule D is the "profits gains or income arising" in an accounting period. But there is no explicit rule to say in which accounting period the repayment falls.

Chapter 6: Supplementary

Section 1255: Meaning of some accounting terms

3173. This section provides definitions of some accounting terms used in this Part. It is based on sections 75A and 75B of ICTA.

3174. *Subsection (1)* deals with the concept of management expenses being "debited in accounts". This expression is used in the rules that determine to which accounting period expenses are referable.

3175. *Subsection (2)* deals with the concept of an amount being "brought into account". This expression is used in the rule that deals with the claw back of relief. There is no reason why the expression should be defined differently in sections 75A(10) and 75B(8) of ICTA. So this section adopts the fuller words of section 75A(10).

3176. *Subsection (3)* removes a small inconsistency between sections 75A(10) and 75B(12) of ICTA by referring to a debit that increases *or creates* a loss.

Part 17: Partnerships

Overview

3177. This Part contains the rules that apply to partnerships. The corresponding rules for income tax are in Part 9 of ITTOIA.

3178. Section 1 of the Partnership Act 1890 defines partnership as "the relation which subsists between persons carrying on a business in common with a view of profit". Section 4 of the Partnership Act 1890 explains that "firm" is the term used for the purposes of that Act for persons in partnership.

3179. The sections in this Act follow the Partnership Act 1890 and refer to the partners collectively as a "firm". But the word "partnership" is commonly used as a synonym for "firm". So the title of the Part and some of the titles of the sections use the word "partnerships", again following the lead of the Partnership Act 1890.

3180. The rules in this Part determine each partner's share of the income of the firm. That income share is then charged under the normal rules for the type of income concerned.

Section 1256: Overview of Part

3181. This section introduces this Part of the Act. It is new. The corresponding rule for income tax is in section 846 of ITTOIA.

Section 1257: General provisions

3182. This section introduces the concept of a "firm". It is new. The corresponding rule for income tax is in section 847 of ITTOIA.

3183. The section drops the references in sections 111 and 114 of ICTA to professions. See *Change 2* in Annex 1 and the commentary on section 35.

Section 1258: Assessment of partnerships

3184. This section makes it clear that, for corporation tax purposes, a firm is not an entity distinct from the partners in the firm. It is based on section 111 of ICTA. The corresponding rule for income tax is in section 848 of ITTOIA.

3185. The section extends the treatment of trades carried on by firms to businesses that are not trades. It is based on section 111(10) of ICTA which was repealed in error by ITTOIA. This brings the income tax and corporation tax codes back into line. See *Change 84* in Annex 1.

3186. In the case of firms established under English law this provision merely confirms their position under that law. But Scottish firms, for example, are legal entities. This provision ensures that all firms are treated in the same way.

Section 1259: Calculation of firm's profits and losses

3187. This section contains the basic rules for calculating the profits of a firm. It is based on sections 114 and 115 of ICTA. The corresponding rule for income tax is in section 849 of ITTOIA.

3188. Section 6(4) of ICTA extends the meanings of "profits" and "trades" in sections 114 and 115 of ICTA. None of the partnership rules in this Act applies to chargeable gains. So the extension of "profits" to include chargeable gains is not needed. And for corporation tax purposes a company cannot:

- carry on a vocation (see *Change 2* in Annex 1);
- be employed; or
- hold an office in partnership.

3189. So this Act does not rewrite either extension in section 6(4) of ICTA.

3190. If some of a firm's partners are resident in the United Kingdom and some are not, the profits of the firm's trade must be determined on different bases. For the resident partners, the determination includes profits arising outside the United Kingdom; for

the non-UK resident partners, the determination is restricted to profits arising from a permanent establishment in the United Kingdom. (If there are other United Kingdom profits, a non-UK resident company is chargeable to income tax on those profits and the rules in ITTOIA apply.)

3191. Section 114 of ICTA is not explicit that the profits may have to be determined on more than one basis. This section brings together the rules for resident and non-UK resident partners. *Subsection (2)* introduces the idea that more than one determination may be needed.

3192. *Subsection (3)* sets out the normal basis for determining the profits, for a partner resident in the United Kingdom. The profits are determined as if the firm were a company resident in the United Kingdom.

3193. *Subsection (4)* sets out an alternative basis for determining the profits. If the company partner is not resident in the United Kingdom the profits of the firm are determined as if the firm were a company not resident in the United Kingdom. That determination is restricted to the profits arising from a permanent establishment in the United Kingdom. So there is no need to rewrite the requirement in section 115(4)(b) of ICTA that the partner's share of the profits is treated as arising from such a permanent establishment.

3194. The profits of the firm are determined by reference to the extent to which they would be *chargeable* to corporation tax. So, in the case of a non-UK resident, the profits of which the partner has a share are those attributable to a permanent establishment in the United Kingdom.

Changes in partnership

3195. Section 114(1) of ICTA provides that the business profits of a firm are calculated for corporation tax "as if the partnership were a company" (referred to in this part of the commentary as the "deemed company"). This rule applies "so long as" a company carries on the business in partnership.

3196. The deemed company exists only during the life of the partnership. So a company is treated as ceasing to carry on a business when that company takes another person into partnership (because the deemed company then carries on the business). And the deemed company is treated as ceasing to carry on a business when the partnership business is taken over by a company on its own.

3197. Furthermore, the deemed company calculation is made without regard to any change in the persons carrying on the business except that a change in the persons is treated as a transfer of the business to a different company if there is no company which carries on the business before and after the change.

3198. The occasions on which a company is treated as ceasing to carry on a business are set out in the rules to which they are relevant (see sections 77(5), 80 and 162(3)). They also appear in this Part in sections 1267(3) and (4) and 1271(3).

Section 1260: Section 1259: supplementary

3199. This section sets out the treatment of losses and distributions in the calculation of the firm's profits under section 1259. It is based on section 114 of ICTA.

3200. The usual rule is that the profits of the firm are calculated as if the firm were a company. On that assumption it is possible that losses brought forward should be deducted before the (net) profits are allocated to the partners. Instead, *subsection (1)* makes clear that losses are not taken into account in the calculation of the firm's profit or loss to be allocated to the partners.

3201. Capital allowances are given as a deduction in calculating profits. So there is no need for the rule in section 114(1)(b) and (2) that gives special treatment to capital allowances.

The same applies to balancing charges, which are treated as business receipts. And the rule about charges (also in section 114(1)(b) of ICTA) is not needed because charges cannot be a deduction in calculating the profits of a trade.

3202. There is a closely related rule in section 116(5) of ICTA. It is that, for the purposes of that section, capital allowances and charges *are* taken into account. As there is no longer a partnership rule that allowances and charges are ignored, there is no need for section 116(5) of ICTA. So it is repealed by Schedule 1 to this Act.

3203. Schedule 1 to this Act introduces a new subsection (4) to section 849 of ITTOA to make clear similarly that losses brought forward are ignored in calculating the firm's profits for income tax purposes.

3204. *Subsection (2)* is based on section 114(1)(a) of ICTA, which provides that "references to distributions shall not apply". It is clear from the context that this rule applies to payments made *by* the firm. So there is no question of a payment of, say, interest being treated as a distribution by the firm under section 209 of ICTA and being disallowed in calculating the firm's profit. See Schedule 1 and *Change 85* in Annex 1.

Section 1261: Accounting periods of firms

3205. This section sets out how accounting periods of a firm are determined. It is based on section 114 of ICTA. The concept of an accounting period of a firm is used in section 1259 for the calculation of the firm's profit or loss.

3206. An accounting period of a firm begins when the rule in section 114(1) of ICTA first applies. That is, when a company first carries on the trade etc in partnership. That circumstance is set out in *subsections (2)(b)* and *(3)* of the section.

3207. An accounting period of a firm ends when the rule in section 114(1) of ICTA no longer applies. That is, when the last company leaves a firm, or (if the company continues to carry on the trade etc) when the company is no longer in partnership. That circumstance is set out in *subsections (2)(c)* and *(4)* of the section.

3208. An accounting period of a firm ends when there is a change in the persons carrying on the trade etc and the change is treated by 114(1)(c) of ICTA as the transfer of the trade etc to a different company. That is, when there is no "corporate continuity" between the members of the firm before and after the change. That circumstance is set out in *subsections (2)(d)* and *(5)* of the section.

3209. The usual rules about an accounting period ending on a date to which the firm makes up accounts and about an accounting period ending on the expiration of 12 months apply without being specifically mentioned in this section.

Section 1262: Allocation of firm's profits or losses between partners

3210. This section is the link between the firm's profit or loss and the amounts assessable on the partners. It is based on section 114 of ICTA. The corresponding rule for income tax is in section 850 of ITTOIA.

3211. The basic rule in this section applies in most cases. But, if the basic rule produces a loss for a partner when the firm's result is a profit, the allocation is adjusted under section 1263. Similarly, if the basic rule produces a profit for a partner when the firm's result is a loss, the allocation is adjusted under section 1264.

3212. In a firm where some partners are liable to income tax and others liable to corporation tax, the rules requiring an adjusted allocation are not straightforward. In this Act they are set out in two separate sections. The Act amends ITTOIA to set out the income tax rules in the same way (in new sections 850A and 850B of ITTOIA) – see Schedule 1.

Section 1263: Profit-making period in which some partners have losses

3213. This section sets out what happens if the calculation of a partner's share of the firm's profit or loss under section 1262 produces a loss, even though the overall result for the firm is a profit. It is new. The corresponding rule for income tax was in section 850 of ITTOIA but is now in the new section 850A of ITTOIA.

3214. The section is most likely to apply when one or more partners are entitled to a salary or interest on the firm's capital. A partner's "loss" determined under section 1262 is, in effect, reallocated to the other partners, to reduce their shares of the profit. See *Change 86* in Annex 1.

3215. *Subsection (2)* sets out the position for company A if it has a profit but any of the other partners has a loss determined under section 1262. The rule is that company A's profit is reduced so that the total of the shares of the profit-making partners is no more than the amount of the firm's profits.

3216. If some of the members of the firm are UK resident and some are non-UK resident (see section 1259), the measure of the firm's profit may vary, depending on the residence of the partner "in relation to" which the firm's profit is calculated. Similarly, if any of the partners is chargeable to income tax, that partner's share is determined under ITTOIA and not under section 1262.

3217. So subsection (2) refers to "the comparable amount" for a partner. This amount may be on a basis different from that appropriate for that partner under section 1259 or the corresponding ITTOIA rule.

Section 1264: Loss-making period in which some partners have profits

3218. This section sets out what happens if the calculation of a partner's share of the firm's profit or loss under section 1262 produces a profit, even though the overall result for the firm is a loss. It is new. The corresponding rule for income tax was in section 850 of ITTOIA but is now in the new section 850B of ITTOIA.

3219. The section is the mirror-image of section 1263. It is most likely to apply when one or more partners are entitled to a salary or interest on the firm's capital. A partner's "profit" determined under section 1262 is, in effect, reallocated to the other partners, to reduce their shares of the loss. See *Change 86* in Annex 1.

3220. *Subsection (2)* sets out the position for company A if it has a loss but any of the other partners has a profit determined under section 1262. The rule is that company A's loss is reduced so that the total of the shares of the loss-making partners is no more than the amount of the firm's losses.

3221. If some of the members of the firm are UK resident and some are non-UK resident (see section 1259), the measure of the firm's loss may vary, depending on the residence of the partner "in relation to" which the firm's loss is calculated. Similarly, if any of the partners is chargeable to income tax, that partner's share is determined under ITTOIA and not under section 1262.

3222. So subsection (2) refers to "the comparable amount" for a partner. This amount may be on a basis different from that appropriate for that partner under section 1259 or the corresponding ITTOIA rule.

Section 1265: Apportionment of profit share between partner's accounting periods

3223. This section allocates a partner's share of the firm's profit or loss to accounting periods of the partner. It is based on section 114 of ICTA.

Section 1266: Resident partners and double taxation agreements

3224. This section ensures that a UK resident company partner's share of the income of a foreign firm remains liable to United Kingdom corporation tax even though the income of the firm as a whole is exempt from United Kingdom corporation tax in accordance with a double taxation agreement. It is based on section 115 of ICTA. The corresponding rule for income tax is in section 858 of ITTOIA.

3225. The business profits article of the United Kingdom/Jersey double taxation arrangement exempts the profits of a Jersey firm from United Kingdom tax. In the case of Padmore v CIR (1989), 62 TC 352 CA[7], the Court of Appeal decided that the exemption extended to the share of the profits arising to a United Kingdom resident individual. The rules in section 115(5) to (5B) of ICTA were enacted to remove the exemption.

3226. *Subsection (1)* sets out the type of company and firm with which the section is concerned. It goes on to identify the sort of exemption from tax that was considered in the Padmore case.

3227. For United Kingdom tax purposes, if it is necessary to consider where a firm is resident, the question is likely to be decided by the place where the firm's business is controlled and managed. But it is possible that, under foreign law, a firm may be considered to be resident elsewhere, for example, by reference to where the firm was established. So the section uses both the "control and management" test and the "resides" test.

3228. *Subsection (2)* makes it clear that the section does no more than remove any exemption under a double taxation arrangement. It does not deny other reliefs, such as tax credit relief. See *Change 87* in Annex 1.

3229. *Subsection (3)* deals with United Kingdom tax credits, which may be relevant to the calculation of a company's "shadow ACT" (see SI 1999/358, made under section 32 of FA 1998). A double taxation arrangement may give a non-UK resident "person" an entitlement to payment of a tax credit on a distribution by a United Kingdom company. This subsection makes it clear that, where that "person" is a firm, only a UK resident partner has the entitlement.

3230. Section 115(5A) of ICTA applies also to capital gains. That part of the rule is not rewritten in this Act. It is moved to TCGA by an amendment to section 59 of TCGA (see Part 2 of Schedule 1 to this Act).

Section 1267: Various rules for trades and property businesses

3231. This section clarifies the position of firms that are affected by the rules in Chapter 14 of Part 3 or section 262 of this Act. It is based on paragraph 13 of Schedule 22 to FA 2002 (as applied to property businesses by section 21B of ICTA). The corresponding rule for income tax is in section 860 of ITTOIA.

3232. The section differs from its income tax equivalent because a positive adjustment on a change of basis is dealt with differently for income tax and corporation tax. For income tax, such an adjustment is the subject of a separate charge, in section 228 or 330 of ITTOIA. For corporation tax, the adjustment is treated as a trade or property business receipt and so is charged to tax under section 35 or 209.

3233. This section explicitly applies to property businesses. In ITTOIA the position is different because the extension to non-trade businesses in section 847 of ITTOIA does not apply to section 860. But section 860 of ITTOIA does apply to property businesses as a result of section 272(1) of ITTOIA, because the restriction in section 272(2) does not exclude rules outside Part 2 such as those in Chapter 7 of Part 3 of ITTOIA. Schedule 1 to this Act amends section 860 of ITTOIA to clarify the income tax position, with a minor related amendment to section 847 of ITTOIA.

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Section 1268: Election for spreading under Chapter 14 of Part 3

3234. This section sets out two rules for firms that make an election under section 186. It is based on section 114 of ICTA and paragraphs 9 and 13 of Schedule 22 to FA 2002. The corresponding rules for income tax are in section 860 of ITTOIA.

3235. *Subsection (1)* ensures that the adjustment charge is not "rolled up" under section 186 just because a company leaves or joins the firm.

3236. *Subsection (2)* is the rule about making an election under section 186. The "date on which the new basis was adopted" is defined in section 1269.

Section 1269: Interpretation of Sections 1267 and 1268

3237. This section explains expressions used in the two preceding sections. It is based on paragraph 13 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 860(6) of ITTOIA.

Section 1270: Special provisions about farming and property income

3238. This section clarifies the position of firms that carry on a farming trade or property business. It is based on sections 15, 53 and 70A of ICTA. The corresponding rule for income tax is in section 859 of ITTOIA.

3239. In section 53(2) of ICTA there is a rule that all farming carried on in the United Kingdom by a company is a single trade. The section refers to a "particular company or partnership".

3240. In section 15 of ICTA there is a similar rule that all property income activity carried on by a person forms a single property business. Paragraph 1(3) of Schedule A refers to a "particular person or partnership". Section 70A(4) of ICTA, which deals with overseas property businesses, refers to a "particular company or partnership".

3241. *Subsection (1)* is the rule that all farming carried on by a firm is a single trade. The subsection also makes it clear that the firm's single farming trade does not include any farming trade carried on by a company separately from the firm.

3242. *Subsections (2)* and *(3)* are the corresponding rules for UK property businesses and overseas property businesses.

Section 1271: Sale of patent rights: effect of partnership changes

3243. This section sets out what happens when there is a sale of patent rights by a trader and there is change in the membership of any firm that carries on the trade. It is based on section 558 of CAA. The corresponding rule for income tax is in section 861 of ITTOIA.

3244. The rules for intellectual property are split:

- the rules that give capital allowances are in CAA;
- the rules that charge capital receipts from the sale of patent rights are in Chapter 3 of Part 9; and
- the special rules that apply to firms are set out in this section and section 1272.

3245. If a trader receives a sum from the sale of patent rights in the ordinary course of the trade the sum is a trade receipt. In that case, it is not a "capital sum" and section 913(1)(a) of this Act ensures that the special rules do not apply.

3246. If a trader receives a capital sum from the sale of patent rights, the sum is excluded from the calculation of the trade profits by the general rule that excludes capital receipts. Instead, the sum is separately charged to corporation tax under Chapter 3 of Part 9 of this Act. The profit on the sale is charged to tax over six years. But the seller may elect

to have the sum charged in the year in which the proceeds of sale are received. Or the charge may be spread in accordance with section 916 or 917 of this Act.

3247. In the case of a taxpayer liable to corporation tax, Part 8 of this Act sets out rules for the taxation of gains and losses on companies' intangible fixed assets. Those rules take priority over any other tax rules (see section 906(1)). So the Part 8 rules generally apply instead of the rule in this section. But Chapter 16 of Part 8 ensures that the Part 8 rules apply only to assets created or acquired on or after 1 April 2002.

3248. *Subsection (1)* sets out the conditions for the section to apply. In particular, there has to be:

- a charge (to income tax or corporation tax) on the proceeds from the sale of patent rights; and
- a change in the persons carrying on the trade during periods in which tax is chargeable.

3249. *Subsection (4)* determines the amount to be charged as income of each company in the period of change. That amount is in two parts:

- for the period up to the change, a time-apportioned part of the amount that would otherwise have been charged for the whole period; and
- for the period after the change, the company's share of the amount still to be charged after the change, apportioned to the period on a time basis.

3250. *Subsection (5)* sets out the general assumption that all the current partners step into the shoes of the persons who were partners at the time of the original sale. The amount charged in each accounting period is arrived at by spreading the remaining charge evenly over the rest of the period for which tax would otherwise have been charged.

3251. One of the consequences of the current partners stepping into the shoes of the original partners is that an amount originally charged to income tax may become charged to corporation tax, and vice versa. This consequence was not explicitly acknowledged in ITTOIA. So Part 2 of Schedule 1 to this Act amends sections 861 and 862 of ITTOIA to clarify how the rule works for income tax. See *Change 89* in Annex 1.

Section 1272: Sale of patent rights: effect of later cessation of trade

3252. This section sets out what happens when there has been a sale of patent rights to which the previous section applied and the last corporate partner leaves the firm. It is based on section 525 of ICTA. The corresponding rule for income tax is in section 862 of ITTOIA. See also paragraph 32463246 of this commentary about the effect of Part 8 of this Act and *Change 89* in Annex 1.

3253. *Subsection (2)* sets out how the "rolled-up" charge is split between the current partners on cessation of the trade. As in section 525(4) of ICTA, the charge is made on the persons who are partners immediately before the cessation. Otherwise, the charge would be allocated by reference to the profit-sharing arrangements in the whole of the final accounting period. Schedule 1 to this Act amends section 862 of ITTOIA to clarify how the rule works for income tax.

Section 1273: Limited liability partnerships

3254. This section contains the rules that treat limited liability partnerships ("LLPs") in the same way for tax purposes as ordinary partnerships ("firms" in this Act). It is based on section 118ZA of ICTA. The corresponding rule for income tax is in section 863 of ITTOIA.

3255. *Subsection (1)(a)* ascribes the *activities* of the LLP to its members. Subsection (1) does not refer to an LLP carrying on a profession. See *Change 2* in Annex 1.

Part 18: Unremittable income

Overview

3256. This Part provides relief from corporation tax if income arising in a territory outside the United Kingdom cannot be remitted to the United Kingdom. It also provides for withdrawal of relief if such income ceases to be unremittable. And it explains how unremittable income is to be valued if relief is not in fact claimed. The Part is based on section 584 of ICTA. The corresponding rules for income tax are in Chapter 4 of Part 8 of ITTOIA.

3257. This Part applies to "income arising in a territory outside the United Kingdom". In the source legislation for this Act, income arising outside the United Kingdom is charged to corporation tax mainly under Schedule D Case V (section 18 of ICTA). But some foreign income is charged under Schedule D Case VI (in circumstances that that Case is applied by a provision other than section 18 of ICTA), or under a non-schedular provision, if the provision covers income arising outside the United Kingdom.

3258. Profits made by the foreign branch of a United Kingdom trade are charged in Part 3. Such profits are not income arising in a territory outside the United Kingdom and this Part does not apply. (But Chapter 12 of Part 3 (deductions from profits: unremittable amounts) provides an equivalent relief in relation to a United Kingdom trade.)

3259. The paragraph headed "unremittable income that arose in an accounting period ending before 1 April 2009" in Part 21 of Schedule 2 to this Act (transitionals and savings), the equivalent for corporation tax purposes of paragraph 153(1) and (2) of Schedule 2 to ITTOIA, ensures that this Part applies for an accounting period ending on or after 1 April 2009 even though the income in question arose in an accounting period ending before that date.

Section 1274: Unremittable income: introduction

3260. This section defines unremittable income and sets out the circumstances in which this Part applies. It is based on section 584(1) of ICTA. The corresponding rule for income tax is in section 841 of ITTOIA.

3261. The source legislation refers to "foreign currency". This means a currency other than the currency of the territory in question. Since the *local* currency must be obtainable, it is superfluous to add that currency not obtainable is 'foreign'.

3262. Condition A for unremittable income refers to the impossibility of obtaining currency in the territory in question and makes explicit that this means currency that could be transferred to the United Kingdom (whether the currency of that or another territory). See *Change 90* in Annex 1.

3263. The requirement in the source legislation, that the inability to transfer the income to the United Kingdom is not due to any want of reasonable endeavours on the part of the claimant, is omitted. See again *Change 90* in Annex 1.

Section 1275: Claim for relief for unremittable income

3264. This section deals with claims for relief and sets out how the relief applies. It is based on section 584(1), (2),(5) and (6) of ICTA. The corresponding rule for income tax is in section 842 of ITTOIA.

3265. The effect of *subsection (1)* is that the unremittable income is omitted from the company's taxable income for the accounting period in which it arises.

3266. *Subsection (4)* defines an Export Credits Guarantee Department payment ("ECGD payment"). The statutory references in the source legislation have been updated. As section 13(1) of the Export and Investment Guarantees Act 1991 delegates the functions

of the Secretary of State under section 2 of that Act to the Export Credits Guarantee Department, the section refers to the role of that Department (rather than the Secretary of State) in administering this scheme.

Section 1276: Withdrawal of relief

3267. This section brings together the consequences both of unremittable income becoming remittable and of a payment being made by the Export Credits Guarantee Department. It is based on section 584(2A) and (5) of ICTA. The corresponding rule for income tax is in section 843 of ITTOIA.

3268. *Subsections (3)* and *(5)* set out when, and at what value, income ceasing to be unremittable is treated as arising. Income so treated as arising is charged under the provision appropriate to the income type (or types) that would have applied to the income when it arose but for the relief.

3269. *Subsection (4)* provides that, when an ECGD payment is made, income is treated as arising at that time to the extent of the payment. This reflects the intention of the legislation as originally drafted. Amendments made by FA 1996 obscured the point. See *Change 91* in Annex 1. Subsection (5) deals with the value of that income.

3270. *Subsection (6)* prevents a double charge under this section. For example, if relief has already been withdrawn because an ECGD payment has been received, there is no further charge – to the extent of that payment – if the income itself subsequently becomes remittable.

Section 1277: Income charged on withdrawal of relief after source ceases

3271. This section sets out how relief given under this Part is withdrawn when income ceases to be unremittable after the source of the income has ceased. It is based on section 584(4) of ICTA. The corresponding rule for income tax is in section 844 of ITTOIA.

3272. If relief cannot be withdrawn in accordance with section 1276, because the trade or property business in question has permanently ceased, the amount in respect of which relief is withdrawn is dealt with as a post-cessation receipt under Chapter 15 of Part 3 (trading income) or Chapter 9 of Part 4 (property income) of this Act. In both cases, the provision in the relevant Chapter limiting its application is disapplied as unnecessary.

3273. For any other case where relief is withdrawn after the source has ceased, *subsection (4)* provides that the income should be taxed as if the source had not ceased. See *Change 19* in Annex 1.

3274. Income charged by virtue of this section is, in the source legislation, charged under Schedule D Case VI (rather than Schedule D Case V or another charge). The potential relevance of such income to relief under section 396 of ICTA (losses from miscellaneous transactions) is preserved by consequential amendments in Schedule 1 to this Act, which amend that section and insert section 834A of ICTA. See the commentary on Schedule 1 for the insertion of section 834A of ICTA.

Section 1278: Valuing unremittable income

3275. This section sets out how unremittable income is valued if relief under this Part is not claimed. It is based on section 584(8) of ICTA. The corresponding rule for income tax is in section 845 of ITTOIA.

3276. The section applies if no claim is made under section 1275 for relief under this Part. In such a case, the charge to tax is not deferred. So the income is charged to corporation tax in the accounting period to which it refers. This section determines the sterling value of the amount to be charged.

Part 19: General exemptions

Overview

3277. This Part groups all of the sections which provide exemption for income otherwise charged to corporation tax by this Act. The exemptions, where relevant, apply to both United Kingdom and foreign income unless one of these kinds of income is expressly excluded in the section.

Section 1279: Exemption of profits from securities free of tax to residents abroad ("FOTRA securities")

3278. This section exempts FOTRA securities specified in section 1280(1) from corporation tax and sets out the two conditions that must be met if that exemption is to apply. It is based on section 154 of FA 1996. The corresponding rule for income tax is in section 714 of ITTOIA.

Section 1280: Section 1279: supplementary provision

3279. This section sets out the three different classes of United Kingdom Government securities exempt in the hands of non-UK residents (FOTRA securities) and defines the term "the exemption condition" and "gilt-edged security" used in this section. It is based on section 154(8) of FA 1996 and section 161 of FA 1998. The corresponding rule for income tax is in section 713 of ITTOIA.

Section 1281: Income from savings certificates

3280. This section provides an exemption for income from savings certificates where the holding is within specified limits. It is based on section 46(1), (3), (4) and (6) of ICTA. The corresponding rule for income tax is in section 692 of ITTOIA.

3281. The source legislation refers to the limits in terms of purchase by, or on behalf of, a person. *Subsection (2)* rewrites this as "acquisition" to avoid confusion for situations such as joint ownership where special regulations apply. It also refers to the regulations as limiting a person's holding in line with the way the regulations are written.

3282. Subsection (2) introduces the words "so far as". This allows exemption to be conferred in part in respect of multiple savings certificates. See *Change 92* in Annex 1.

Section 1282: Income from Ulster Savings Certificates

3283. This section provides an exemption for income from Ulster Savings Certificates for holdings within specified limits. It is based on section 46 of ICTA, which also deals with savings certificates generally (see section 1281). The corresponding rule for income tax is in section 693 of ITTOIA.

3284. Although Ulster Savings Certificates have not been issued since March 1997, there are still holdings which have not been redeemed. Consequently it is necessary to rewrite this provision to ensure that interest continuing to be paid in respect of these holdings is exempt from corporation tax.

3285. *Subsection (4)* introduces the words "so far as". This allows exemption to be conferred in part in respect of multiple savings certificates. See *Change 92* in Annex 1.

3286. Subsection (4) uses "acquisition" rather than purchase and refers to a person's holding in line with the way the regulations are written.

3287. *Subsection (5)* does not specify that the claim for exemption is to be made to the Board. Where a notice to deliver a corporation tax return has been issued, paragraphs 57 and 58 of Schedule 18 to FA 1998 require the claim to be made in the return or by amendment of the return if possible. See *Change 1* in Annex 1.

Section 1283: Interest from tax reserve certificates

3288. This section exempts interest on tax reserve certificates from corporation tax. It is based on section 46(2) of ICTA.

Section 1284: Housing grants

3289. This section exempts from corporation tax grants paid under legislation intended to assist in providing, maintaining or improving housing. It is based on section 578 of ICTA. The corresponding rule for income tax is in section 769 of ITTOIA.

3290. *Subsection (1)* reflects the effect of the devolution settlements. See *Change 15* in Annex 1.

Section 1285: UK company distributions

3291. This section sets out the exemption from the charge to corporation tax on dividends and other distributions made by a UK resident company. It is based on section 208 of ICTA.

3292. The judgement in the case of Strand Options and Futures Ltd v Vojak, 76 TC 220 CA[8], provides judicial interpretation of section 208 of ICTA. The Court of Appeal held that the exemption referred specifically to leaving dividends and other distributions out of account in computing *income*, which does not mean that the amount of a distribution should be left out of account in computing a chargeable gain.

3293. *Subsection (2)* encapsulates the court's interpretation of the legislation in respect of distributions and their inclusion in a chargeable gains computation.

3294. Section 337A(1)(a) of ICTA, rewritten as section 1305, denies a deduction in computing profits for corporation tax purposes in respect of dividends and other distributions. The wording of section 208 of ICTA makes no distinction between receipts and deductions in computing income, and it therefore potentially overlaps with section 337A(1)(a) of ICTA. The words "as receipts" have therefore been added to this section to clarify its role.

3295. The section also provides signposts to certain exceptions to the general rule.

Section 1286: VAT repayment supplements

3296. This section exempts VAT repayment supplement from corporation tax. It is based on section 827 of ICTA. The corresponding rule for income tax is in section 777 of ITTOIA.

Section 1287: Incentives to use electronic communications

3297. This section exempts from corporation tax incentives provided under regulations for the use of electronic communications. It is based on section 143 of FA 2000. The corresponding rule for income tax is in section 778 of ITTOIA.

Part 20: General calculation rules

Overview

3298. This Part contains a number of generally applicable rules. They apply to all income charged to corporation tax.

3299. The rules are included here to save repetition at numerous points in the Act. Some of the rules apply mainly to trading and property income within Parts 3 and 4 of this Act. The approach for income tax in ITTOIA is to put one version of the rule in the trading income Part, with another version of the rule in the general provisions Part. But for

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corporation tax the rules apply also to expenses of management (see Part 16 of this Act) and expenses of insurance companies (see section 76 of ICTA).

Chapter 1: Restriction of deductions

Section 1288: Unpaid remuneration

3300. This section defers a deduction for employees' (or an office-holder's) remuneration in a period of account if that remuneration remains unpaid nine months after the period has ended. It is based on section 43 of FA 1989. The corresponding rule for income tax is in section 36 of ITTOIA.

3301. Section 43 of FA 1989 was introduced when the assessment of employment income was put on a receipts basis. A deduction for employees' pay may be linked to the time when the pay is received by the employees.

3302. This section uses "income from any source" rather than "profits or gains", to define the scope of the rule. See the commentary on the omission of "gains" in the overview of Part 3 of this Act. There is a separate rule for expenses of management in section 1249.

3303. Schedule 2 to this Act preserves the commencement rule for the amendment of the source legislation by Schedule 24 to FA 2003.

Section 1289: Unpaid remuneration: supplementary

3304. This section provides definitions and further explanation of the main rule in section 1288. It is based on section 43 of FA 1989. The corresponding rule for income tax is in section 37 of ITTOIA.

3305. *Subsection (1)* applies section 1288 to provisions made in the accounts for amounts that may become employees' remuneration.

3306. *Subsection (3)* deals with the case in which the company submits its tax return before the end of the nine month limit in section 1288(2) and all or any of the remuneration is unpaid. The company must assume the remuneration will remain unpaid. If, subsequently, the remuneration is paid within the time limit the calculation can be adjusted and the return amended. See *Change 68* in Annex 1.

Employee benefit contributions

Overview

3307. The next eight sections deal with the deduction allowed in respect of an employer's contribution to an employee benefit scheme. They are based on Schedule 24 to FA 2003. The corresponding rules for income tax are in sections 38 to 44 of ITTOIA.

3308. The sections give a comprehensive set of rules for determining when deductions can be made for payments made by an employer to a third party to hold or use to provide benefits for the employer's employees.

Section 1290: Employee benefit contributions

3309. This section sets out the conditions under which a deduction may be allowed. It is based on paragraphs 1 and 8 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 38 of ITTOIA.

3310. The legislation rewritten in this section does not apply to deductions that would otherwise be allowed for periods ending before 27 November 2002, or in respect of employee benefit contributions made before that date. This limitation is preserved in Schedule 2 (transitionals and savings).

Section 1291: Making of "employee benefit contributions"

3311. This section defines the transactional characteristics which must be present if a payment is to qualify for relief as an "employee benefit contribution". It is based on paragraphs 1 and 9 of Schedule 24 to FA 2003. The corresponding rule for income tax is in section 39 of ITTOIA.

Section 1292: Provision of qualifying benefits

3312. This section sets out what is meant by the provision of qualifying benefits. It is based on paragraph 2 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 40 of ITTOIA.

Section 1293: Timing and amount of certain qualifying benefits

3313. This section sets out:

- when benefits in the form of money are treated as provided; and
- how to calculate the value of benefits provided by the transfer of an asset.

3314. It is based on paragraphs 2 and 5 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 41 of ITTOIA.

Section 1294: Provision or payment out of employee benefit contributions

3315. This section sets out the rules for allocating the provision of qualifying benefits, or payment of qualifying expenses, by the third party against the employee benefit contributions received. It is based on paragraph 4 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 42 of ITTOIA.

Section 1295: Profits calculated before end of 9 month period

3316. This section applies if the company makes its corporation tax return before the end of the nine month period. It is based on paragraph 6 of Schedule 24 to FA 2003. The corresponding rule for income tax is in section 43 of ITTOIA.

Section 1296: Interpretation of sections 1290 to 1296

3317. This section interprets and defines terms. It is based on paragraphs 3 and 9 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 44 of ITTOIA.

Section 1297: Life assurance business

3318. This section modifies the operation of section 1290 where the company in question is charged on the I minus E basis in respect of life assurance business and claims a deduction for expenses under section 76 of ICTA. It is based on paragraph 7 of Schedule 24 to FA 2003.

Section 1298: Business entertainment and gifts

3319. This section and the following two sections deal with expenditure on business entertainment or gifts. It is based on section 577 of ICTA. The corresponding rule for income tax is in sections 45 and 867 of ITTOIA.

3320. Section 577 of ICTA denies a deduction for certain expenses "in computing profits chargeable to corporation tax under Schedule D". Profits chargeable to corporation tax under Schedule D include profits of a business which is neither a trade nor a property business. And section 577(7)(b) of ICTA indicates that references to a trade, for the purposes of the section, include references to a business.

3321. The exceptions to the general rules are not limited to trades. See *Change 93* in Annex 1.

Section 1299: Business entertainment: exceptions

3322. This section provides exceptions to the prohibition in section 1298 relating to business entertainment in certain circumstances. It is based on section 577 of ICTA. The corresponding rules for income tax are in section 46 of ITTOIA.

Section 1300: Business gifts: exceptions

3323. This section provides exceptions to the prohibition in section 1298 relating to business gifts in certain circumstances. It is based on section 577 of ICTA. The corresponding rules for income tax are in section 47 of ITTOIA.

3324. *Subsection (3)* allows the Treasury to increase the monetary limit in paragraph (b). See *Change 94* in Annex 1.

3325. *Subsection* (5) makes an exception for gifts to charities and named bodies. Section 577(9) of ICTA limits this exception to the computation of profits under Schedule D Cases I and II, that is, to income calculated under rules rewritten in Part 3 of this Act. It was not intended that the exception should be applied narrowly to the disadvantage of a business other than a trade or property business. This section extends the exception to such businesses. See *Change 93* in Annex 1.

Section 1301: Restriction of deductions for annual payments

3326. This section prevents annual payments for which the consideration is either a dividend or not taxable from being deducted in calculating a company's income from any source. It is based on section 125 of ICTA. The corresponding income tax rule is in sections 843 and 904 of ITA.

3327. *Subsections (4)* to *(6)* together set out the conditions that must be met by an annual payment in order for the rule in *subsection (1)* to apply to the payment.

3328. The source legislation specifies that the payment must not be interest (section 125(2)(a) of ICTA). Annual payments within *subsection (2)* do not include interest, so this does not need to be stated explicitly. In addition, no specific reference is made to annuities (also mentioned in the source legislation) as these are simply one type of annual payment.

3329. This section does not rewrite the exclusion in section 125(3)(a) of ICTA for payments which in the hands of the recipient are income falling within section 627(2)(a) of ITTOIA. Such payments cannot be relevant for corporation tax purposes since such payments can only be made by an individual. Nor does this section rewrite the commencement provision in section 125(5) of ICTA, which is spent.

Section 1302: Social security contributions

3330. This section prevents a deduction for most social security contributions for any corporation tax purpose. It is based on section 617 of ICTA. The corresponding rule for income tax is in section 868 of ITTOIA.

Section 1303: Penalties, interest and VAT surcharges

3331. This section contains the general rule that tax penalties and interest are not to be deducted. It is based on section 827 of ICTA. The corresponding rule for income tax is in section 869 of ITTOIA.

3332. This section refers to "profits" because the rule covers both the calculation of income and deductions (such as expenses of management within Part 16) from total profits.

3333. Section 90(1)(b) of TMA prohibits a deduction for interest payable "under this Part" of TMA. Section 90(2) cancels the prohibition for interest under sections 87 and 87A of TMA. This is because interest under those sections may be taken into account as a loan relationship debit (see Parts 5 and 6 of this Act). But the prohibition does apply to interest under section 86 of TMA, which applies for corporation tax purposes only for accounting periods ending before 1 October 1993. So that rule is "saved" by Schedule 2 to this Act and not rewritten in this section.

3334. The table in *subsection (2)* sets out the specific statutory references because a general description of the penalties etc would not be precise enough. But the second column of the table is a description of the tax to indicate what is involved.

Section 1304: Crime-related payments

3335. This section prohibits any deduction for expenses incurred in making a payment:

- the making of which is a criminal offence, or which would be a criminal offence if the payment were made in the United Kingdom; or
- which is made in response to a demand, the making of which is a criminal offence.

3336. The section is based on section 577A of ICTA. The corresponding rule for income tax is in section 870 of ITTOIA.

3337. The source legislation denies a deduction for certain crime-related payments "in computing profits chargeable to corporation tax under Schedule D". Profits chargeable to tax under Schedule D include profits of a business which is neither a trade nor a property business.

3338. The section applies to income charged to corporation tax. Some kinds of income are not charged under Schedule D in the source legislation. But the prohibition of a deduction is not thought to have any practical effect on income that is not charged under Schedule D. So the scope of the prohibition is unchanged.

3339. The section overrides any provision which otherwise allows a deduction to be made in calculating the profits of a trade. See section 51(1)(b) of this Act.

Section 1305: Dividends and other distributions

3340. This section sets out the prohibition on deducting dividends or other distributions made by a company in computing that company's profits chargeable to corporation tax. It is based on section 337A(1)(a) of ICTA.

Chapter 2: Other general rules

Section 1306: Losses calculated on same basis as miscellaneous income

3341. This section is based on numerous provisions, including section 827 of ICTA. The corresponding rule for income tax is in section 872 of ITTOIA.

3342. The application of the section is limited to "miscellaneous income", defined in *subsection (3)* by reference to section 834A of ICTA (inserted by Schedule 1 to this Act). The source legislation does not generally limit the scope of the rule. For example, section 827(1) of ICTA says "the payment shall not be allowed as a deduction in computing any income, profits or losses for any corporation tax purposes". But in practice this section affects only the calculation for corporation tax purposes of amounts, other than profits within Part 3 or 4 of this Act, chargeable under a provision listed in the table in section 834A of ICTA.

3343. *Subsection (2)* ensures that this rule does not overturn any rules about the calculation of losses. For example, see section 398 of ICTA (which deals with the calculation of losses for the purposes of a claim under section 396 of ICTA).

3344. See the related commentary on section 47 of this Act.

Section 1307: Apportionment etc of miscellaneous profits and losses to accounting period

3345. This section provides for apportionment of profits and losses when a company's period of account does not coincide with an accounting period. It is based on section 72 of ICTA. The corresponding rule for income tax is in sections 203 and 871 of ITTOIA.

3346. Section 72 of ICTA applies "in the case of any profits or gains chargeable… under Case I, II or VI of Schedule D". Apportionment is therefore not limited to the case of profits or losses of a trade. See the related commentary for section 52.

3347. The section applies where income is chargeable under a provision to which section 834A of ICTA applies. That section is inserted by Schedule 1 to this Act. Section 834A of ICTA does not apply to income to which Chapter 8 of Part 10 (income not otherwise charged) applies which arises from a source outside the United Kingdom (see subsection (3) of that section). *Subsection (2)* of this section qualifies the reference to that section so that the benefit of the apportionment rules extends to such income (that is, to income charged in the source legislation under Schedule D Case V). See *Change 95* in Annex 1.

3348. The only circumstance in which aggregation within *subsection (3)(b)* will occur is when a company is in liquidation and has fixed accounting periods of 12 months in accordance with section 12 of this Act.

3349. This section does not carry over the rewrite change in section 871(5) of ITTOIA whereby apportionment is permitted by a measure of time other than the number of days in the respective periods, as required by section 72(2) of ICTA. HMRC consider that a day cannot fall into more than one accounting period.

3350. See also the paragraph headed "miscellaneous profits and losses: apportionment to accounting periods ending before 1 April 2009" in Part 21 of Schedule 2 to this Act which provides for a period of account that straddles the end of the financial year 2008 and the beginning of the financial year 2009.

Section 1308: Expenditure brought into account in determining value of intangible asset

3351. This section provides that expenditure on research and development, if not of a capital nature, may be taken into account for the purposes of Part 13, even though for accounting purposes it has been brought into account in determining the value of an intangible asset. It is based on section 53 of FA 2004.

Section 1309: Payments treated as made to visiting performers

3352. This section provides that some payments made to a company are not to be included in the company's income. It is based on sections 556 and 558 of ICTA. The corresponding rule for income tax is in sections 13 and 14 of ITTOIA.

3353. Section 966 of ITA requires deduction of tax from certain payments to entertainers and sportsmen and women. The section also applies in some cases to payments made to a person other than the performer. In those cases section 13(5) of ITTOIA treats the payments as made instead to the performer.

Part 21: Other general provisions

Section 1310: Orders and regulations

3354. This section sets out how orders and regulations are to be made or may be annulled. It is based on section 828 of ICTA. The corresponding rule for income tax is in section 873 of ITTOIA.

Section 1311: Apportionment to different periods

3355. This section sets out how apportionments to different periods are to be made. It is based on section 834 of ICTA.

Section 1312: Abbreviated references to Acts

3356. This section provides details of abbreviations used in this Act. The corresponding list for income tax is in Part 1 of Schedule 4 to ITTOIA.

Section 1313: Activities in UK sector of continental shelf

3357. This section sets out how certain activities carried on in the UK sector of the continental shelf are treated for corporation tax purposes. It is based on section 830 of ICTA. The corresponding rule for income tax is in section 874 of ITTOIA.

Section 1314: Meaning of "caravan"

3358. This section defines "caravan". It is based on sections 15 and 70A of ICTA, section 29 of the Caravan Sites and Control of Development Act 1960, section 13 of the Caravan Sites Act 1968 and section 8 of the Mobile Homes Act 1975. The corresponding rule for income tax is in section 875 of ITTOIA.

3359. It effects a change in the law in two ways. First it provides a uniform definition of "caravan" for the whole of the United Kingdom. Second it applies that definition to all occurrences of "caravan" in this Act. See *Change 96* in Annex 1.

Section 1315: Claims and elections

3360. This section provides that references to a claim or election are to claims or elections in writing. It is based on paragraphs 57, 58 and 59 of Schedule 18 to FA 1998.

Section 1316: Meaning of "connected" persons and "control"

3361. This section defines "connected" persons and "control" by reference to definitions in ICTA.

Section 1317: Meaning of "farming" and related expressions

3362. This section defines "farming" and "market gardening" and clarifies the meaning of "forestry" and "woodlands". It is based on section 832 of ICTA and section 154 of FA 1995. The corresponding rules for income tax are in section 996 of ITA.

3363. Section 832(1) of ICTA defines "farm land" and "market garden land". It then goes on to say that "farming" and "market gardening" "shall be construed accordingly". The reasons for this approach are largely historic and date from the time when the charge on farming and market gardening was under Schedule B. "Farm land" and "market garden land" are no longer terms used in the rules concerned with farming and market gardening; they remain only in the definition in section 832(1) of ICTA.

3364. The definitions in this section take a different approach. They define "farming" and "market gardening" by reference to the nature of the activity, not the land on which the activity is carried out. Farming excludes market gardening.

3365. Farming is an activity which is given differing taxation treatment depending on whether or not the land is situated in the United Kingdom. Section 832(1) of ICTA provides that the definitions of "farm land" and "market garden land" are confined to land occupied in the United Kingdom.

3366. There is no territorial restriction in the definitions in this Act. Instead the territorial restriction is included in the rewrite of section 53(1) and (2) of ICTA as section 36 of this Act and not in the definitions.

3367. *Subsection (1)* provides the definition of "farming". It requires the land to be occupied wholly or mainly for the purposes of husbandry. This reflects a long-standing distinction in tax law between profits resulting from the taxpayer's occupation of the land and profits from an activity in which occupation of the land is merely incidental.

3368. In the first case the trader exploits or uses the land, for example, by growing crops or grazing animals. In the second case the trader occupies the land only because a physical location, such as a shop or factory, is needed from which to carry on the trade. Factory farming, that is the intensive rearing of fish or livestock, is not farming for tax purposes. This is because the animals do not live or draw their sustenance from the land.

3369. Husbandry is a fairly old-fashioned term but one that is the subject of a considerable body of case law. The status of any marginal case must be determined in the light of that case law subject to the clarification given in *subsection (2)*.

3370. The definition of "farm land" in section 832 of ICTA excludes "any dwelling or domestic offices". This section does not repeat this exclusion of farmhouses.

3371. As originally enacted, the definition of farm land in section 832(1) of ICTA specifically included the farmhouse and farm buildings as part of the farm land. The House of Lords in IRC v Korner and Others (1969), 45 TC 287 HL, held that the effect of this provision was that a farmhouse was an asset of the trade for which a 100% deduction could be obtained. This applies even if the farmhouse is used as a private residence. An amendment was introduced in FA 1969 to reverse the effect of that decision. This is why the definition of "farm land" in section 832(1) of ICTA excludes "any dwelling or domestic offices".

3372. In practice a farming company is allowed to make deductions in respect of expenditure of a revenue nature on office buildings used purely for business purposes. Such expenditure has always been treated as being incurred wholly and exclusively for the purposes of the trade and not prohibited from being deducted under section 74(1)(a) of ICTA.

3373. Section 74(1)(c) of ICTA deals with the deduction of rent where only part of a dwelling house or domestic offices are used for trade purposes. Again, in practice, a company whose trade is farming is permitted to make deductions in respect of such houses and offices.

3374. In the case of any other expenses of a residential property which is subject to dual private and business use a company is permitted to apportion these and the proportion attributable to trade use is allowed as a deduction. Again this treatment applies to farming companies. See section 54 of this Act (expenses not wholly and exclusively for trade and unconnected losses).

3375. A company which wishes to claim a deduction for the proportion of expenses of a farmhouse attributable to trade rather than private purposes can do so through section 54. Omitting the exclusion of farmhouses and domestic offices from the definition of farming gives statutory effect to what occurs in practice.

3376. *Subsection (2)* identifies two specific types of activity as "husbandry" and therefore farming.

3377. Paragraph (a) is based on the definition of market garden land in section 832(1) of ICTA. Hop growing is generally recognised to be farming but is often spoken of as taking place in a garden. This could bring it within the definition of "market garden land" in section 832(1) of ICTA but for the fact that hop growing is excluded from that definition. Subsection (2)(a) makes clear that hop growing is farming.

3378. Paragraph (b) is based on the ordinary meaning of the word farming. Stud farming has generally been assumed to be farming for income tax purposes. The reference to "the breeding and rearing of horses and the grazing of horses in connection with those activities" makes clear what that activity encompasses for the purposes of this Act.

3379. *Subsection (5)* defines "market gardening". It makes it clear that the produce sold must have been grown on the relevant land rather than being bought in for resale.

Section 1318: Meaning of grossing up

3380. This section explains what is meant by "grossing up" for the purposes of this Act and provides a formula for calculating the gross amount to be taxed. It is new. The corresponding rule for income tax is in section 998 of ITA.

Section 1319: Other definitions

3381. This section defines various terms.

Section 1320: Interpretation: Scotland

3382. This section deals with the application to Scotland of certain terms used in the Act. It is based on section 24 of ICTA. The corresponding rule for income tax is in section 879 of ITTOIA.

3383. *Subsection (2)* is based on *Change 15* in Annex 1 and gives certainty to the meaning of "enactment".

Section 1321: Interpretation: Northern Ireland

3384. This section deals with the application to Northern Ireland of certain terms used in the Act. It is new. The corresponding rule for income tax is in section 880 of ITTOIA.

3385. It clarifies the meaning of "enactment". See *Change 15* in Annex 1.

Section 1322: Minor and consequential amendments

3386. This section introduces Schedule 1. It is new.

Section 1323: Power to make consequential provision

3387. This section provides a power for the Treasury to make by order consequential amendments additional to those contained in Schedule 1. It is new.

3388. The power is in substance the same as that in section 1028 of ITA. As with that power, it will not be exercised without the agreement of the Tax Law Rewrite Project's Consultative and Steering Committees to the proposed modifications.

3389. *Subsection (2)* provides that the power may not be used after 31 March 2012. It is sensible to enable additional consequential amendments to be made in this way only over a limited period, and it would in any case become progressively more difficult to do so accurately as subsequent Finance Bills are enacted. The date of 31 March 2012 takes account of this while giving a reasonable amount of time for missed consequential amendments to come to light.

3390. *Subsection (4)* provides that the power may contain provision having retrospective effect. Whether that would be appropriate would need to be considered on a case-by-

case basis. As the power can be used only to make provision in consequence of this Act, any retrospective effect is limited to provision having effect from the date the Act comes into force.

Section 1324: Power to undo changes

3391. This section provides a power for the Treasury to undo changes in the law made by the Act for the purpose of restoring the effect of the law to what it was immediately before 1 April 2009. It is new. A corresponding provision is in section 1029 of ITA.

3392. The power will not be exercised without the agreement of the Tax Law Rewrite Project's Consultative and Steering Committees to the proposed modifications. It will make it possible for any errors made in rewriting the source legislation, or in making consequential amendments, to be corrected without recourse to a Finance Bill.

3393. *Subsection (2)* provides that the power may not be exercised after 31 March 2010. As with section 1029 of ITA, it is considered sensible to time-limit the power in this way, especially as successive Finance Acts may make it progressively more difficult to make such amendments. The time limit will provide a reasonable period for missed consequential amendments to come to light.

3394. *Subsection (4)* provides that the power may contain provision having retrospective effect. Whether that would be appropriate would need to be considered on a case-by-case basis.

Section 1325: Transitional provisions and savings

3395. This section introduces Schedule 2 and provides for the Treasury to make transitional or savings provisions additional to those contained within the Schedule. It is new. A corresponding provision is in section 1030 of ITA.

3396. The power will not be exercised without the agreement of the Tax Law Rewrite Project's Consultative and Steering Committees.

3397. *Subsection (3)* provides that the power may contain provision having retrospective effect.

Section 1326: Repeals and revocations

3398. This section introduces Schedule 3.

Section 1327: Index of defined expressions

3399. This section introduces Schedule 4.

Section 1328: Extent

3400. This section provides for the Act to form part of the law of each part of the United Kingdom.

Section 1329: Commencement

3401. This section provides for the commencement of the Act.

3402. This Act deals for the most part only with corporation tax. However, it does amend legislation relating to income tax and capital gains tax, mostly consequentially. Separate provision is made about commencement in relation to those amendments.

Section 1330: Short title

3403. This section specifies the short title for the Act.

Schedule 1: Minor and consequential amendments

Part 1: Income and Corporation Taxes Act 1988

The charge to corporation tax

3404. See the commentary on Chapter 1 of Part 2 for an explanation of the charges to corporation tax in this Act. That Chapter deals with the charge to corporation tax on profits.

3405. The charge under section 2 is on amounts of income and on chargeable gains that together form the "profits pot". The label "the charge to corporation tax on income" is explained in section 2(2). There are examples of consequential amendments expressed in these terms in the amendments to section 761(1) and section 776(3A) of ICTA.

3406. There are also consequential amendments to charges to an amount of corporation tax. These charges do not fall within the "profits pot" and are provisions of an administrative nature mainly recovering excessive relief. Two examples are the amendment to section 399(3) of ICTA and the amendment to paragraph 27(4) of Schedule 16 to FA 2002.

3407. References to Schedule D Case VI are removed in these consequential amendments: see the commentary on the amendment inserting section 834A of ICTA.

Section 15 of ICTA

3408. Section 15(1A) of ICTA is not rewritten because it is no longer necessary. It is part of a framework in which income tax and corporation tax are, broadly, governed by the same provisions. In that context its purpose is to keep the property income of a non-UK resident company chargeable to income tax separate from that company's property income chargeable to corporation tax. But the provisions governing income tax have been separated from those governing corporation tax in the rewrite. Specifically, Part 3 of ITTOIA deals with property income charged to income tax and Part 4 of this Act deals with property income charged to corporation tax. Section 3(1)(b) prevents the provisions in ITTOIA from applying to income of a non-resident within the charge to corporation tax. Together, this is all that is required to achieve the result of dividing a non-UK resident company's property income between separate income tax and corporation tax property businesses.

Section 42 of ICTA

3409. Sections 240 to 242 of this Act rewrite the application of section 42 of ICTA for cases within section 42(1)(a) of ICTA (determination of amounts which may be chargeable to corporation tax). So section 42(1)(a) of ICTA is repealed.

3410. Section 42 of ICTA continues to apply for cases within section 42(1)(b) of ICTA (determination of amounts which may be chargeable to income tax).

Section 74 of ICTA

3411. Section 74(1) of ICTA lists various items in respect of which no deduction is allowed in computing profits charged to corporation tax under Schedule D Case I.

3412. Section 74(1)(f) provides that in computing the amount of the profits to be charged to corporation tax under Case I, no sum shall be deducted in respect of:

> ((f) any capital withdrawn from, or any sum employed or intended to be employed as capital in, the trade …, but so that this paragraph shall not be treated as disallowing the deduction of any interest

3413. The proposition in the second half of section 74(1)(f) of ICTA that the prohibition of any deduction in respect of capital should not be construed as disallowing the deduction of interest has been overtaken by the loan relationships legislation in Chapter 2 of Part 4 of FA 1996.

3414. The tax treatment of returns from corporate debt now follows accountancy treatment in taxing a profit or allowing a loss at the time the return is credited or debited in the company's accounts. And section 100 of FA 1996 extends the corporate debt regime to include interest arising other than in respect of the lending of money, for example interest on trade debts.

3415. So the second half of section 74(1)(f) is redundant and this Act repeals it.

3416. Section 74(1)(h) of ICTA prohibits deductions for interest forgone on capital used in the trade or in improving the trade premises. It is unlikely that any accounts drawn up in accordance with generally accepted accounting practice would include a deduction for notional interest. So section 74(1)(h) of ICTA is redundant and this Act repeals it.

3417. Section 74(1)(k) of ICTA prohibits deductions for "any average loss beyond the actual amount of loss after adjustment".

3418. Generally accepted accountancy practice in such cases is to make a provision in the year of loss and review that provision in subsequent years. Without section 74(1)(k), the tax treatment of the average loss follows generally accepted accountancy practice. See *Change 97* in Annex 1.

3419. Section 74(1)(m) of ICTA prevents a deduction for any annuity and other annual payment "payable out of the profits". Because the rule applies only to amounts payable "out of the profits", it has no application to the calculation of those profits. So section 74(1)(m) of ICTA is redundant and this Act repeals it.

Sections 76ZA to 76ZO of ICTA

3420. A number of rules about calculating profits apply:

- in calculating the profits of a trade (or property business);
- to the calculation of expenses of management for the purpose of section 75 of ICTA; and
- to the calculation of expenses of insurance companies under section 76 of ICTA.

3421. This Act rewrites the first set of rules in Part 3 or, in some cases, in Part 20.

3422. This Act rewrites the second set of rules in Part 16 or, in some cases, in Part 20.

3423. This Act does not rewrite section 76 of ICTA. Instead, it inserts sections 76ZA to 76ZO into ICTA, to provide a version of the rules adapted to insurance companies to which section 76 of ICTA applies. The new sections follow the corresponding rules in this Act. So the new sections repeat the changes to the law made by this Act. See (in the order in which they appear in this Schedule) *Changes 14, 16, 82, 12, 17, 82, 15, 18, 68, 10 and 83* in Annex 1.

3424. In section 76ZN of ICTA subsection (3)(a)(ii) caters for the possibility that the release of a debt for car hire may be a "reversal" within section 76(7) of ICTA. In that case, this rule ensures that the reversal is restricted by the appropriate fraction.

Section 84A of ICTA

3425. Section 84A continues in force for income tax purposes.

Section 86 of ICTA

3426. Section 86 of ICTA allows a company to deduct the cost of an employee seconded to a charity or educational establishment in calculating the profits to be charged to corporation tax.

3427. Section 86(5) of ICTA lists educational establishments in Scotland for the purposes of relief under section 86 of ICTA. Section 86(5)(d) of ICTA refers to "a self-governing school within the meaning of the Self-Governing Schools etc (Scotland) Act 1989". Self-governing schools were abolished on 1 April 2003. So section 86(5)(d) of ICTA is redundant.

Section 89 of ICTA

3428. Section 89 of ICTA is not rewritten for corporation tax purposes. See the commentary on section 55 and *Change 8* in Annex 1.

Section 92 of ICTA

3429. Section 92 of ICTA applies to regional development grants under Part 2 of the Industrial Development Act 1982. The Industrial Development Act 1982 was repealed by the Statute Law (Repeals) Act 2004 with effect from 22 July 2004. No applications under Part 2 of the 1982 Act could be made after 31 March 1988 and there are no payments outstanding in respect of grants made before that date. So section 92 of ICTA is redundant.

Section 101 of ICTA

3430. The Act does not cater for a company carrying on a profession. So this section is repealed. See *Change 39* in Annex 1.

Section 116(4) of ICTA

3431. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 119(2) of ICTA

3432. Section 119(2) of ICTA is not rewritten because it is otiose. See *Change 53* in Annex 1.

Section 209(6A) of ICTA

3433. Section 209(6A) of ICTA provides that alternative finance return shall not be treated as a distribution for the purposes of the Corporation Tax Acts. It rewrites section 54(1) and (2) of FA 2006.

Section 337A(2)(b) of ICTA

3434. Section 337A(2)(b) of ICTA is not rewritten because it only duplicates other provisions with the same effect.

3435. Section 337A(2)(b) of ICTA provides that no deduction shall be made in computing income for the purposes of corporation tax in respect of losses from intangible fixed assets which come within Schedule 29 of FA 2002 except in accordance with the rules of that Schedule. However section 337A(2)(b) achieves nothing that is not already achieved by the provisions of Schedule 29. Section 337A(2)(b) is expressed to apply in respect of "losses from intangible assets within Schedule 29". Paragraph 1(2) of Schedule 29 states that the Schedule "also has effect for determining how a company's losses in respect of intangible fixed assets are brought into account for the purposes of corporation tax". And paragraph 1(3) of Schedule 29 states that, apart from specified exceptions, "… the amounts to be brought into account in accordance with this Schedule

[29] in respect of any matter are the only amounts to be brought into account for the purposes of corporation tax in respect of that matter".

Section 396 of ICTA

3436. These amendments make the adaptations necessary to this section and its heading as a result of the abolition of Schedule D and its Cases by this Act.

3437. The main reference in section 396(1) of ICTA to tax charged under Schedule D Case VI has been replaced by a reference to tax charged under or by virtue of "a relevant provision". This ties in with the substituted subsection (2) which, in common with the approach taken generally to replacing references to Schedule D Case VI, refers to the table of provisions in section 834A of ICTA for this purpose but with the exclusion of one provision in that table. The reference to section 761(1)(b)(ii) of ICTA derives from the replaced section 396(2) of ICTA.

3438. Section 834A of ICTA is inserted by this Schedule. It is the equivalent for corporation tax of the income tax provision in section 1016 of ITA. For further information, see the commentary in these notes on section 834A of ICTA.

3439. See also section 436A of ICTA which excludes a loss under that section from relief under section 396 of ICTA and prevents any relief under the latter section being set against profits under section 436A.

3440. The inserted section 396(2A) and (2B) of ICTA preserves relief for losses arising in an accounting period ending on or before 31 March 2009 against any income arising from a relevant provision in later accounting periods. Subsection (2B) reflects the commencement date for the insertion of a reference to Chapter 5 of Part 17 of ICTA in the superseded subsection (2).

Section 399 of ICTA

3441. Section 399(1B) of ICTA is not rewritten for corporation tax purposes. The loss relief provisions it restricts, in particular section 396 of ICTA (losses from miscellaneous transactions), cannot apply. The gains that match the losses in question are not chargeable to tax and so losses are not eligible for relief. This provision is the equivalent for corporation tax purposes of section 399(1) of ICTA. That provision was not rewritten but repealed by ITTOIA for the same reasons.

Section 431 of ICTA

3442. A new label "life assurance trade profits provisions" is inserted into section 431(2) of ICTA. It is used in various consequential amendments to the life assurance provisions of the Corporation Tax Acts. They include the use of the label, instead of "provisions applicable to Case I of Schedule D" (or some variant), in places such as section 434(1) of ICTA, section 83YC(10) of FA 1989 and section 210A(10A) of TCGA.

Sections 586 and 587 of ICTA

3443. These amendments repeal sections 586 and 587 of ICTA. See *Change 99* in Annex 1.

Section 695 of ICTA

3444. This amendment repeals section 695 of ICTA. Subsection (6) has not been rewritten. See *Change 100* in Annex 1.

Section 779 of ICTA

3445. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 781 of ICTA

3446. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 782 of ICTA

3447. Subsection (9) is concerned with successions. Section 337(1)(b) of ICTA and section 18 of ITTOIA are not concerned with successions. And section 337(1)(a) is not rewritten in this Act. So the closing words of subsection (9) are no longer needed and this Act omits them.

Section 785 of ICTA

3448. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 798A of ICTA

3449. Subsection (4)(a) of this section applies to all income chargeable to tax under Schedule D Case V. But the rule in subsection (3) applies only if there are deductions or expenses allowable in the calculation of the income. So the amendments by this Act identify such foreign income as comprising only:

- foreign trading income (the new subsection (4)(a));
- income from an overseas property business (the new subsection (4)(b)); and
- foreign miscellaneous income (the new subsection (4)(c)).

3450. The new subsection (5) preserves the distinction between post-cessation receipts charged to tax by section 103 of ICTA (to which section 798A does not apply) and those charged to tax by section 104 of ICTA (to which section 798A does apply).

Sections 807B to 807G of ICTA

3451. These amendments insert sections 807B to 807G into ICTA. These sections rewrite double taxation relief provisions in Schedule 9 (loan relationships) to FA 1996 and Schedules 26 (derivative contracts) and 29 (intangible fixed assets) to FA 2002. Those provisions were inserted in those Schedules by The Corporation Tax (Implementation of the Mergers Directive) Regulations (SI 2007/3186) and amended by The Corporation Tax (Implementation of the Mergers Directive) Regulations 2008 (SI 2008/1579).

3452. Because of the similarity of the provisions for each regime (loan relationships, derivative contracts and intangible fixed assets) each section deals with all three regimes.

Section 817 of ICTA

3453. This amendment repeals section 817 of ICTA. See *Change 101* in Annex 1.

Section 826(5A) of ICTA

3454. Section 749A of ITTOIA rewrites the exemption from income tax in section 826(5) of ICTA. Section 826(5A) of ICTA, which states that the exemption from tax does not extend to corporation tax, is repealed with this subsection.

Section 834(1) of ICTA

3455. The partial definition of income inserted into section 834(1) of ICTA provides that income includes anything to which the charge to corporation tax on income applies. It reflects the fact that, where something that is not income by nature is made subject to the charge on income, it is impliedly treated as income for corporation tax purposes.

3456. The terms of the partial definition assume you know what the charge on income applies to. Therefore, its relevance is confined to contexts other than defining the application of the charge. As with the other definitions in section 834(1), the partial definition does not apply if the context otherwise requires.

Section 834A of ICTA

3457. This amendment provides for the purposes of corporation tax the equivalent of section 1016 of ITA.

3458. This Act omits the Schedules and the cases of Schedule D under which most income has been charged. There are various places in the Corporation Tax Acts, notably section 396 of ICTA, where there is a need to refer generically to the charging scope of Schedule D Case VI.

3459. This amendment inserts section 834A of ICTA. The section provides a list that replicates the scope of Schedule D Case VI so far as relevant to those generic references in the Corporation Tax Acts to Case VI. As in the income tax equivalent, the list omits those purely administrative uses of Case VI to recover excess relief, over-repayments of tax and the like, to which the generic references of Case VI have no application.

3460. Section 834A(3) of ICTA excludes from the list certain foreign income charged under Chapter 8 of Part 10 of this Act (which deals with income not otherwise charged, whether the source is in or outside the United Kingdom), as such income is not within Schedule D Case VI.

Section 842 of ICTA

3461. This amendment includes the insertion of subsections (2D) and (2E) in section 842 of ICTA. It is based on paragraph 39 of Schedule 26 to FA 2002.

Section 843C of ICTA

3462. This amendment inserts a new section into ICTA. The explanation of "total profits" follows the use of the expression in section 9(3) of ICTA.

Paragraph 5 of Schedule 30 to ICTA

3463. This amendment repeals paragraph 5 of Schedule 30 to ICTA. See *Change 102* in Annex 1.

Part 2: Other enactments

TMA

Section 12AE of TMA

3464. This Act legislates the "Crown Option". So this section is not needed and is repealed. See *Change 55* in Annex 1.

Section 19(2) of TMA

3465. This subsection is obsolete because sections 34 to 36 of ICTA have not charged sums under Schedule D Case VI since 1 April 1998.

Section 31(3) of TMA

3466. This Act legislates the "Crown Option". So this section is not needed and is repealed. See *Change 55* in Annex 1.

Section 42(7) of TMA

3467. A number of trading income rules which require a claim in the source legislation are rewritten without that requirement. As a consequence the references in this section to claims under sections 84, 91B and 101(2) of ICTA and section 43(5) of FA 1989 are removed without replacement. See *Changes 28, 38, 39 and 68* in Annex 1.

Section 109A of TMA

3468. The residence rules in section 66 of FA 1988 and section 249 of FA 1994 apply for the purposes of the Taxes Acts as defined in section 118 of TMA. This Act rewrites those rules for the purposes of the Corporation Tax Acts (Chapter 3 of Part 2). Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, this new section is introduced into TMA to apply to that Act the rules given in Chapter 3 of Part 2.

IHTA

Section 91 of IHTA

3469. Section 91 of IHTA currently refers to Part 16 of ICTA for the meaning of "charges on residue". This term is not rewritten in this Act and therefore the meaning is inserted into section 91 of IHTA. See the commentary on section 947.

FA 1988

Paragraph 3(1) of Schedule 12 to FA 1988

3470. This Schedule deals with the change of status of building societies. The rule in this paragraph prevents the change of status from being a discontinuance of the building society's trade for the purposes of CAA.

3471. The main rules about what is a discontinuance for the purposes of CAA are in section 577 of CAA (and sections 558 and 559 deal with, respectively, partnership changes and successions). This Act is drafted on the basis of a company starting or ceasing to carry on a trade etc, rather than on the basis of a trade etc commencing or being discontinued. So section 337(1)(a) of ICTA is not specially rewritten and there is no longer any rule that *treats* any event as the equivalent of the setting up, commencement or discontinuance of a trade etc. It follows that paragraph 3(1) of Schedule 12 to FA 1988 is no longer needed and this Act repeals it.

TCGA

Section 59 of TCGA

3472. This section is amended to rewrite section 115(5) to (5C) of ICTA so far as it applies to chargeable gains of a company. The addition of the words "so far as providing for that relief" make clear that the rule (for both capital gains tax and corporation tax) goes no further than removing any exemption for chargeable gains in a double taxation arrangement. See *Change 87* in Annex 1.

Sections 116A and 116B of TCGA

3473. These amendments insert two new provisions rewriting section 91G(1) of, and (2) and paragraph 5 of Schedule 10 to, FA 1996 respectively. These two provisions within the loan relationships regime (Chapter 2 of Part 4 of FA 1996) are, in essence, capital gains provisions.

Sections 151E to 151G of TCGA

3474. These amendments insert new provisions which rewrite parts of both the loan relationships regime (Chapter 2 of Part 4 of FA 1996) and the rules on alternative finance arrangements in FA 2005 (rewritten as part of the loan relationships regime in Part 6 of the Act). These provisions are, in essence, capital gains provisions.

3475. Section 151E, which rewrites section 84A(8) of FA 1996, is to be repealed from an appointed day (see Part 8 (loan relationships) of Schedule 2).

Sections 156ZA and 156ZB of TCGA

3476. These amendments insert new provisions which rewrite those parts of the intangible assets regime in Schedule 29 to FA 2002 which are, in essence, capital gains provisions.

3477. This includes those parts of paragraph 132 of Schedule 29 to FA 2002 which have permanent effect. Paragraph 132(2) to (4) provides rules of transition dealing only with a temporary overlap of the capital gains and intangible fixed assets regimes (unless there is an extension under section 152(3) of TCGA of the time limit) and can never be relevant to disposals after 31 March 2003. So they are not rewritten.

Section 158 of TCGA

3478. This Act is drafted on the basis of a company starting or ceasing to carry on a trade etc, rather than on the basis of a trade etc commencing or being discontinued. So section 337(1)(a) of ICTA is not specially rewritten and there is no longer any rule that requires an event to be *regarded* as the equivalent of the setting up, commencement or discontinuance of a trade etc. It follows that the closing words of section 158(2) of TCGA are no longer needed and this Act omits them.

Section 286A of TCGA

3479. The residence rules in section 66 of FA 1988 and section 249 of FA 1994 apply for the purposes of the Taxes Acts as defined in section 118 of TMA. This Act rewrites those rules for the purposes of the Corporation Tax Acts (Chapter 3 of Part 2). Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, this new section is introduced into TCGA to apply to that Act the rules given in Chapter 3 of Part 2.

FA 1995

Section 126 of FA 1995

3480. This section no longer applies for corporation tax purposes, following the amendment of it by FA 2003 and the enactment of the scheme of corporation tax for non-UK resident companies. In subsection (7A)(b) the reference to section 114 of ICTA would need amendment but the whole of paragraph (b) is no longer needed and so is repealed by this Act.

Section 127 of FA 1995

3481. This amendment is a consequence of removing the term “profit share return” from the provisions covering alternative finance arrangements. Refer to the commentary on section 513. Sub-paragraph (ca) is amended to include what is currently profit share return under section 49A of FA 2005 and sub-paragraph (cb) can be omitted.

FA 1998

Paragraph 84 of Schedule 18 to FA 1998

3482. Paragraph 84 of Schedule 18 to FA 1998 makes administrative provision for HMRC to operate the "Crown Option" under which they may determine which Case of Schedule D applies if an item falls within more than one Case of that Schedule.

3483. This Act provides priority rules for all such possible overlaps (see, for example, section 982 (provisions which must be given priority over Part 10)). These reflect how the Crown Option is applied. So the administrative provisions in paragraph 84 of Schedule 18 to FA 1998 are redundant. See *Change 55* in Annex 1.

FA 1999

Section 63 of FA 1999

3484. Section 63 of FA 1999 provides transitional relief to mitigate the effect on football and other sports clubs of new accounting standards for the treatment of intangible assets.

3485. Section 63 of FA 1999 applies only to contracts entered into before the beginning of the first accounting period in which a club adopts the new accounting standards. The new accounting rules are effective for accounting periods ending on or after 23 December 1998. So section 63 applies only to contracts entered into before 24 December 1999.

3486. It is unlikely that any contract entered into before 24 December 1999 is still in force when this Act comes into effect. So section 63 of FA 1999 is considered to be redundant. See *Change 103* in Annex 1.

FA 2000

Section 46 of FA 2000

3487. The amendments to this section include those needed to replace the references to Schedule D Case I or VI, as a result of the omission by this Act of the Schedules and the cases of Schedule D. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

3488. A number of the references in subsection (2A) have been omitted as unnecessary. These are not within the provisions listed in section 834A of ICTA to which subsection (2) now refers. But they are not in fact relevant to the exemption in this section, which applies to income "applied solely for the purposes of the charitable company" (subsection (3)). The omitted references all provide for a recovery of tax or similar charge and therefore do not represent income of the charity that could be so applied.

CAA

Sections 108, 112, 115, 263 265, 559 and 577 of CAA

3489. This Act is drafted on the basis of a company starting or ceasing to carry on a trade etc, rather than on the basis of a trade etc commencing or being discontinued. The amendments to these sections reflect this change of approach. See *Change 104* in Annex 1.

FA 2002

Paragraph 141 of Schedule 29 to FA 2002

3490. Paragraph 141 of Schedule 29 to FA 2002 is not rewritten. Paragraph 141(2) provides that references in Schedule 29 to the Inland Revenue are, subject to stated exceptions, references to any officer of the Board. The exceptions mentioned in paragraph 141(1)

are in relation to the discretionary extension of the time limits for group relief under Part 6 of Schedule 29 and for reinvestment relief under Part 7 of Schedule 29 and in relation to clearance applications in respect of specified provisions in Part 11 of Schedule 29. In the case of these exceptions "Inland Revenue" means the Board. Matters to be dealt with by the Board are traditionally those requiring the exercise of judgement and discretion in particularly sensitive areas. The "Board" here is stated to mean the Commissioners for Inland Revenue reflecting directly the defined usage of terms in section 1(1) of TMA.

3491. Paragraph 141 of Schedule 29 to FA 2002 provides a way for Schedule 29 to make the necessary references to Revenue officers while preserving the distinction between functions that could be performed at an "ordinary" level in the department and those that could not. The terminology has however been overtaken by the creation of HMRC and the provisions of CRCA. If paragraph 141 were rewritten, it would be necessary to translate there the references to "Board", "Inland Revenue" and "Commissioners for Inland Revenue" into the post-CRCA equivalents while preserving the "special treatment" in respect of the provisions referred to in paragraph 141(1).

3492. However this is not necessary. A general interpretative provision is appropriate when the intangible fixed assets rules are set out in a separate Finance Act Schedule. But in this Act, these rules are part of the main body of the corporation tax rules. So the appropriate post-CRCA term is simply inserted into each provision.

3493. For intended references to "any officer of the Board" under the general rule in paragraph 141(2) of Schedule 29 to FA 2002, the post-CRCA term is "any officer of Revenue and Customs" (section 50(1) of CRCA).

3494. For intended references to the "Commissioners for Inland Revenue" under the specific rule in paragraph 141(1) and (3) of Schedule 29 to FA 2002, the post CRCA term is the "Commissioners for Her Majesty's Revenue and Customs" (sections 1(1) and 50(1) of CRCA). However, as explained in the notes relating to the sections involved, changes are proposed in respect of paragraph 35(2) of Schedule 29 to FA 2002 (rewritten as section 753(2)) and paragraph 39(1)(a) of Schedule 29 to FA 2002 (rewritten as section 756(1)) to reflect the fact that the power attributed there to the Commissioners for HMRC is, in practice, exercised by an officer of HMRC (see also *Change 1* in Annex 1).

3495. It is not necessary to rewrite the final sentence in paragraph 141(1) of Schedule 29 to FA 2002 which refers to the authority to delegate Board's functions. Under section 13 of CRCA practically all functions of the Commissioners are stated to be delegable to an officer of the Department. The established rewrite approach to denoting a function as proper to the Commissioners for HMRC is to leave section 13 of CRCA to spell out that it need not be carried out by the Commissioners personally.

Energy Act 2004

Sections 28 and 44 of the Energy Act 2004

3496. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

ITTOIA

Section 48 of ITTOIA

3497. Section 48 of ITTOIA restricts the amount which can be deducted in calculating the profits of a trade for income tax purposes in respect of the cost of the hire of a car or motor cycle with a retail price (when new) of more than £12,000 other than "a qualifying hire car or motor cycle".

3498. The amendments in this paragraph remedy two errors in section 48 of ITTOIA.

3499. Section 578A(4) of ICTA restricts a recovery charge if *any* deduction has been restricted under section 578A(3). Section 48(3) of ITTOIA deals only with a previous restriction under section 48(2). The amendment extends the restriction on the recovery charge to cases where the original restriction was made to any other deduction.

3500. Section 48(4) of ITTOIA refers to a "rebate or release" but neither paragraph of the subsection deals with a rebate. The amendment to paragraph (a) ensures that the subsection applies to rebates as well as to releases of debts.

3501. See *Change 83* in Annex 1.

Section 49 of ITTOIA

3502. Section 48 of ITTOIA restricts the amount which can be deducted in calculating the profits of a trade for income tax purposes in respect of the cost of the hire of a car or motor cycle with a retail price (when new) of more than £12,000 other than "a qualifying hire car or motor cycle".

3503. This amendment remedies a small omission in the definition in section 49 of ITTOIA of "qualifying hire car" for the purpose of section 48 of ITTOIA. See *Change 105* in Annex 1.

Sections 79, 79A and 80 of ITTOIA

3504. These amendments clarify the operation of ITTOIA in cases where there is a change in the persons carrying on a trade etc. See *Change 17* in Annex 1.

Sections 155 of ITTOIA

3505. This amendment allows as a deduction all levies and costs under FISMA. See *Change 22* in Annex 1.

Sections 175 to 184 of ITTOIA

3506. These amendments cater for the possibilities that trading stock is transferred to a person carrying on a profession or vocation or that work in progress is transferred to a person carrying on trade. See *Change 39* in Annex 1.

Section 303 of ITTOIA

3507. This amends Rule 1 in section 303 of ITTOIA so that the rule remains the same for income tax as it is for corporation tax. See *Change 50* in Annex 1.

Section 860 of ITTOIA

3508. This amendment makes clear that the section applies to property businesses. See *Change 88* in Annex 1.

Section 749A of ITTOIA

3509. Section 749A of ITTOIA rewrites section 826(5) of ICTA which was overlooked in the preparation of ITTOIA. It exempts from income tax interest on corporation tax repayments.

Sections 861 and 862 of ITTOIA

3510. These amendments make clear how the rules about spreading receipts from the sale of patent rights apply when there is a change in persons carrying on a trade. See *Change 89* in Annex 1.

FA 2005

Section 49(2) of FA 2005

3511. This amendment is a consequence of replacing the term "profit share return" with "alternative finance return". Refer to the commentary on section 513. Amendments for the same reason are also required for sections 49A, 51, 52, 56 and 57 of FA 2005.

FA 2006

Sections 46 and 47 of FA 2006

3512. The provisions about film production companies, film tax relief and supporting definitions in sections 31 to 36 of FA 2006 are rewritten. Those definitions are repealed along with the other provisions that are rewritten. But since those FA 2006 definitions also apply for the purposes of sections 46 and 47 of FA 2006 (withdrawal of existing reliefs), this amendment ensures that the rewritten definitions apply for the purposes of sections 46 and 47 of FA 2006.

Section 121 of FA 2006

3513. Section 114(1)(a) of ICTA does not apply to payments received by companies carrying on a trade etc in partnership. So subsection (4) of this section is repealed. See *Change 85* in Annex 1.

Paragraph 28 of Schedule 10 to FA 2006

3514. This paragraph determines a company's share in the profits or losses of a business. Sub-paragraph (2) refers to section 114(2) of ICTA. That reference is replaced by one to section 1262 of this Act.

3515. Sections 1263 and 1264 legislate a non-statutory practice (see *Change 86* in Annex 1). The rules in those sections would not have been taken into account for the purposes of Schedule 10 to FA 2006. So they are excluded by the amendment.

3516. The reference in sub-paragraph (2)(b) to a share in capital allowances and balancing charges has no effect because such allowances and charges are taken into account in calculating the profits or losses of the business. So paragraph (b) is not reproduced in the amendment.

ITA

Section 835A of ITA

3517. The residence rules in section 66 of FA 1988 and section 249 of FA 1994 apply for the purposes of the Taxes Acts as defined in section 118 of TMA. This Act rewrites those rules for the purposes of the Corporation Tax Acts (Chapter 3 of Part 2). Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, this new section is introduced into ITA to apply the rules given in Chapter 3 of Part 2 for the purposes of income tax.

Schedule 2: Transitionals and savings

Part 1: General provisions

3518. These paragraphs ensure continuity of the law, despite the fact that this Act repeals and rewrites provisions.

3519. Paragraph 2 makes clear that the proposition about the continuity of the law in paragraph 1 does not apply to changes in the law made by this Act.

3520. The paragraphs in this Part stand instead of section 17(2) of the Interpretation Act 1978 and provide a comprehensive set of transitional arrangements.

Part 2: Changes in the law

3521. This paragraph allows anyone affected by a minor change in the law made by this Act to elect that the change does not apply to events occurring before 1 April 2009 in an accounting period that straddles that date. This allows the Act to be applied as soon as possible without imposing charges retrospectively.

Part 3: Charge to corporation tax on income

Effect of repeal of section 9(1) of ICTA on relevance of case law

3522. The case law to which the saving is relevant is the case law relating to the construction of source legislation rewritten in the Act whose application for corporation tax purposes depended on section 9(1) of ICTA (which applies income tax principles for corporation tax purposes).

Part 5: Company residence: exceptions to section 14

3523. These paragraphs apply where a company incorporated in the United Kingdom carried on business before 15 March 1988, the commencement date for section 66 of FA 1988 (rewritten in Chapter 3 of Part 2). These paragraphs rewrite parts of paragraphs 1, 2 and 5 of Schedule 7 to FA 1988. Paragraphs 4 and 5 of that Schedule are spent.

3524. United Kingdom incorporated companies which received Treasury consent to migrate from the United Kingdom before the commencement date (paragraph 1) and those with an application in the pipeline before the commencement date (paragraph 2) retain their foreign residence (despite section 14) until they cease to carry on business or become resident in the United Kingdom under other rules. The provision for the Treasury to consent to company migrations (most recently section 765 of ICTA) was repealed with effect from the commencement date for section 66 of FA 1988.

Part 6: Trading income

Reserves of marketing authorities etc

3525. This paragraph makes clear that the status of schemes or arrangements approved by or made with the National Assembly for Wales before 26 May 2007 is preserved. See *Change 15* in Annex 1.

Part 7: Property income

Lease premiums: time limits for claims for repayment of tax

3526. This paragraph provides that the time limit for claims for repayment of tax under section 238 or 239 is six years after the events described in those sections. This preserves the period of six years mentioned in section 36(2)(b) of ICTA (charge on sale of land with right to reconveyance) until the Treasury make an order under this paragraph.

Part 8: Loan relationships

Exemption for interest on tax overpaid for accounting periods ending before 1 July 1999

3527. Section 34 of FA 1998 removed the exemption from corporation tax for interest under section 826(1) of ICTA (interest on tax overpaid) for payments made in accounting periods ending on or after 1 July 1999. Section 826(5A) of ICTA, which provides that

the exemption does not apply for corporation tax purposes, is not rewritten in this Act as the interest naturally falls to be charged as income by Part 5 of this Act.

5½% Treasury Stock 2008-2012 not redeemed before 6 April 2009

3528. Because this Treasury Stock may be redeemed within a maximum of three years the exemption from charge under Part 5 for amounts other than interest (section 96(2) of FA 1996) is rewritten in this Schedule. See the commentary in the overview of Chapter 12 of Part 5.

Part 10: Derivative contracts

Extended meaning of reference in section 591(6)(b)

3529. This paragraph extends the list of provisions relevant to condition E in section 591 (conditions A to E mentioned in section 589(5)). It is based on paragraph 4(2D) of Schedule 26 to FA 2002.

Disapplication of section 645

3530. This paragraph disapplies section 645 (creditor relationships: embedded derivatives which are options) to a derivative contract if paragraph 9(2) of Schedule 10 to FA 2004 has effect in relation to the asset representing the creditor relationship which hosts the derivative contract. It is based on paragraphs 12(11C) and 45D(2) and (4) of Schedule 26 to FA 2002.

3531. That provision of FA 2004 deems an asset representing a creditor relationship no longer to be such if the asset was in existence at a date not later than 31 December 2005. See the following paragraphs for the rules that apply if a derivative contract would be within section 645 if this paragraph did not apply.

Existing assets representing creditor relationships: options

3532. This paragraph, supplemented by the next two, disapplies section 574 (non-trading credits and debits to be brought into account under Part 5) in respect of a derivative contract and modifies the application of TCGA in respect of the "original creditor relationship" mentioned in section 645 (creditor relationships: embedded derivatives which are options), if that section would have applied to the derivative contract but for the disapplication in the preceding paragraph. This paragraph is based on paragraphs 12(11C) and (11D), 45A(2) and 45FA(1), (3), (4), (6) and (8) of Schedule 26 to FA 2002.

3533. *Sub-paragraph (2)* disapplies section 574 in respect of the "relevant credits and debits" arising on the option. Any gain or loss on the exercise or abandonment of the option is dealt with under the provisions of TCGA, as those provisions apply to the creditor relationship. "Relevant credits and debits" are defined in section 659.

3534. The first modification of TCGA in respect of the original creditor relationship, in *sub-paragraph (3)*, is the same as that made by section 645(8). The creditor relationship is not treated as a "qualifying corporate bond" although section 117(A1) of TCGA would otherwise treat it as such.

3535. The second modification, in *sub-paragraph (4)*, is to the amount or value of the consideration applicable to the asset representing the creditor relationship on a disposal of that asset. So much of any interest in respect of the creditor relationship as is brought into account under Part 5 (loan relationships) but, because of the terms of the disposal, is not paid or payable to the company to which it accrues, is deducted from the consideration. In effect, the charge under that Part is given priority over the charge to corporation tax on chargeable gains.

3536. The third modification, in *sub-paragraph (6)*, also affects the amount of that consideration. It adjusts that amount for any "relevant exchange gains" and "relevant exchange losses", as those terms are defined in the paragraph below. The consideration is first increased by any such losses and then reduced by any such gains. If that reduction would exceed the amount of the consideration, that amount becomes nil and, under *sub-paragraph (7)*, the excess is added to incidental costs of acquisition under section 38 of TCGA.

3537. The definition of "relevant exchange gains" and "relevant exchange losses" refers to such gains and losses in respect of the asset representing the creditor relationship as are brought into account under Part 5 (loan relationships) for an accounting period throughout which the company holds the asset. Gains and losses are apportioned as necessary if the company only holds the asset for part of an accounting period. The effect of the adjustments to the consideration is to reverse the application of that Part to exchange gains and losses in respect of the asset in question so that those exchange adjustments are taken into account only in the chargeable gains arising in respect of the asset representing the creditor relationship.

3538. The second of these paragraphs provides definitions for the purposes of the first paragraph. It is based on paragraphs 12(11C) and 45FA(7) of Schedule 26 to FA 2002.

3539. The third of these paragraphs provides for the meaning in the first paragraph of the asset representing the creditor relationship if there has been a reorganisation of share capital. It is based on paragraphs 12(11C) and 45FA(5) of Schedule 26 to FA 2002.

Disapplication of section 648

3540. This paragraph disapplies section 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences) to a derivative contract if paragraph 11(2) of Schedule 10 to FA 2004 has effect in relation to the asset representing the creditor relationship. It is based on paragraphs 12(11C) and 45F(2) and (7) of Schedule 26 to FA 2002.

3541. That provision of FA 2004 deems an asset representing a creditor relationship linked to the value of assets no longer to be such if the asset was in existence at a date not later than 31 December 2005. See the following paragraphs for the rules that apply if a derivative contract would be within section 648 if this paragraph did not apply.

Existing assets representing creditor relationships: contracts for differences

3542. This paragraph and the next one make, with one exception, corresponding provision in respect of a derivative contract and its host contract, if section 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences) would apply to the derivative contract but for the disapplication in the preceding paragraph, to that made by the paragraphs above for "existing assets representing creditor relationships: options". The exception is that these paragraphs do not provide specially for exchange gains and losses ("relevant exchange gains" and "relevant exchange losses" in the earlier paragraphs). These paragraphs are based on paragraphs 12(11C) and (11D) and 45FA(1), (2), (3), (4) and (5) of Schedule 26 to FA 2002.

Disapplication of section 658

3543. This paragraph disapplies section 658 (chargeable gain or allowable loss treated as accruing when certain debtor relationships come to an end) to a derivative contract (and makes a consequential provision) if the liability representing the debtor relationship that hosts the derivative contract was owed before a date that is usually in 2005. It is based on paragraphs 45K(2) and 45KA(1) of Schedule 26 to FA 2002.

3544. The consequential provision is that, if section 658 would apply to a derivative contract but for this paragraph, this paragraph disapplies section 574 (non-trading credits and debits to be brought into account under Part 5) in respect of the relevant credits and debits arising on the derivative contract. Any gain or loss arising on the contract for differences is dealt with under the provisions of TCGA, as those provisions apply to the liability representing the debtor relationship. "Relevant credits" and "relevant debits" are defined in section 659.

Disapplication of section 661

3545. This paragraph disapplies section 661 (contract which became derivative contract) if the time when the relevant contract became a derivative contract was before 30 December 2006 (the date by reference to which the amendments made by the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006 (SI 2006/3269) have effect.). It is based on paragraph 43A(4) of Schedule 26 to FA 2002.

Disapplication of section 666

3546. This paragraph disapplies section 666 (allowable loss treated as accruing where amount paid in discharge of obligations under debtor relationship) if the liability representing the debtor relationship was owed before a date which is usually in 2005. It is based on paragraph 45JA(1) and (2) of Schedule 26 to FA 2002.

Contracts which became derivative contracts on 16 March 2005

3547. This paragraph brings into account as a chargeable gain or allowable loss, when a company ceases to be a party to the contract, the gain or loss latent in a contract that became a derivative contract from 3.00pm on 16 March 2005 (the time at which the 2005 Budget announced proposed changes to the definition of what is a derivative contract). It is based on paragraph 4A(1), (2) and (3) of Schedule 26 to FA 2002.

3548. A contract that was not a derivative contract before that time but became one after that time is commonly one that formerly met the conditions for its underlying subject matter to be "excluded property" (see the commentary on section 589 (contracts excluded because of underlying subject matter: general)). The Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2005 (SI 2005/646) amended the conditions for that purpose from that time to cut down the range of excluded property (see the conditions in section 591 (conditions A to E mentioned in section 589(5))). Rather than covering most cases where the underlying subject matter of the contract is shares, either by themselves or in conjunction with holdings in shares, the excluded property rule now focuses on contracts used to hedge assets which are shares on which chargeable gains arise.

3549. The paragraph only applies if the contract was a "chargeable asset" immediately before it became a derivative contract (see the definition of that term in section 703).

3550. *Sub-paragraph (5)* requires a chargeable gain or allowable loss to be brought into account on the assumption the company disposed of the contract immediately before it became a derivative contract and did so for consideration equal to the book value of the contract (if any) at the end of the last accounting period of the company before that to which the changes made by SI 2005/646 apply.

3551. Paragraph (b) of *sub-paragraph (6)* defines that period. In the source legislation, the words used are "the company's accounting period immediately before its first new period". The term "new period" is not otherwise used in SI 2005/646. But a "new period" cannot predate the first period to which the amendments made by those regulations apply (as set out in article 1 of SI 2005/646). The paragraph has therefore been aligned with the commencement terms of SI 2005/646. See *Change 106* in Annex 1.

Contracts which became derivative contracts on 28 July 2005

3552. This paragraph treats a relevant contract to which it applies as a derivative contract entered into by a company on 28 July 2005 and determines the value of the consideration given for the contract. It also brings into account as a chargeable gain or allowable loss when the company ceases to be a party to the contract the gain or loss latent in the contract at 28 July 2005. It is based on paragraph 4B(1), (2), (3) and (4) of Schedule 26 to FA 2002.

3553. The Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment No 2) Order 2005 (SI 2005/2082) extends the scope of the amendments made by SI 2005/646 to the "excluded property" rules (see section 589 (contracts excluded because of underlying subject matter: general)). See the comments on the amendment of the "excluded property" rules in connection with the preceding paragraph.

3554. A contract to which this paragraph applies is one that was not a derivative contract immediately before 28 July 2005 (although it was a "chargeable asset" at that point). But it would have been a derivative contract had an accounting period of the company begun on that date, that is, when the amendments made by SI 2005/2082 came into force. Because of the rule in this case, it is immaterial when the actual accounting period of the company began in which 28 July 2005 falls.

3555. The definition of "chargeable asset" in section 703 applies.

3556. *Sub-paragraph (6)* brings into account the chargeable gain or allowable loss latent in the contract at the time it is treated as becoming a derivative contract. It does so in the same way as the preceding paragraph with one exception. This is that the consideration for the disposal is equal to the fair value of the contract on 28 July 2005 (that is, the same figure as is taken to be the consideration for the deemed derivative contract in the subsequent application of Part 7 to the contract).

Plain vanilla contracts which became derivative contracts before 30 December 2006

3557. This paragraph modifies the amounts otherwise allowable as acquisition costs under section 38 of TCGA on the disposal of a plain vanilla contract if the disposal occurs because the company ceases to be a party to the contract. It is based on paragraph 4D of Schedule 26 to FA 2002.

3558. There are two conditions to be met. The first is that the plain vanilla contract was previously not a derivative contract but became one at a date before 30 December 2006. Although the paragraph does not specify in what circumstances the contract became a derivative contract, it is likely to be the case that it had ceased to satisfy the conditions in section 589 (contracts excluded because of underlying subject matter: general) under which the underlying subject matter of the contract was "excluded property".

3559. The second condition is that neither of the two preceding paragraphs applies on the company ceasing to be a party to the contract.

3560. 30 December 2006 is the date by reference to which the amendments made by the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006 (SI 2006/3269) have effect.

3561. *Sub-paragraph (2)* disapplies section 699 (priority of Part 7 for corporation tax purposes) in respect of a disposal to which this paragraph applies (that is, the provisions of this paragraph do not exhaust the application of the Corporation Tax Acts to this disposal).

3562. The adjustments made by this paragraph to the acquisition costs allowable under section 38 of TCGA are similar to those made by a number of provisions in Chapter 8 of Part 7. As with those sections, this paragraph in effect reverses the treatment of credits

and debits in respect of the derivative contract so that double counting is avoided when the contract is disposed of.

3563. And similarly again to those sections, if the adjustment to be made under *sub-paragraph (3)* is a reduction that exceeds the amounts otherwise allowable under section 38 of TCGA, the excess is added to the consideration for the disposal.

3564. "Plain vanilla contract" is defined in section 708.

Issuers of securities with embedded derivatives: deemed options

3565. This paragraph disapplies sections 653 and 655 and varies the application of section 654 in a case where the company was a party to the debtor relationship in question immediately before its first accounting period to begin on or after 1 January 2005. It is based on paragraph 45J(4) of Schedule 26 to FA 2002.

3566. The paragraph preserves the commencement rules that apply on the insertion of paragraph 45J of Schedule 26 to FA 2002.

Contract becoming derivative contract on 12 March 2008

3567. This paragraph determines the consideration treated as given for a relevant contract that became a derivative contract on 12 March 2008 by virtue of certain provisions of FA 2008. It is based on paragraph 20 of Schedule 22 to FA 2008.

3568. Paragraph 20 of Schedule 22 to FA 2008 amends the source legislation for sections 579(1) and 589(5) with effect from 12 March 2008, the effect of which is that a number of relevant contracts became derivative contracts. This paragraph determines the consideration treated as given for such a derivative contract so that the provisions setting out the credits and debits to be brought into account under Part 7 may be applied.

Avoidance relying on continuity of treatment provisions: transactions before 16 May 2008

3569. This paragraph preserves the commencement rules applying on the introduction of the source legislation for section 629. It is based on paragraph 5(3) of Schedule 22 to FA 2008.

Disposals for consideration not fully recognised by accounting practice: disposals before 16 May 2008

3570. This paragraph preserves the commencement rules applying on the introduction of the source legislation for section 698. It is based on paragraph 4(3) of Schedule 22 to FA 2008.

References to Companies Act 2006

3571. This paragraph provides for the interpretation of references to section 286 of the Companies Act 2006 until such time as that section is brought into force. It is based on regulation 6 of The Corporation Tax (Implementation of the Mergers Directive) Regulations 2008 (SI 2008/1579).

3572. The paragraph applies the equivalent provision in the predecessor Companies Act until an order brings section 658 of the Companies Act 2006 into force.

Repeal of provisions concerning exchange gains and losses from derivative contracts

3573. This paragraph preserves the prospective repeal by F(No 2)A 2005 of some provisions dealing with exchange gains and losses. It is based on paragraph 9(1) of Schedule 6 to F(No 2)A 2005.

Part 14: Other relief for employee share acquisitions

Accounting periods beginning before 1 January 2003

3574. This paragraph preserves the transitional provision in paragraph 33 of Schedule 23 to FA 2003. This transitional might be required to prevent a double deduction in the case of an option granted before 1 January 2003 but exercised after 30 March 2009.

Part 17: Film production

Application of Part 15 etc to films that commenced principal photography before 1 January 2007 but were not completed before that date

3575. Section 52 of FA 2006 contains powers to make transitional provisions relating to films that started principal photography before 1 January 2007 but which were not completed before that date. The Corporation Tax (Taxation of Films) (Transitional Provisions) Regulations 2007 (SI 2007/1050) have been made under section 52 of FA 2006.

3576. Some of the tax provisions which are modified, for transitional purposes, by SI 2007/1050 are rewritten in Part 15 but others (such as the withdrawal of existing film reliefs for both income tax and corporation tax purposes) are not rewritten or are, effectively, rewritten elsewhere (in the Part dealing with intangible fixed assets).

3577. These paragraphs adapt the transitional provisions in SI 2007/1050 so that they refer to the appropriate places in FA 2006, Part 15 of this Act or elsewhere in this Act.

Part 19: Unremittable income

Unremittable income that arose in an accounting period ending before 1 April 2009

3578. This paragraph ensures that the relief given by Part 18 of this Act, and any withdrawal of that relief by virtue of section 1276 or 1277, is not restricted to income that arose in an accounting period ending on or after 1 April 2009 or, as regards withdrawal of relief, to claims under that Part.

Part 21: Other provisions

Miscellaneous profits and losses: apportionment to accounting periods ending before 1 April 2009

3579. Section 1307 applies to various sources of income that are taxed under Schedule D Case VI in the source legislation. It rewrites section 72 of ICTA which allows the profits of a period of account to be apportioned.

3580. The basis of assessment for such income is the full amount of the profit arising in the accounting period (section 8). If accounts are prepared for any of these sources it may be necessary to apportion the profits of accounts made up to a period which is not itself an accounting period to arrive at the figure of profit that arises in each relevant accounting period.

3581. Section 1329 provides that the Act takes effect for corporation tax purposes for accounting periods ending after 31 March 2009. This paragraph provides that the rewritten legislation applies to a period of account that straddles 1 April 2009 even though an accounting period or periods ending before 1 April 2009 are affected. This Act includes a number of minor changes in the law. Without this paragraph it would be necessary for taxpayers to take account of those changes only for the accounting period ending on or after 1 April 2009.

3582. If the taxpayer does not want the new law to apply to a transaction that occurred before 1 April 2009 it can elect for the old legislation to continue to apply (see Part 2 of this Schedule).

Charge to tax under Case VI of Schedule D in subordinate legislation

3583. These paragraphs preserve the effect of references to Schedule D Case VI in subordinate legislation. Where a provision such as section 396 of ICTA refers to something "within the charge to corporation tax under Case VI of Schedule D", that reference is sufficient to pick up any such part of the charge as is applied in secondary legislation. For an example of this, see paragraph 58 of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).

3584. Such references to Schedule D Case VI are replaced by references to provisions in the table in section 834A of ICTA (which is inserted by Schedule 1 to this Act). The first paragraph ensures that such parts of the charge to corporation tax that are in secondary legislation are treated as within the table in that section. The second paragraph ensures that any such secondary legislation that had effect for the purposes of loss relief in respect of a transaction to which Schedule D Case VI applied continues to have equivalent effect.

Schedule 3: Repeals and revocations

3585. This Schedule contains repeals and revocations of enactments including some spent enactments.

Schedule 4: Index of defined expressions

3586. This Schedule lists expressions defined in this Act or in other Acts.

3587. The definition of "registered industrial and provident society" is inserted into section 834(1) of ICTA by Schedule 1 to this Act.

COMMENCEMENT

3588. Section 1329 provides for it to have effect:

- for corporation tax purposes, for accounting periods ending on or after 1 April 2009; and
- for income tax and capital gains tax purposes, for the tax year 2009-10 and subsequent tax years.

HANSARD REFERENCES

3589. The following table sets out the dates and Hansard references for each stage of this Act's passage through Parliament.

Stage	*Date*	*Hansard or other Parliamentary reference*
House of Commons		
Introduction	4 December 2008	Vol 485 Col 154
Second Reading Committee	15 January 2009	
Second Reading (formal)	19 January 2009	Vol 486 Col 592
Joint Committee on Tax Law Rewrite Bills		

Stage	***Date***	***Hansard or other Parliamentary reference***
First Report of Session 2008-2009	27 January 2009	HL 22 2008-2009
		HC 160 2008-2009
House of Commons		
Third Reading	3 March 2009	Vol 488 Cols 764 to 765
House of Lords		
Introduction	4 March 2009	Vol 708 Col 734
Second and third readings	25 March 2009	Vol 709 Cols 721 to 729

Royal Assent – 26 March 2009	House of Lords Hansard Vol 709 Col 755
	House of Commons Hansard Vol 490 Col 484

ANNEX 1: MINOR CHANGES IN THE LAW

CHANGE 1: REFERENCES TO "OFFICER OF REVENUE AND CUSTOMS": SECTIONS 11, 88, 106, 236, 389, 460, 617, 753, 756, 916, 917 AND 1282

This change replaces references to the "Board of Inland Revenue" in the source legislation with references to "an officer of Revenue and Customs".

It brings the income and corporation tax codes back into line.

References in the source legislation to the "Board of Inland Revenue" are treated by section 50(1) of the Commissioners for Revenue and Customs Act 2005 (CRCA) as references to "the Commissioners for Her Majesty's Revenue and Customs". The rest of this note accordingly refers to the Commissioners for Her Majesty's Revenue and Customs ("the Commissioners") rather than to the Board of Inland Revenue.

The provisions affected by this change will in future authorise or require things to be done by or in relation to an officer of Revenue and Customs rather than by or in relation to the Commissioners. This reflects the way in which Her Majesty's Revenue and Customs is organised and operates in practice. Section 13 of CRCA allows nearly all functions conferred on the Commissioners to be exercised by any officer. All of the functions affected by this change, which are in the main concerned with administrative processes, are in fact exercised by officers of the Commissioners, and the Commissioners themselves are not personally involved in their exercise.

Where the source legislation provides for a claim or election to be made to the Commissioners, this Act does not expressly state to whom such a claim or election is to be made. Where a notice to deliver a corporation tax return has been issued paragraphs 57 and 58 of Schedule 18 to FA 1998 require the claim to be made in the return or by amendment of the return if possible. A return must be made to the officer who issued it. A notice amending a return must be made to an officer. Similarly, where the claim is made outside a return or amendment, paragraph 2(1) of Schedule 1A to TMA requires the claim to be made to an officer.

Each provision affected by the conversion of references to the Commissioners will be identified in the Table of Origins by a cross-reference to this change.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

CHANGE 2: TRADING INCOME: OMISSION OF REFERENCES TO A COMPANY CARRYING ON A PROFESSION OR A VOCATION: SECTION 35 (AND OTHER SECTIONS)

This change omits references to a profession and to a vocation where the source legislation refers to the carrying on by a company of a trade, profession or vocation.

The change is reflected in numerous sections in Part 3, the trading income Part. It is included in the origins of the main provisions affected.

The meaning of "company"

"Company" in the Tax Acts means "any body corporate or unincorporated association but does not include a partnership, a local authority or a local authority association" (section 832(1) of ICTA). This note accordingly looks at corporate bodies and then at unincorporated associations.

The definition in section 832(1) of ICTA is subject to:

- some qualifications that deal with particular topics; and
- a general proviso that the definition "does not apply where the context otherwise requires because some other definition of "company" applies".

Both the qualifications and the general proviso are in section 832(2) of ICTA. They do not affect the discussion in this note.

Corporate bodies and professions

"Profession" is not defined for tax purposes. As long ago as 1919 Scrutton L J said:

> it seems to me as at present advised that a "profession" in the present use of language involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production, or sale, or arrangements for the production or sale of commodities. The line of demarcation may vary from time to time. The word "profession" used to be confined to the three learned professions - the Church, Medicine and Law. It has now, I think, a wider meaning. It appears to me clear that a journalist whose contributions have any literary form, as distinguished from a reporter, exercises a "profession"; and that the editor of a periodical comes in the same category. CIR v Maxse (1919), 12 TC 41 CA on page 61.

The question whether or not a corporate body can carry on a profession for the purposes of corporation tax is one of interpretation of the corporation tax legislation. This is apparent from the general rules under which the acts of individuals are attributed to corporate bodies.

A wide variety of acts performed by individuals are in law attributed to corporate bodies under rules derived from the constitutions of the bodies, from company law and from general principles which also operate between individuals, such as agency and vicarious liability. These rules of attribution enable the rights and liabilities of corporate bodies arising out of the acts of individuals to be defined.

Under these principles many acts carried out by a corporate body's agents in conducting its business may be treated as acts of the body for the purposes, for instance, of liability in contract or tort. But an act that is treated as an act of the corporate body for one purpose would not necessarily be treated as the body's act for another purpose. For example, a corporate body generally has no criminal liability for the acts of its agents.

The rules of attribution are of little help when considering whether a corporate body is capable of carrying on a profession for the purposes of corporation tax. To begin with, the question is not obviously one of attribution. What is in doubt is not whether particular activities should be attributed to the corporate body, but whether a particular activity carried on by the body (namely the carrying on of a business consisting of the provision of professional services) should be classified as trading or as a profession. The principles of agency are not designed to answer questions such as whether a principal may carry on a profession by virtue of the fact that the principal's agent carries on a profession. And because it is arguable that the language of the corporation tax legislation implicitly excludes the application of the rules about professions to companies (see below), the question must in any case be approached as one of interpretation.

There are two main grounds for arguing that there are no acts which would, for the purposes of corporation tax, constitute the carrying on of a profession by a corporate body. The first is based on the nature of a profession. The second is based on internal evidence in the corporation tax legislation.

Before turning to those arguments this note looks briefly at some decided cases.

Case law

HMRC know of no case in which it was necessary to decide whether a corporate body can carry on a profession for tax purposes.

William Esplen, Son and Swainston Ltd v CIR (1919), 2 KB 731 concerned a corporate body whose shareholders and directors were three naval architects who had previously carried on their profession in partnership. Their activities had not changed in any way since incorporation.

There was an exception from Excess Profits Duty for:

Any profession, the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on …

Rowlatt J said in his judgment that the company was not carrying on a profession for the purpose of that provision. But his reasoning was that "profession" in that provision means a profession the profits of which are mainly dependent on the personal qualifications of the person who carries it on, and only an individual can have professional qualifications. In CIR v Peter McIntyre Ltd (1926), 12 TC 1006 CS on page 1014 the Lord President (Clyde) explained Rowlatt J's decision as follows:

It follows from what has been said that the profits of a profession may, or may not, fall within the statutory exemption, according as the person who carries it on is an individual on the one hand, or a corporate person on the other hand. For a professional business may be carried on by a company as well as by an individual; but, if by a company, it is difficult to see how the profits can be dependent on the company's personal qualifications, for the simple reason that a company is incapable of personal qualifications. That is all, as I understand, that was decided by Mr. Justice Rowlatt in William Esplen, Son and Swainston, Ltd. v The Commissioners of Inland Revenue, (1919) 2 K.B. 731, and I respectfully think his decision was right.

The decision in the Esplen case was referred to by Scrutton L J in Brighton College v Marriot (1925), 10 TC 213 HL. He said on page 226:

It is clear that a private schoolmaster would be assessed as carrying on a profession, but it has been decided in Esplen's case, (1919) 2 K.B. 731, that a limited company employing professional men to do professional work does not carry on a profession; it must be assessed, if at all, as carrying on a trade…...

And on page 227:

The question then is: Do the Company in carrying on the school carry on a trade? In my view, when any person habitually and as a matter of contract supplies money's worth for full money payment, he "trades" within the meaning of Schedule D.

But his interpretation of that decision appears to go too wide and should probably not be given much weight.

So these cases contribute little to the question whether a corporate body can carry on a profession for the purposes of corporation tax.

The nature of a profession

A profession is carried on by a person who uses his or her professional skills, knowledge and training to carry on the distinctive work of the profession, whether it is sculpting, school teaching, the work of an architect etc. Although a professional person can delegate some of his or her work, it is never the case that the possession of knowledge, or the carrying on of activities, by one individual can constitute the carrying on of a profession by another individual. There is no reason why the position should be any different between a company and an individual.

Since the person who has the skills and knowledge and does the professional work must be an individual, it appears that only an individual can carry on a profession. This conclusion is founded on ordinary notions of what is involved in carrying on a profession, and coincides with the instinct that a person who carries on the profession of architecture must be the person who is by qualification an architect (and similarly with other professions).

This suggests that the starting point ought to be that a company cannot carry on a profession for the purposes of corporation tax legislation. But there is a contrary argument. The view is sometimes taken that a business of supplying professional services may be equated with a profession. On this view it is proper to say that a person who carries on such a business carries on a profession even if that person does not personally provide the professional services.

Since references to carrying on a profession may be used either in the strictest sense, or in a looser sense to include a business of providing professional services, the first argument based on the nature of a profession is not conclusive.

"Profession" in the corporation tax legislation

The second argument that there are no acts which would, for the purposes of corporation tax, constitute the carrying on of a profession by a corporate body is based on internal evidence in the corporation tax legislation.

FA 1965

The drafters of FA 1965 proceeded on the basis that a corporate body cannot carry on a profession.

It is true that section 53 of FA 1965 (see now section 9 of ICTA) provided that:

…. any income shall for purposes of corporation tax be computed in accordance with income tax principles, all questions as to the amounts which are or are not to be taken into account as income, or in computing income ... being determined in accordance with income tax law and practice….

….

((3) Accordingly, for purposes of corporation tax income shall be computed, and the assessment shall be made, under the like Schedules and Cases as apply for the purposes of income tax …

Therefore, if a corporate body were to have profits from carrying on a profession those profits could be calculated and taxed under Schedule D Case II as applied for corporation tax purposes:

Case II: tax in respect of any profession or vocation not contained in any other Schedule (section 18(3) of ICTA)

But it is significant that professions are not anywhere catered for explicitly in the corporation tax code introduced by FA 1965.

So, for example, the following provisions of FA 1965 did not cater for professions:

- Section 50 brought non-UK resident companies within the charge to corporation tax, but only if they carried on a trade in the United Kingdom through a branch or agency. (See now section 11 of ICTA.)
- Section 51 set out the rules for determining when a company's accounting period begins and ends.
  - — Subsection (3)(c) provided that an accounting period ends on "the company beginning or ceasing to carry on a trade, or to be, in respect of a trade, within the charge to tax". (See now section 12(3)(c) of ICTA.)
  - — Subsection (5) set out the rule that applies if "a company carrying on more than one trade makes up accounts of any of them to different dates". (See now section 12(5) of ICTA.)
- Section 54(2) provided that "where a company begins or ceases to carry on a trade, or to be within the charge to corporation tax in respect of a trade" the profits computation was on the basis that the trade commenced or ceased. (See now section 337(1) of ICTA.)
- Section 56(2) dealt with capital allowances to be made "in taxing a trade". They were to be treated "as a trading expense". (See now sections 247 and 251 of CAA where the income tax and corporation tax rules are combined.)

- Sections 58 and 59 set out the loss relief rules, wholly in terms of trades. The special rule for "trade charges" in section 58(8) referred to "payments made wholly and exclusively for the purposes of a trade". (See now sections 393 and 393A of ICTA.) This carries through to group relief as a result of the reference to section 393A in section 403ZA of ICTA.
- Section 61 provided for continuity in the case of a company reconstruction without change of ownership - "The trade shall not be treated as permanently discontinued". (See now section 343(2) of ICTA.)

Section 89 (see now section 6(4)(b) of ICTA) provides that in the provisions discussed above:

"trade" includes "vocation", and includes also an office or employment…

but there is no general extension to include professions.

If the corporation tax code was intended to cover professions it is extraordinary that the references to trades in these key provisions were not extended to professions. Nor is there any mention of professions in the 1965 Notes on Clauses.

In line with the apparent intentions of the 1965 legislation, it has long been the Inland Revenue/ HMRC view that a corporate body cannot carry on a profession for corporation tax purposes. Where a corporate body carries on a business consisting of the provision of professional services the practice is to treat it as carrying on a trade.

References to "profession" in the current corporation tax legislation

A significant number of references to "profession" in the current legislation (some two dozen or more) arise as a result of the ITTOIA split of income tax from corporation tax. Where the source legislation applied to both income tax and corporation tax and concerned professions the reference to profession was maintained in the corporation tax only rule. This was done on the basis that if companies cannot carry on professions the references do no harm, and because the issue was seen as one to address in the context of the rewrite of corporation tax.

A slightly smaller number appear in provisions that apply to both income tax and corporation tax. They are clearly needed until these provisions are split into income tax and corporation tax rules.

A dozen or so are concerned with partnerships that might be made up of both income and corporation taxpayers. If a partnership consists of an individual and a corporate body and exists to exploit the professional services of the individual it may well be correct to regard the individual as carrying on the profession but the company as carrying on a trade.

A small number cannot be explained in any of the above ways.

Corporate bodies and professions - conclusions

There are three conclusions:

- the nature of a profession and some comments in the case law suggest that corporate bodies cannot carry on a profession for corporation tax purposes – when they provide professional services they are trading;
- consistent with that, the 1965 corporation tax code made no explicit provision for professions; and
- references in the current legislation arise for a mixture of reasons, are inconsistent and therefore shed no great light on the issue.

So there are strong grounds for concluding that for the purposes of the charge to corporation tax under Schedule D Case II there are no activities that should be taken to constitute the carrying on of a profession by a corporate body.

Corporate bodies and vocations

The nature of a vocation

"Vocation" is not defined for tax purposes.

According to the Oxford English Dictionary a vocation is:

- the fact or feeling of being called to undertake some specific career, function or occupation;
- a strong feeling of fitness or suitability for a particular career;
- a mode of life or employment regarded as requiring dedication.

The thread that ties all of these definitions together is that the exercise of a vocation requires a personal commitment to a particular activity.

Corporate bodies are artificial persons. They are not animated by callings. They do not have careers, still less can they be said to have feelings of fitness and suitability as regards a particular set of activities. Nor do they have a mode or a way of life and they do not engage in activities out of a sense of dedication.

That being the case it does not appear possible for a corporate body to carry on a vocation.

FA 1965

Section 89(2)(j) of FA 1965 provided that "trade" includes "vocation" for the purpose of Part 4 of the Act (taxation of companies and of company distributions). (See now section 6(4)(b) of ICTA.) Notes on Clauses explain that this is because:

> an old Court decision suggests that a bookmaking business may have to be considered as a vocation rather than a trade in the strict sense.

That decision is found in Partridge v Mallandaine, 2 TC 179. That case was heard in the High Court in 1886. Today there is little doubt that a company carrying on a bookmaking business is trading.

Corporate bodies and vocations – conclusions

There are two conclusions:

- corporate bodies cannot carry on a vocation; and
- although the 1965 corporation tax code makes explicit provision for vocations this is the result of an excess of caution for reasons that are no longer relevant.

Unincorporated associations

The meaning of "unincorporated association"

In Conservative and Unionist Central Office v Burrell (1981), 55 TC 671 CA on page 699 Lawton LJ considered the meaning of "unincorporated association" for the purposes of s.832(1) of ICTA:

It is sufficiently like a "company" for it to be put in the charging section within the ambit of that word. The interpretation section makes it clear that the word "company" has a meaning extending beyond a body corporate but not as far as a partnership or a local authority. I infer that by "unincorporated association" in this context Parliament meant two or more persons bound together for one or more common purposes, not being business purposes, by mutual undertakings, each having mutual duties and obligations, in an organisation which has rules which identify in whom control of it and its funds rests and on what terms and which can be joined or left at will. The bond of union between the members of an unincorporated association has to be contractual.

The HMRC view of unincorporated associations differs from this in two main respects. These are that the union between the members need not be legally enforceable and that there is no reason why an unincorporated body should not have trading or business objectives or carry on significant commercial activities.

Unincorporated association or partnership?

In the case of Blackpool Marton Rotary Club v Martin (1989), 62 TC 686 CA the club argued that it fell within the definition of a partnership because it was an association of persons "carrying on a business in common with a view of profit" (section 1 of the Partnership Act 1890). This was rejected by the Commissioners and their decision was confirmed by Hoffman J. He contrasted the position of partners, who are individually entitled to some proportion of profits, with the members of the club, who were not individually entitled to share in any profits which might arise from its activities. Their entitlement was to whatever privileges were conferred upon them by the rules of the club and no more.

Unincorporated associations and professions

The Blackpool case shows that if individuals come together to carry on a profession and are entitled to share the profit as it arises the arrangement will be a partnership liable to income tax rather than an unincorporated association liable to corporation tax.

HMRC are not aware of any instance of an unincorporated association being assessed to corporation tax as carrying on a profession.

Unincorporated associations and vocations

HMRC are not aware of any instance of an unincorporated association being assessed to corporation tax as carrying on a vocation.

Unincorporated associations – conclusions

The corporation tax charge under Schedule D Case II on the profits of a profession or vocation of an unincorporated association does not have any practical effect.

It is theoretically possible that the application of trading income rules to activities that a company could argue is a profession or a vocation could lead to a change in the measure of taxable profits.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 3: TRADING INCOME: PROFITS OF MINES, QUARRIES AND OTHER CONCERNS: SECTION 39

This change identifies two consequences of the approach taken to the rewrite of section 55 of ICTA.

It brings the income tax and corporation tax codes back into line.

Section 55 of ICTA provides that profits arising out of land in the case of certain listed concerns shall be charged to tax under Schedule D Case I (Schedule D Case 1 rules are rewritten largely in Part 3 of this Act). The concerns listed include mines, quarries, railways and canals.

Section 55 of ICTA is rewritten as section 39. It treats the profits and losses of the concern as if they were the profits or losses of a trade. This has two consequences.

(1) Section 55 of ICTA does not specify how the profits to be taxed under Schedule D Case I are to be calculated. Section 39(1) makes clear that the profits are calculated in the same way as trade profits. This means that the calculation rules in Part 3 of this Act will apply. It is possible that the calculation rules in Part 3 might produce a result less favourable than the result which would have been produced by the calculation rules contemplated by

section 55. But since it is not possible to say which calculation rules were contemplated by section 55, it is impossible to be certain whether or not this is indeed so.

(2) Section 55 of ICTA refers only to profits. In practice loss relief is allowed for losses of concerns as if they were trade losses. Section 39(4) gives that practice statutory effect. Legislating this practice will invariably be favourable.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 4: TRADING AND PROPERTY INCOME: CARAVAN SITES WHERE TRADE CARRIED ON: SECTIONS 43 AND 213

This change gives statutory effect to ESC C36 (caravan sites where there is both trading and letting income).

It brings the income tax and corporation tax codes back into line.

ESC C36 states:

Where the proprietor of a caravan site carries on material activities associated with the operation of that site which constitute trading, there may be included as receipts of that trade any site income from the letting of pitches for static or touring caravans, and any income from letting caravans where the letting does not of itself amount to a trade.

In practice there is an element of trade, such as the operation of a site shop or the provision of leisure facilities such as a café, included in the operation of most caravan sites.

This change gives a company which meets the qualifying conditions a statutory right to treat receipts from letting caravans or pitches as receipts of the trade of operating a caravan site. So trading losses (including those brought forward) may be available against the caravan site receipts.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 5: TRADING AND PROPERTY INCOME: SURPLUS BUSINESS ACCOMMODATION: SECTIONS 44 AND 213

This change gives statutory effect to the HMRC practice on receipts from surplus business accommodation known as Revenue Decision 9.

It brings the income tax and corporation tax codes back into line.

The case of Salisbury House Estate Ltd v Fry (1930), 15 TC 266 HL is authority for the proposition that the income tax Schedules are mutually exclusive so any amount received by a company from the letting of premises surplus to the requirements of the company's trade should not be taken into account in calculating the profits of the trade but assessed separately to tax as income from property under Schedule A. Similarly, any outgoings in respect of the premises should be apportioned between the part which is let and the part used for the purposes of the trade.

In practice, HMRC do not object to a company including receipts from letting surplus business accommodation in trade receipts provided certain conditions are met. This practice, published in the February 1994 edition of Tax Bulletin under the heading "Revenue Decisions – Schedule D Cases I and II – Letting Surplus Business Accommodation", is referred to in some reference books as Revenue Decision 9. The practice extends to trades within Schedule D Case V.

The conditions in Revenue Decision 9 are:

- the accommodation is temporarily surplus to the current requirements of the trade;
- part of the accommodation is used for trade purposes;

- the rental income is comparatively small; and
- the rent is in respect of the letting of surplus business accommodation only – not surplus land.

In legislating the conditions in Revenue Decision 9, section 44 sets out rules for determining whether accommodation is temporarily surplus to requirements. These are:

- that the accommodation must have been used for the purposes of the trade within the last three years (or acquired within that period);
- that the accommodation must be let for a term of not more than three years; and
- that the company must intend to use the accommodation for trade purposes at a later date.

This gives taxpayers increased certainty as to whether the condition is met.

If the conditions are met, trading losses (including those brought forward) may be available against the receipts from letting the surplus business accommodation.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 6: TRADING AND PROPERTY INCOME: RENTS IN RESPECT OF WAYLEAVES WHERE ASSOCIATED WITH A TRADE: SECTIONS 45, 213, 279 AND 288

This change shifts the charge on rents from certain wayleaves associated with a trade from Schedule D Case V and Case VI to a charge on trade profits.

It brings the income tax and corporation tax codes back into line.

Section 120 of ICTA makes provision about rent payable in respect of "any easement enjoyed in the United Kingdom in connection with any electric, telegraphic or telephonic wire or cable" other than an easement of a kind mentioned in section 119(1) of ICTA. Section 119 of ICTA applies to certain easements which are or might be used or enjoyed in connection with any of the concerns listed in section 55 of ICTA. Those concerns include mines, quarries, certain industrial concerns, canals, docks, markets, bridges, ferries, and railways. "Rent" and "easement" both have wide meanings for this purpose (see section 119(3) of ICTA).

Section 120(1) of ICTA provides for the rent from electric-line easements to be charged under Schedule D unless other income from the land to which the easement relates is charged under Schedule A. In that case the rent is charged to tax under Schedule A, section 120(1A) of ICTA.

Section 120(1) of ICTA does not specify under which Case of Schedule D the rent is to be charged. In practice, where the easement relates to land on which a person carries on a trade, the rent is charged under Schedule D Case I and, in other cases, under Case VI. In the absence of section 120 of ICTA the rent would be charged to tax under Schedule A. Section 120 of ICTA does not apply to rent from easements relating to land outside the United Kingdom, which is charged to tax under Schedule D Case V.

Section 120(1) of ICTA as it applies to trades is rewritten in section 45. Under section 45:

- the word "easement" is rewritten as "wayleave". The rest of this note refers to wayleaves;
- rents from wayleaves related to land associated with a trade will be charged to corporation tax under Part 3 of this Act (as profits of the trade) if the taxpayer so chooses and has no other income from the land in question; and
- all other rents from wayleaves will be charged to income tax under Part 4 of this Act (property income).

This enacts the existing non-statutory practice for easements to which section 120 of ICTA applies which are associated with a trade but represents a change both in practice and in the law as respects:

- wayleaves other than those connected with "electric, telegraphic or telephonic wire or cable";
- wayleaves relating to land outside the United Kingdom; and
- wayleaves of a kind mentioned in section 119(1) of ICTA.

Section 45 makes clear that any expenses incurred in respect of the wayleave can also be allowed as deductions in calculating the profits.

Section 119(1) of ICTA is rewritten in Chapter 7 of Part 4 of this Act. Under the law as it applies before the commencement of this Act, rent in respect of a wayleave that meets the conditions in both sections 119(1) and 120(1) of ICTA is taxed under section 119 of ICTA. Section 288(3) of this Act reverses that order of priority. This is necessary to allow the company to have such rent taxed as the profits of a trade. It will not prevent a claim for relief under section 273 of this Act (relief in respect of mineral royalties) as rent for an electric-line wayleave would not qualify for such relief.

All rents that are in practice charged to tax under Schedule D Case VI (see the table in section 834A of ICTA) by virtue of section 120(1) of ICTA, as that section applies before the commencement of this Act, are charged under section 277 (charge to tax on rent receivable for a UK electric-line wayleave). The table in section 834A is inserted by Part 1 of Schedule 1 to this Act, and is a list of places where some of the Schedule D Case VI charges are rewritten.

The application of trading income rules to income which previously was subject to Schedule D Case V or Case VI could increase access to allowable deductions and to loss relief.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 7: TRADING AND PROPERTY INCOME: RELATIONSHIP BETWEEN RULES PROHIBITING DEDUCTIONS AND RULES ALLOWING DEDUCTIONS: SECTIONS 51 AND 214

This change resolves any conflict between the rules prohibiting a deduction in calculating trade profits and the rules allowing a deduction in calculating trade profits in favour of the rule allowing the deduction. But any conflict is unlikely.

The change brings the income tax and corporation tax codes back into line.

Parts 3 and 20 of this Act set out a number of rules that restrict the deductions allowed in the calculation of trade profits. Each of these is a "prohibitive rule".

Part 3 of this Act also sets out a number of rules that allow deductions in the calculation of trade profits. Most of these rules are in Chapter 5 of Part 3 of this Act. Each of these is a "permissive rule".

In some cases the source legislation for a permissive rule overrides a specific prohibitive rule. In other cases the source legislation provides that a deduction is allowed "notwithstanding anything in section 74 [of ICTA]". Such a form of words overrides all the restrictive rules in section 74 of ICTA. See, for example, section 82A of ICTA rewritten as section 87. In other cases the source legislation says merely that a deduction is allowed.

Section 51 makes clear that the permissive rule has priority over any prohibitive rule with the four exceptions set out in subsection (1)(b) of the section.

In the case of car and motor cycle hire section 578A of ICTA makes clear that the provision restricts the amount of any deduction.

In the cases of unpaid remuneration and employee benefit contributions section 43 of FA 1989 and paragraph 1 of Schedule 24 to FA 2003 impose a timing rule that naturally overrides any permissive rule. And, in an instance where a conflict may arise, section 86 of ICTA (seconded employees) allows the deduction only "to the like extent" as if the employee had not been seconded.

In the case of crime-related expenditure the order of priority reflects the view that in enacting section 577A of ICTA Parliament intended that there should be no circumstances in which anyone should obtain a tax deduction by making a crime- related payment.

The order of priority given by section 51 is relevant only if the expenditure is capable of falling within both a permissive rule and a prohibitive rule. This is most likely to happen in the case of the general restriction in section 54. In these cases the source legislation leaves no uncertainty about the extent to which the prohibitive rule is overridden. The only area of uncertainty is where the restriction is imposed by a provision other than section 74 of ICTA. For example, the restriction that section 577 of ICTA imposes on business expenditure.

There is rarely scope for overlap between a specific permissive rule and a specific prohibitive rule. This is because the terms for either rule to apply are so closely defined. As a question of fact the expenditure will fall into one category or the other. But in the event of any overlap section 51 changes the law by giving priority to the permissive rule.

For example, it is unlikely that expenditure that meets the conditions for section 83 of ICTA (patent fees etc) to apply would also be business expenditure disallowed by section 577 of ICTA. If it does the source legislation is silent on which rule takes priority. Section 51 gives priority to the permissive rule.

Section 214 applies the same order of priority to the profits of a property business.

If there is any doubt in the source legislation about which rule takes priority this change resolves the doubt in favour of the rule that allows the deduction.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 8: TRADING INCOME: ALIGN RULES FOR DEBTS PROVING IRRECOVERABLE AFTER TRADE DEEMED TO HAVE CEASED WITH GENERAL RULES FOR BAD DEBTS: SECTION 55 AND SCHEDULE 1

This change aligns the relief given for bad debts by section 89 of ICTA with the relief given by section 88D of ICTA.

Section 337(1) of ICTA sets out what happens if a company begins or ceases to carry on a trade or begins or ceases to be within the charge to corporation tax. Its trade profits are calculated as if the trade begins or ceases to be carried on.

Section 89 of ICTA provides relief for bad debts if there is an "event" within section 337(1) of ICTA or if there is a change in the persons carrying on the trade. It gives relief for bad debts which meet certain conditions. Since the trade carried on before the event or change is deemed to be different from the trade carried on after the event or change section 74(1)(e) of ICTA would otherwise prohibit a deduction for bad debts. The desired effect is to treat the trade as continuing as far as bad debts are concerned.

Although the aim of section 89 of ICTA is the same as that of section 88D of ICTA (that is, to give relief for bad trade debts), there are significant differences between the two sections and the nature of the relief given. Specifically:

- section 89 gives relief for debts which are irrecoverable, whereas section 88D gives relief for an impairment loss;
- section 89 requires proof that a debt is irrecoverable, whereas section 88D has no corresponding requirement; and

- section 88D refers to debts released as part of a "statutory insolvency arrangement", whereas section 89 makes no mention of this.

The approach adopted in this Act is to focus on the company carrying on the trade rather than on the trade. So it does not matter whether the debt was created when another taxpayer was carrying on the trade and this Act repeals section 89 of ICTA without rewriting it (see Schedule 1). The change extends the more generous provisions of section 88D of ICTA to debts within section 89 of ICTA. This simplifies the law by bringing the bad debt relief provisions for companies into one section.

This change is in taxpayers' favour in principle and may in practice benefit some. But the numbers affected and the amounts involved are likely to be small.

CHANGE 9: TRADING INCOME: CAR HIRE: RELEASE OF DEBT AFTER DEBTOR HAS CEASED TRADING: SECTION 56

This change reduces the amount charged as a post-cessation receipt when a debt relating to the hire of a car with a new retail value of more than £12,000 is released after the debtor has ceased trading.

It brings the income tax and corporation tax codes back into line.

Section 578A of ICTA restricts the amount which a company carrying on a trade can deduct in respect of the cost of hiring a car or motor cycle with a retail value, when new, of more than £12,000. The restriction takes the form of a reduction calculated by reference to the difference between the £12,000 limit and the retail price.

Section 578A(4) of ICTA provides that where there is a rebate of a hire charge, or a debt to which section 94 of ICTA applies is released, the amount brought into account in respect of the rebate or release is reduced in the same proportion as that in which the trading deduction was restricted.

Section 578A(4) of ICTA deals only with a continuing trade. This change extends the same treatment to debts wholly or partly released after the debtor has ceased to trade and taxed as post-cessation receipts under section 193 of this Act.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 10: TRADING INCOME ETC: CAR HIRE: HIRE AGREEMENTS WITHOUT OPTION TO PURCHASE: SECTIONS 57 AND 1251 AND SCHEDULE 1

This change extends the definition of "qualifying hire car" for the purpose of restricting the amount allowed as a deduction for the cost of hiring a car to include cars hired under a hire-purchase agreement where there is no option to purchase.

The change brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Section 578A of ICTA restricts the amount which a company can deduct in respect of the cost of hiring a car or motor cycle with a retail value, when new, of more than £12,000. Section 578A of ICTA does not apply to a car or motor cycle which is a "qualifying hire car" as defined in section 578B(2) of ICTA.

Section 578B(2) of ICTA defines a "qualifying hire car" as a car which is:

(a) … hired under a hire-purchase agreement … under which there is an option to purchase exercisable on the payment of a sum equal to not more than 1 per cent. of the retail price … when new, or

(b) … a qualifying hire car for the purposes of Part 2 of the Capital Allowances Act (under section 82 …)

The definition of "qualifying hire car" in section 578B(2) of ICTA does not extend to cars hired under a hire-purchase agreement where there is no option to purchase. In practice, HMRC do not apply the restriction in section 578A of ICTA on the amount of deduction to cars hired under such agreements. This section legislates that practice by including cars hired under a hire-purchase agreement where there is no option to purchase in the definition of hire car in subsection (2)(a) of the section. So the hirer gets a deduction for the full amount of the hiring costs.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZN of ICTA (inserted by Schedule 1 to this Act).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 11: TRADING INCOME: LEASE PREMIUMS ETC: DEDUCTION FOR TENANT UNDER TAXED LEASE IF LAND IS OUTSIDE THE UNITED KINGDOM: SECTIONS 62 AND 66

This change makes relief available for tenants under taxed leases of land used in connection with a trade, where the land is outside the United Kingdom.

It brings the income tax and corporation tax codes back into line.

Section 87(2) of ICTA provides in certain cases for a trading deduction to be given to a tenant under a lease, if previously an "amount chargeable" had arisen in relation to the lease concerned.

Section 87(1) of ICTA defines "amount chargeable" to include:

(a) any amount [that] falls to be *treated as a receipt of a Schedule A business* by virtue of section 34 or 35, …

((c) any amount [that] falls to be treated as a receipt of a UK property business by virtue of any of sections 277 to 282 of ITTOIA 2005…

Section 70A(5) of ICTA provides that:

The income from an overseas property business shall be computed for the purposes of Case V of Schedule D in accordance with the rules applicable to the computation of the profits of a Schedule A business.

So if the lease is of land outside the United Kingdom, sections 34 and 35 of ICTA may apply to a landlord/assignor by virtue of section 70A(5) of ICTA. The amount given by section 34 or 35 of ICTA in cases where the land is outside the United Kingdom is treated as a receipt of an overseas property business.

But section 70A(5) of ICTA does not deem an overseas property business receipt to be a receipt of a Schedule A business. So a company occupying land outside the United Kingdom under a lease in respect of which the landlord has been treated as receiving an overseas property business receipt is not entitled to relief, under section 87(2) of ICTA (see the italicised words in the above extract from section 87(1) of ICTA), in circumstances in which it would have been entitled to relief if the land had been in the United Kingdom.

Similarly a company which occupies land outside the United Kingdom under a lease in respect of which the landlord has been treated as receiving an overseas property business receipt under sections 277 to 282 of ITTOIA is not entitled to relief in circumstances in which it would have been entitled to relief if the land had been in the United Kingdom. That is because section 87(1)(c) of ICTA refers to amounts which are treated as receipts of a UK property business under sections 277 to 282 of ITTOIA.

Section 62(1) provides for a tenant to be treated as incurring expenses by reference to a taxed receipt under section 63 regardless of where the land in question is situated. Section 66(1) restricts, regardless of where the land in question is situated, the expenses that section 65 (land

not occupied by tenant but employed for purposes of tenant's trade) treats a tenant as incurring under section 63 where there is a reduction under the additional calculation rule by reference to that taxed receipt. The same changes were made for income tax in sections 60 and 64 of ITTOIA (see Change 13 in ITTOIA).

This change will result in a company receiving relief under section 63 where there is currently no entitlement to relief.

Section 295 of ITTOIA (as amended by Schedule 1 to this Act) and section 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. This means that widening entitlement to relief under section 63 may, in certain circumstances, reduce the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Act.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

CHANGE 12: REQUIRING AN APPORTIONMENT TO BE JUST AND REASONABLE: SECTIONS 63, 67, 78, 229, 234, 255, 1185, 1194 AND 1241 AND SCHEDULE 1

This change requires certain apportionments that are not required to be made on a just and reasonable basis in the source legislation to be made on that basis.

It brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Apportionments are sometimes to be made on a specified basis, such as time apportionment. But often they are left to be made according to what is reasonable in the particular circumstances. This change is concerned with such apportionments.

In some cases where there is an apportionment under legislation rewritten in this Act, the apportionment is required by the source legislation to be made on a just and reasonable basis. In other cases, it is required to be made only on a just basis or only on a reasonable basis, or there are no requirements. It is now the practice to require an apportionment to be just and reasonable. There is no reason why an apportionment should not be on a just and reasonable basis. And it is desirable that all apportionments of this nature should be made on the same basis.

Accordingly, where an apportionment under legislation rewritten in this Act is not required to be made on a just and reasonable basis, the rewritten provision requires the apportionment to be made on a just and reasonable basis. The changes are as follows:

- section 30(2)(a) of ICTA (apportionment of deemed payment in respect of expenditure on sea walls, as may be just) (see section 255(2));
- section 37(3) of ICTA (apportionment of appropriate fraction of the amount chargeable on the superior interest attributable to a part of premises required to be just) (see section 229(3));
- section 37(6) of ICTA (amount chargeable on the superior interest to be proportionately adjusted between parts of premises; no explicit requirements as to the basis on which the adjustment is to be made) (see section 234(7));
- section 87(3) of ICTA (apportionment of deemed rent attributable to part of land not occupied for the purposes of a trade, profession or vocation required to be just) (see section 63(5));
- section 87(5) of ICTA, which applies section 37(6) of ICTA (amount chargeable on the superior interest to be proportionately adjusted between parts of premises; no explicit requirements as to the basis on which the adjustment is to be made) (see section 67(6));

- section 579(5) of ICTA (apportionment of a redundancy payment where the employee is employed in different capacities; no requirements as to the basis on which the apportionment is to be made) (see sections 78(2) and 1241(2));
- section 35(2) of FA 2006 (apportionment of expenditure as between UK expenditure and non-UK expenditure, for purposes of film production provisions, required to be fair and reasonable) (see section 1185(2)); and
- paragraph 8 of Schedule 4 to FA 2006 (estimates for purposes of film production company provisions required to be fair and reasonable) (see section 1194).

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZH of ICTA (inserted by Schedule 1 to this Act).

It is difficult to identify even a theoretical difference between a just and reasonable apportionment and an apportionment on another basis. But this change is presented on the basis that there may be such a difference.

This change makes minor amendments to a number of existing rules, but is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 13: TRADING AND PROPERTY INCOME: LEASE PREMIUMS ETC: RESTRICTIONS ON EXPENSES UNDER SECTIONS 63 AND 232 IN RESPECT OF TAXED RECEIPT: SECTIONS 66, 67, 233 AND 234

This change clarifies how expenses that a tenant is treated under section 37(4) of ICTA (property business) or section 87(2) of ICTA (trade) as incurring by reference to a taxed receipt are affected in certain cases. Those cases are where there is a reduction, under section 37(2) of ICTA (later chargeable amount) or under section 288 of ITTOIA (additional calculation rule), by reference to that taxed receipt.

It brings the income tax and corporation tax codes back into line.

Section 37(4) of ICTA provides:

Subject to subsection (5) below, a company which is for the time being entitled to the head lease shall be treated for the purpose, in computing the profits of a Schedule A business, of making deductions in respect of the disbursements and expenses of that business as paying rent for those premises (in addition to any actual rent), becoming due from day to day, during any part of the period in respect of which the amount chargeable on the superior interest arose for which the company was entitled to the head lease, and, in all, bearing to that amount the same proportion as that part of the period bears to the whole.

Section 37(5) of ICTA modifies section 37(4) of ICTA if the reduced amount of a later chargeable amount has been calculated under section 37(2) of ICTA by reference to the amount chargeable on the superior interest ("ACSI"). Section 37(5) of ICTA provides:

Where subsection (2) above applies, subsection (4) above shall apply for the period in respect of which the later chargeable amount arose only if the appropriate fraction of the amount chargeable on the superior interest exceeds the later chargeable amount, and shall then apply as if the amount chargeable on the superior interest were reduced in the proportion which that excess bears to that appropriate fraction.

The appropriate fraction is defined in section 37(7) of ICTA.

The general principle behind section 37(5) of ICTA is that, if part of ACSI has been used under section 37(2) of ICTA to reduce a later chargeable amount, only the balance of the ACSI should be available under section 37(4) of ICTA. This is achieved by reducing the amount of rent that the tenant is treated, in relation to the ACSI, as paying under section 37(4) of ICTA for the period in respect of which the later chargeable amount arose. And if (in the calculation under section 37(2) of ICTA) the appropriate fraction of the ACSI was fully used to reduce the later

chargeable amount, no rent is treated as incurred under section 37(4) of ICTA for the period in respect of which the later chargeable amount arises.

The same general principle applies under section 37A of ICTA where part of ACSI has been used under section 288 of ITTOIA (additional calculation rule). The appropriate fraction is defined in section 37A(6) and (7) of ICTA.

Section 87(5) of ICTA applies section 37(5) of ICTA (part of ACSI used under section 37(2) of ICTA) if a tenant under a taxed lease is treated as paying rent under section 87(2) of ICTA in circumstances in which section 87(4) of ICTA applies.

Section 87A of ICTA applies section 37A of ICTA (part of ACSI used under section 288 of ITTOIA) if a tenant under a taxed lease is treated as paying rent under section 87(2) of ICTA in circumstances in which section 87(4) of ICTA applies.

The following explanation is in terms of sections 37 and 87 of ICTA but is equally applicable to sections 37A and 87A of ICTA.

Later chargeable amount reduced by more than one ACSI

It is possible that:

- the reduced amount, under section 37(2) of ICTA, of a later chargeable amount is nil, and
- the reduced amount of nil has been calculated by reference to more than one ACSI, but
- the appropriate fraction of each ACSI does not exceed the later chargeable amount.

In these circumstances, section 37(5) of ICTA prevents any relief under section 37(4) of ICTA for the period in respect of which the later chargeable amount arose.

But it is more consistent with the principle behind section 37(5) of ICTA that if the *total* of the appropriate fractions of the ACSI involved exceeds the later chargeable amount, rent equal to that excess should be treated as paid for the period in respect of which the later chargeable amount arose. Otherwise, that excess will not be available to provide relief under section 37(4) of ICTA. It will be lost, unless it can be used in the calculation of a reduced amount for a different later chargeable amount.

To deal with such a case, section 233(3) uses the test that the "daily amount" of the taxed receipt must exceed the "daily reduction" of the lease premium receipt. Then section 233(6) (by reference to section 230(6)) limits the "daily reduction" of the lease premium receipt to the reduction that is attributable to the taxed receipt in question. The same change was made for income tax in section 293 of ITTOIA (see Change 15(A) in ITTOIA).

Overlap in periods for which more than one later chargeable amount is reduced by one ACSI

It is also possible that the reduced amount of more than one later chargeable amount has been calculated under section 37(2) of ICTA by reference to an ACSI and that the amount of each of the later chargeable amounts has been reduced to nil. In these circumstances, section 37(4) and (5) of ICTA work satisfactorily if there is no overlap between the periods in respect of which each of the later chargeable amounts arose. But it is not at all clear how section 37(4) and (5) of ICTA are intended to operate if there is such an overlap.

If there is an overlap between the periods in respect of which each of the later chargeable amounts arose, it is reasonable that section 37(5) of ICTA should apply so that the *total* of the reductions in all later chargeable amounts by reference to the ACSI should be taken into account in determining how much, if any, rent should be treated as paid under section 37(4) of ICTA.

To deal with such a case, section 233(2) and (5) make explicit provision if there is an overlap in the periods for which more than one lease premium receipt is reduced under section 228 or

under section 288 of ITTOIA by reference to a taxed receipt. The same change was made for income tax in section 293 of ITTOIA (see Change 15(A) in ITTOIA).

Without these changes, section 233 would produce the same result as section 37(5) of ICTA if there is one taxed receipt and one lease premium receipt. These changes make section 233 work if:

- a lease premium receipt is reduced by reference to *more than one* taxed receipt; or
- a taxed receipt reduces *more than one* lease premium receipt and there is an overlap in the periods in relation to which those lease premium receipts arise.

Section 66(2), (5) and (6) is based on that part of section 87(5) of ICTA that applies section 37(5) of ICTA. It includes similar changes to those in section 233. The same change was made for income tax in section 64 of ITTOIA (see Change 15(A) in ITTOIA).

Later chargeable amounts arise in relation to different parts of the premises covered by the head lease

Section 37(6) of ICTA provides for the application of section 37(4) and (5) of ICTA if the later chargeable amount is in respect of a lease of only part of the premises subject to the head lease.

Section 37(6) of ICTA does not deal with the possibility that:

- more than one lease of part of the premises is granted out of the head lease;
- later chargeable amounts in respect of each such lease are reduced under section 37(3) of ICTA by reference to ACSI; and
- there is an overlap in the receipt periods of those later chargeable amounts.

This possibility is dealt with in section 234(5). The same change was made for income tax in section 294 of ITTOIA (see Change 15(B) in ITTOIA).

Section 67 is based on that part of section 87(5) of ICTA that applies section 37(6) of ICTA. Section 67(4) includes a similar change to that in section 234. The same change was made for income tax in section 65 of ITTOIA (see Change 15(B) in ITTOIA).

Section 295 of ITTOIA (as amended by Schedule 1 to this Act) and section 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. So if, as a result of this change, the relief to which a company is entitled is increased or decreased, this may affect the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Act.

This change is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 14: TRADING INCOME ETC: CLARIFICATION OF POSITION OF EMPLOYEES SECONDED TO CHARITIES: SECTIONS 70 AND 1235 AND SCHEDULE 1

This change provides that a company which seconds an employee to a charity or educational establishment is entitled to a deduction in calculating its profits, irrespective of the duties undertaken by the employee while on secondment.

The change brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Section 86 of ICTA gives relief for companies which second employees to charities or educational establishments. It does this by providing that, notwithstanding anything in the general rules on deductions not allowable in section 74 or 75 of ICTA, the cost of the seconded employee:

> shall continue to be deductible in the manner and to the like extent as if, during the time that his services are so made available … they continued to be available for the purposes of the employer's trade …

So if the costs of the employee would not be allowed under the normal rules – for example because the employee is employed on a capital project – the employer is not entitled to any deduction under section 86 of ICTA.

In practice, the costs of the secondment are allowed whatever the nature of the work carried out by the employee during the secondment. So if, for example, an employee is seconded to a medical charity to help build a hospice, the company is allowed to deduct the cost of employing the seconded person. This change gives statutory effect to that practice.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZB of ICTA (inserted by Schedule 1 to this Act).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 15: DEVOLUTION: SECTIONS 71, 81, 83, 155, 1243, 1284, 1320 AND 1321 AND SCHEDULES 1 AND 2

This change concerns the effect of the devolution settlements.

The change brings the income tax and corporation tax codes back into line. It also applies to management expenses and to the establishment of marketing authorities and similar statutory bodies.

Sections 81 and 1243

The references to the Department for Employment and Learning in these sections reflect:

- the transfer of functions from the Department of Economic Development to the Department of Higher and Further Education, Training and Employment under Part II of Schedule 2 to SR (NI) 1999 No. 481; and
- the renaming of that Department as the Department of Economic Development by the Department for Employment and Learning Act (Northern Ireland) 2001.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZJ of ICTA (inserted by Schedule 1 to this Act).

Section 83

The approval function in section 79(4) of ICTA conferred on the Secretary of State is exercisable in relation to Scotland by the Scottish Ministers (see SI 1999/1750 made under section 63 of the Scotland Act 1998).

Section 83 of this Act reflects that transfer of functions. So far as the function under section 79(4) of ICTA is concerned, SI 1999/1750 is partly superseded by this Act. One consequence is that any change in the persons by whom those functions are exercisable will have to be made by primary legislation.

Section 155

Section 509 of ICTA provides special rules for the treatment of the statutory reserve funds which must in certain circumstances be maintained by certain statutory authorities. Section 509(3) of ICTA defines the terms "Minister of the Crown" and "government department" to include a "Head of Department or a Department in Northern Ireland".

Section 155(1) of this Act maintains parity of treatment throughout the United Kingdom following the recent devolution settlements by rewriting the definition of "Minister of the

Crown" to refer to a Minister of the Crown, the Scottish Ministers or the Welsh Ministers. Similarly, section 155(2) rewrites the definition of "government department" to refer to a government department, a Northern Ireland department, a part of the Scottish Administration, and a part of the Welsh Assembly Government.

Some functions that are relevant for the purposes of section 509 of ICTA were, as a result of transfers of functions, exercisable in relation to Wales by the Welsh Ministers (see SI 1969/388, SI 1978/272, SI 1999/672 and the Government of Wales Act 2006). Some functions that may be relevant for the purposes of section 509 of ICTA (but not the function of making schemes under section 13 of the Agriculture Act 1967) were, as a result of transfers of functions, exercisable for Scotland by the Scottish Ministers (see SI 1999/1747).

The effect of section 85(1) of the Government of Wales Act 2006 is that, so far as statutory functions that are relevant for the purposes of section 509(1) or (2) of ICTA are exercisable by the Welsh Ministers, the corresponding references in those subsections to "a Minister of the Crown or government department" include the Welsh Ministers.

Section 117 of the Scotland Act 1998 (construction of references to Ministers of the Crown in pre-commencement enactments) does not appear to be relevant for present purposes, as it relates only to the exercise of functions within devolved competence.

Section 1284

In Schedule 1 to the Interpretation Act 1978 "Act" is defined to mean an Act of Parliament and "enactment" is defined as not including "an enactment comprised in, or in an instrument made under, an Act of the Scottish Parliament". The definitions in that Schedule apply "unless the contrary intention appears" (see section 5 of the 1978 Act).

Section 578 of ICTA confers an exemption from tax in relation to housing grants made under any enactment. Under the Interpretation Act 1978 it is not clear that "enactment" covers Acts of the Scottish Parliament ("ASPs") or Scottish statutory instruments. And it is not clear that "enactment" covers all of the different kinds of legislation which may apply to Northern Ireland.

Sections 1320 and 1321 of this Act provide that ASPs, Scottish statutory instruments and Northern Ireland legislation are covered by the reference to "enactment" in section 1284. So payments under them are capable of falling within the exemption in that section. If this is a change, it is in line with practice, reflects the intention of the devolution settlement and widens the scope of the exemption.

It is very unlikely that these changes have any effect on any tax liabilities.

The changes are in line with current practice and reflect the devolution settlements.

CHANGE 16: TRADING INCOME ETC: RETRAINING COURSES: DEDUCTION NO LONGER DEPENDENT ON EMPLOYEE'S EXEMPTION: SECTIONS 74 AND 1238 AND SCHEDULE 1

This change removes the link in the source legislation between the employee's exemption and the employer's entitlement to a deduction.

This change brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Section 588(3)(b) of ICTA permits a deduction when:

> by virtue of section 311 of ITEPA 2003, no liability to income tax arises in respect of the payment or reimbursement [of retraining course expenditure].

The requirement for the deduction to be allowed in section 74(1) or 1238(1) is that the "relevant conditions" must be met. "Relevant conditions" is defined in section 74(2) or 1238(3) which cross-refer to the detail of the conditions in section 311 of ITEPA. That does not include the employee's exemption from tax under that provision.

This change removes the requirement that the employee must be exempt on the benefit under section 311 of ITEPA. An employee may not be taxable on the employment income at all. That may be on account of the employee's residence position or on account of where the duties of the employment are performed. In such a case there is no need to deny relief to the employer.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZD of ICTA (inserted by Schedule 1 to this Act).

The effect is that the employer's entitlement to a deduction ceases to be dependent, in part, on the employee's exemption.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 17: TRADING INCOME ETC: REDUNDANCY PAYMENTS: LEGISLATE THE PRACTICE OF ALLOWING VOLUNTARY PAYMENTS MADE IN CONNECTION WITH A CESSATION OF PART OF A TRADE OR BUSINESS: SECTIONS 79 AND 1242 AND SCHEDULE 1

This change legislates the practice of allowing as a deduction voluntary redundancy payments made in connection with the cessation of part of a trade or business.

The change brings the income tax and corporation tax codes into line. It also applies to management expenses.

Statement of Practice 11/81 extends the operation of section 90 of ICTA to payments in connection with the cessation of *part* of a trade. Section 79(1) and (4) of this Act gives effect to that practice. And section 1242(1) and (4) extends the rule to the case where a part of an investment business ceases to be carried on.

Schedule 1 to this Act amends ITTOIA to make clear that the practice applies to the cessation of part of a trade even if there is a change in the membership of a partnership.

If part of the trade or business continues, it would be possible to allow the deduction in the period of account in which the payment is made. But it is logical, and usually beneficial to the taxpayer, to make the deduction in the last period of account in which the part of the trade or business was carried on.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 18: TRADING INCOME ETC: CONTRIBUTIONS TO LOCAL ENTERPRISE ORGANISATIONS OR URBAN REGENERATION COMPANIES: DISQUALIFYING BENEFITS: SECTIONS 82, 1244 AND 1253 AND SCHEDULE 1

This change concerns the anti-avoidance rules in sections 79(3) and (9), 79A(3) and (4) and 79B(3) and (4) of ICTA.

The change brings the income tax and corporation tax codes back into line. It also applies for management expenses.

The aim of the anti-avoidance rules is to stop companies obtaining a deduction for contributions that have strings attached. For example, a company may give money to a local enterprise agency which is used to meet the costs of a shareholder's relative setting up in business. These costs would normally not be tax deductible. So the anti-avoidance rules are designed to prevent the costs becoming tax deductible by passing the money through a local enterprise organisation.

The denial of the deduction in the source legislation is "all or nothing". This may cause a problem. For example, a company gives £1 million to a training and enterprise council, but asks that employees be given free places on a word processing course (worth say £5000). The anti-avoidance rule bars any deduction under these provisions.

When section 79A of ICTA was enacted in 1990 an assurance was given that in a case such as this a deduction would be allowed. In practice HMRC ignore such benefits, or treat the payment as split into two, one part for the training and one for the donation.

Paragraph 47610 of the HMRC Business Income Manual makes it clear that relief is not denied if the costs of obtaining the benefit provided would have been allowable as a deduction if incurred directly on an arm's length basis. So the section disallows a deduction only if there is a "disqualifying benefit".

Even if there is a "disqualifying benefit" the deduction may not be lost entirely. Instead, the deduction is restricted to take account of the benefit.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZK of ICTA (inserted by Schedule 1 to this Act).

The change may give some relief in a case where the source legislation denies it because there is a benefit to the company making the contribution.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 19: TRADING INCOME ETC: INCOME CHARGED ON WITHDRAWAL OF RELIEF AFTER SOURCE CEASES: SECTIONS 82, 101, 108 AND 1277

This change treats certain amounts as post-cessation receipts and other amounts as if the source had not ceased.

It brings the income tax and corporation tax codes back into line.

Sections 79(9), 79A(4), 79B(4), 83A(4), and 84(4) of ICTA and section 55(4) of FA 2002 create a charge under Schedule D Case VI if the trader is not chargeable under Schedule D Case I or II in the accounting period in which a benefit is received. Section 491(3) of ICTA creates a similar charge on a distribution by a mutual concern. Section 584(4) of ICTA creates a charge under Schedule D Case VI if overseas income becomes remittable after the trade or other source of income has ceased.

This Act unpacks Schedule D Case VI charges and deals with the income where it logically belongs. If the income becomes trading income, by treating the benefit or distribution as a post-cessation receipt, this Act:

- allows the trader to make the same deductions as those available from other post-cessation receipts;
- removes any possibility that the benefit is charged both by the specific rule about benefits and by any general rule; and
- preserves the loss relief position by amending section 396 of ICTA and listing Chapter 15 of Part 3 of this Act in section 834A of ICTA (see Schedule 1 to this Act).

Section 1277(4) of this Act contributes to the unpacking of Schedule D Case VI charges. It treats the source of the overseas income as not having ceased, where income that was relieved under section 1275 ceases to be unremittable after the source has actually ceased. The income is then charged under the provision that would apply had section 1276 (withdrawal of relief) applied instead. The loss relief position under section 396 of ICTA is again preserved by Schedule 1 to this Act.

In some cases this change may allow relief for deductions from post-cessation receipts that are not available in the source legislation.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 20: TRADING INCOME: PATENT FEES PAID: SECTIONS 89 AND 90

This change sets out the basis on which a deduction is allowed for patent fees. It brings the timing of the deduction into line with the vast majority of deductions allowed in calculating trading income.

It brings the income tax and corporation tax codes back into line.

Section 83 of ICTA allows a deduction for "fees paid or expenses incurred" in connection with the grant of patents etc. It is thought that the "fees paid" are those paid when a patent application is made. Such fees are incurred only when they are paid. So it is unlikely that business accounts would recognise the fees until they are paid.

There is no doubt that "expenses" include "fees".

These sections allow a deduction for all expenses on the basis of the amounts incurred. In principle the rule in these sections may allow companies to take a deduction for fees earlier than the ICTA rule.

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

CHANGE 21: TRADING INCOME: PAYMENTS TO EXPORT CREDITS GUARANTEE DEPARTMENT: SECTION 91

This change allows payments to the Export Credits Guarantee Department ("ECGD") to be deducted in calculating the profits of a trade when the expense is payable rather than when it is paid.

It brings the income tax and corporation tax codes back into line.

Section 88 of ICTA allows a company carrying on a trade to deduct "sums paid" to the ECGD in calculating the profits of that trade.

Section 91 follows accounting treatment in allowing traders to deduct a payment to the ECGD at the time it is payable.

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

CHANGE 22: TRADING INCOME ETC: ALLOW ALL FISMA LEVIES AND COSTS: SECTIONS 92, 104 AND 1246 AND SCHEDULE 1

This change ensures that all payments of levies and costs under FISMA are allowed as deductions.

Trading income

Section 76A of ICTA allows a deduction for "any sum expended … in paying a levy". "Levy" is defined in section 76A(2) by listing the sorts of payment that may be required under FISMA.

- The first sort of payment relates to the legal assistance scheme in connection with hearings before the Financial Services and Markets Tribunal (see sections 134 to 136 of FISMA).
- The second sort of payment relates to the Financial Services Compensation Scheme. A levy in connection with this scheme may be made on an "authorised person" (see section 31 of FISMA) by the "scheme manager" (see section 212 of FISMA). The power to do this is in section 213(3)(b) of FISMA.

- The third sort of payment relates to the ombudsman scheme (see sections 225 to 234 of FISMA). The expenses of the scheme are funded by payments required from authorised persons by the Financial Services Authority under section 234 of FISMA.
- The fourth sort of payment relates to the ombudsman's "compulsory jurisdiction" (see section 226 of FISMA). Under paragraph 15 of Schedule 17 to FISMA the scheme operator may require a respondent (defined in section 226(1) to mean the person complained of) to pay a fee.
- The fifth sort of payment relates to the ombudsman's "voluntary jurisdiction" (see section 227 of FISMA). Under paragraph 18 of Schedule 17 to FISMA the scheme operator sets "standard terms" for dealing with complaints dealt with under the voluntary jurisdiction. Paragraph 18(3) of Schedule 17 allows the standard terms to require the making of payments to the scheme operator (paragraph (a)) and to include the award of costs (paragraph (b)).

The first four sorts of payment may be described as contributions towards the costs of running the schemes that are set up by FISMA. And, within the fifth sort of payment, the payments to the scheme operator also have the character of a contribution to running costs (in that case, of the voluntary jurisdiction).

It is clear that the contributions to running costs are allowable. But the position of "costs" is unclear. Section 76A(2)(e) excludes payments "other than an award which is not an award of costs under costs rules". "Costs rules" are defined in subsection (6) as rules made under section 230 of FISMA (which are not relevant to the voluntary jurisdiction) and rules contained in the "standard terms" for the voluntary jurisdiction. The standard terms published by the Financial Standards Authority do not distinguish between:

- the levies to be paid on the same basis as those for the compulsory jurisdiction; and
- the costs that may be awarded against a respondent.

Management expenses

Section 76B of ICTA allows a deduction for "any sums paid … by way of a levy or as a result of an award of costs under the costs rules". The definitions of "levy" and "costs rules" are imported from section 76A.

As with the trading income rule, it is clear that the contributions to running costs are allowable. But, unlike in the trading income rule, all "costs" are also allowable.

What the Act does

If section 76A(2)(e) of ICTA means that some costs are not allowable as a trading deduction it is difficult to explain why this is the case. So the trading income rule in section 92 is brought into line with the management expenses rule.

Section 76A of ICTA applies only to an "authorised person". But section 76B apparently applies more widely. It is conceivable that an unauthorised person may make a payment within section 76A. There is no reason why such a person should not have a trading deduction. So section 92 is not restricted to authorised persons.

Section 76A of ICTA does not apply to an "investment company". This rule was not changed when most of the rules about investment companies were amended to refer to companies with investment business. The rule applies only to give a deduction under Schedule D Case I. In the rare case of an investment company carrying on a trade there is no reason why it should not have a trading deduction. So section 92 does not exclude investment companies.

Amendments to section 155 of ITTOIA (see Schedule 1 to this Act) keep the income tax and corporation tax codes in line.

This change allows a deduction for some levies or costs that are not allowed by the source legislation.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 23: TRADING INCOME: REVERSE PREMIUMS: EXCLUDED CASES: SECTION 97

This change restores an exemption that was incorrectly removed by ITTOIA.

Paragraph 6 of Schedule 6 to FA 1999 exempted from the charge on reverse premiums a premium relating to an individual's only or main residence. The rule was rewritten for income tax in section 100(2) of ITTOIA. Paragraph 509(5) of Schedule 1 to ITTOIA omits paragraph 6 of Schedule 6 from FA 1999 on the assumption that the exemption is not relevant for corporation tax.

But paragraph 1(1)(a) of Schedule 6 to FA 1999 caters for different persons receiving the reverse premium and entering into the transaction. So it is possible for an individual to enter into a property transaction which relates to a residence but for a (connected) company to receive the reverse premium. In such a case the exemption is relevant to companies and this change reinstates it.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 24: TRADING INCOME: ASSETS OF MUTUAL CONCERNS: EXCLUDE DISTRIBUTIONS OF CHARGEABLE GAINS FROM THE CHARGE TO TAX: SECTION 101

This change defines the profits out of which a chargeable distribution is made so as to exclude distributions of chargeable gains.

It brings the income tax and corporation tax codes back into line.

Section 491(1) of ICTA excludes distributions of assets representing capital from the charge in subsection (3). Subsection (8) explains what is meant by such assets. It is generally understood that chargeable gains made by the concern do not represent capital as described in subsection (8). So distributions of such gains are within the charge in subsection (3).

Nevertheless, HMRC do not in practice seek to apply section 491 of ICTA to distributions of chargeable gains. The section adopts a positive approach to defining the distributions to which the section applies. The condition in section 101(1)(d) of this Act refers to profits of the mutual business. Chargeable gains are not profits of the mutual business and so the section reflects the current practice. So such gains are no longer within the charge in subsection (3).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 25: TRADING INCOME: SUMS RECOVERED UNDER INSURANCE POLICIES ETC: SECTION 103

This change gives statutory effect to the accountancy treatment for crediting a sum recovered under an insurance policy.

It brings the income tax and corporation tax codes back into line.

Section 74(1) of ICTA lists various items in respect of which no deduction is allowed in computing profits to be charged to corporation tax including:

((l) any sum recoverable under an insurance or contract of indemnity

A sum recovered under an insurance policy or contract of indemnity is a receipt and not therefore an item in respect of which a deduction would normally be made in calculating profits for corporation tax.

The courts have interpreted section 74(1)(l) of ICTA and the enactments from which it is derived as prohibiting the deduction of a loss or expense *to the extent that* the loss or expense is recovered under an insurance policy or contract of indemnity (even where that recovery is on capital account). See, for example, Lawrence LJ's description of the meaning of the equivalent provision in the Income Tax Act 1918[9] on page 381 of Green v J Gliksten and Son Ltd (1929), 14 TC 364 HL:

> in arriving at the balance of profits or gains there has to be no deduction in respect of a loss which is covered by insurance to the extent by which that loss is so recovered.

Section 103 achieves the same effect as section 74(1)(l) of ICTA by bringing a capital amount recovered into account as a trade receipt rather than by prohibiting a deduction in respect of the loss or expense in respect of which it is recovered. This makes the proposition easier to understand without changing the law.

Section 74(1)(l) of ICTA requires a deduction in respect of a loss or expense to be reduced by the amount of any insurance recovery. But where the loss and the recovery fall in different periods the accountancy treatment is to deduct the loss or expense in the period in which it is incurred and to credit the recovery in the period in which it arises.

In practice, HMRC allow traders to follow the accounting treatment in crediting the recovery. This informal concession is set out in paragraphs 40130 and 40755 of the HMRC Business Income Manual. Section 103 gives the concession statutory effect.

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

CHANGE 26: TRADING INCOME: GIFTS OF TRADING STOCK: DROP THE NEED FOR THE GIFT TO BE PLANT AND MACHINERY IN THE HANDS OF THE EDUCATIONAL ESTABLISHMENT: SECTION 105

This change removes the requirement that a gift to an educational establishment should qualify as plant and machinery in the hands of the educational establishment.

It brings the income tax and corporation tax codes back into line.

Section 84(1) of ICTA (gifts to educational establishments) gives relief for the gift of an article that "qualifies as plant or machinery". Subsection (2) sets out what those words mean. The similar relief in section 83A of ICTA for gifts of trading stock to charities does not have the same condition. The change brings the relief for gifts to educational establishments into line with the relief for gifts to charities. There is no longer the need for a gift to qualify as plant and machinery before relief can be given.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 27: TRADING INCOME: GIFTS OF TRADING STOCK: GIFTS "FOR THE PURPOSE OF" A CHARITY ETC: SECTION 105

This change brings the wording of the relief for a gift to a charity, a registered club or one of the special bodies listed in section 105(4) of this Act into line with that for a gift to an educational establishment.

It brings the income tax and corporation tax codes back into line.

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9 Paragraph (k) of Rule 3 of the rules applicable to Cases I and II of Schedule D

Section 84 of ICTA allows relief for a gift of an article "for the purposes of a designated educational establishment". Those words ensure that the relief is available even if the gift is made to a person (such as a local education authority) who becomes the legal owner of the article so that it can be used in a school. In many cases the gift is not "to" the school.

Section 83A of ICTA allows similar relief but in this case the gift must be "to" a charity. The section, instead, follows the section 84 model and allows relief for a gift "for the purposes of" a charity, a registered club or one of the listed bodies. This widens the circumstances in which relief is available.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 28: TRADING INCOME: GIFTS OF TRADING STOCK: DROP THE NEED FOR A CLAIM: SECTION 105 AND SCHEDULE 1

This change removes the requirement that a company should make a claim for relief on a gift to an educational establishment.

It brings the income tax and corporation tax codes back into line.

Section 84(3) of ICTA provides that the relief does not apply unless "the donor makes a claim". The general approach of this Act is not to require a claim for a trading deduction. In this case, the relief takes the form of removing the obligation to include a trade receipt. But the same principle applies here.

Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Act removes the reference to section 84 of ICTA in paragraph (a) of that subsection and does not replace it.

The similar relief for gifts to charities in section 83A of ICTA does not require a claim. So this change makes the two reliefs consistent.

The provisions that govern claims are not the same as the provisions that govern returns. But in practice dropping the need for a claim has only the following two consequences, both of which relate to the time available for "claiming" the relief.

First, the absolute time limit for making a claim is replaced by a time limit that may vary according to the particular circumstances. That may be because the return is issued late or because the taxpayer makes a late return. Accordingly, HMRC are no longer able to refuse a claim because it is late by reference to an absolute time limit: returns time limits and sanctions apply and they depend on the date the return was issued and submitted.

Second, mistake relief claims under paragraph 51 of Schedule 18 to FA 1998 are possible if too much tax is paid as a result of omitting the relief from the tax return. Claims under paragraph 51 of Schedule 18 to FA 1998 must be made within six years of the end of the accounting period to which the return relates.

This change is in taxpayers' favour in principle and may benefit some taxpayers in practice. But the numbers affected and the practical effects are likely to be small.

CHANGE 29: TRADING INCOME: GIFTS OF MEDICAL SUPPLIES AND EQUIPMENT: SECTION 107

This change makes clear that the reliefs for gifts out of trading stock of medical supplies apply only for corporation tax purposes.

In FA 2002:

- section 55 applies only to companies;
- the deduction for expenses in subsection (3) applies only for corporation tax purposes;

- subsections (3) and (4) refer to an "accounting period" of the company (which is a defined term only for corporation tax purposes); and
- the charge to tax under subsection (4) on any benefit attributable to the making of the gift is a charge to corporation tax.

This leaves open the theoretical possibility that the relief for the gift in subsection (2) (but not for the associated costs) is available to a non-UK resident company liable to income tax (because it carries on a trade in the United Kingdom other than through a permanent establishment in the United Kingdom). Any charge (under Schedule D Case VI) on a benefit received by such a company would be charged to corporation tax, even though the company is not otherwise within the charge to that tax.

It would be surprising if Parliament's intention was that subsection (2), but not subsection (3), should apply for income tax purposes; or that the charge on a benefit should be to a tax to which a company is not already chargeable.

In practice, it is very unlikely that trading stock could belong to a trade that is carried on in the United Kingdom, but not through a permanent establishment.

So section 107 of this Act rewrites section 55 of FA 2002 as providing only corporation tax relief and Schedule 1 to the Act repeals that section.

The change removes the possibility of income tax relief. But there is a minor theoretical benefit to taxpayers because the change also removes the possibility of a corporation tax charge on a company otherwise liable only to income tax.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 30: TRADING INCOME: HERD BASIS RULES: MEANING OF "SUBSTANTIAL PART OF HERD": SECTION 111 AND SECTION 118

This change gives statutory effect to the practice of treating 20% of the herd as substantial.

It brings the income tax and corporation tax codes back into line.

A number of sections in the herd basis rules refer to "a substantial part of the herd".

- section 116(1) (sale of animals from herd);
- section 117(1) (sale of whole or substantial part of herd);
- section 118(4) and (5) (acquisition of new herd begun within five years of sale);
- section 120(1) (replacement of part sold within five years of sale); and
- section 124(1) (slaughter under disease control order).

What constitutes a substantial part of the herd or a substantial difference is primarily a question of fact. But this change gives statutory effect to a long-standing practice set out in paragraph 55525 of the HMRC Business Income Manual. This provides that 20% of the herd will be regarded as substantial. This does not, however, prevent a smaller percentage from being regarded as substantial.

This change assists taxpayers because it provides for certainty and uniformity. It grants relief in circumstances where the test in the source legislation (evaluation of all the facts) might have been denied.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 31: TRADING INCOME: HERD BASIS RULES: SALE OF WHOLE OR SUBSTANTIAL PART OF HERD: SECTIONS 117 AND 118

This change merges the rules in paragraph 3(7) to (9) of Schedule 5 to ICTA.

It brings the income tax and corporation tax codes back into line.

Paragraphs 3(7) to (9) of Schedule 5 to ICTA set out the rules relating to the sale of all or most of a herd within 12 months.

Paragraph 3(7) of Schedule 5 to ICTA applies when a herd is sold as a whole and then replaced. Paragraph 3(8) of Schedule 5 to ICTA deals with cases where the whole of a herd is sold "in circumstances in which sub-paragraph (7) above does not apply". Or when a substantial part of a herd is sold. Paragraph 3(9) of Schedule 5 to ICTA sets out rules for the circumstances where paragraph 3(8) but not 3(7) of Schedule 5 to ICTA is relevant, provided that replacement begins to take place within five years.

ICTA does not make clear how quickly a herd must be replaced in order for paragraph 3(7) - rather than paragraph 3(8) of Schedule 5 to ICTA - to apply. This change merges these rules.

There are three practical differences between the application of the rules in paragraph 3(7) and those in paragraph 3(8) and 3(9) of Schedule 5 to ICTA.

First, paragraph 3(8) of Schedule 5 to ICTA directs that neither the profit nor the loss on the sale is to be taken into account. So, in effect, the farmer may obtain a tax-free gain on any profit from the sale. By contrast paragraph 3(7) of Schedule 5 to ICTA does not say how to deal with the proceeds of sale before it is known how many of the old herd will be replaced.

Second, if the farmer subsequently acquires a new production herd (which must be treated as a replacement herd) or animals to replace the part of the herd sold, paragraph 3(9) of Schedule 5 to ICTA recovers any tax-free gain made on the sale of the old animals. To achieve this the proceeds of the sale of each animal are brought into account at the time the replacement animal is acquired. By contrast paragraph 3(7) of Schedule 5 to ICTA contains no timing rule.

Third, in providing for the sale proceeds to be brought into account, paragraph 3(9) of Schedule 5 to ICTA allows the trading receipt to be reduced if the replacement animal is of worse quality than the old animal (on an enforced sale). Paragraph 3(7) of Schedule 5 to ICTA, however, does not permit such a reduction to be made.

Merging these rules removes these differences. It gives a common set of rules where a whole herd is sold, whether at once or over a period of up to a year. These are the rules set out in paragraphs 3(8) and (9) of Schedule 5 to ICTA.

Section 117 begins the process of merger by providing that in all cases where a herd or a substantial part of a herd is sold within a year the profit or loss which arises from that sale is not to be taken into account. That rule is then made subject to the rules which follow in section 118 and section 120 which concern the acquisition of a new herd or replacement of a substantial part of a herd respectively.

It is possible that merging the rules may disadvantage the farmer who sells a herd over a period of 12 months and replaces it with a new, smaller herd. In this case section 118(4) taxes the profit on the difference if the difference is not substantial. That subsection is based on paragraph 3(11) of Schedule 5 to ICTA and is consistent with herd rules viewed as a whole.

But it is arguable that paragraph 3(11) of Schedule 5 to ICTA does not apply to all disposals within paragraph 3(8) of Schedule 5 to ICTA. This is because paragraph 3(11) applies "Where the herd is sold as a whole" while paragraph 3(8) applies both if the herd is sold "either all at once or over a period not exceeding twelve months". But unless the rule in paragraph 3(11) of Schedule 5 to ICTA is applied to all cases where a herd is sold within a year it would be difficult, if not impossible, to merge the rules in paragraphs 3(7) to 3(9) of Schedule 5 to ICTA. This is because it would be necessary to distinguish between the two circumstances in paragraph 3(8)

in which a herd may be sold and apply different results to the two situations. This is likely to involve a more significant change in the law than the approach adopted in section 118(4).

This change assists taxpayers because it provides a single coherent set of rules.

This change may be adverse to some taxpayers because it removes the possible argument that paragraph 3(11) did not apply to circumstances to which paragraph 3(8) applied. In other words, it removes the possible argument that, where a farmer sells a herd over a period of 12 months and replaces it with a new herd which is not substantially smaller than the old one, the notional profit on the difference is not taxable.

This change may be favourable to some taxpayers because by applying the rule in paragraph 3(8) (that disposal proceeds are taxed only when acquisition costs are allowed) to circumstances to which paragraph 3(7) would have applied, the possibility that disposal proceeds are taxable immediately is removed.

This change is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 32: TRADING INCOME: HERD BASIS ELECTIONS: FIVE YEAR GAP IN WHICH NO PRODUCTION HERD KEPT: SECTION 123

This change gives statutory effect to the practice in paragraph 55630 of the HMRC Business Income Manual (BIM 55630).

It brings the income tax and corporation tax codes back into line.

Paragraph 4 of Schedule 5 to ICTA provides a special rule for herd basis elections where there is a gap of at least five years when the farmer does not keep a production herd of a particular class. The farmer is treated as never having kept such a production herd at all.

This approach sits oddly with the rule in paragraph 2(4) of Schedule 5 to ICTA that a herd basis election is irrevocable. It is not clear which rule has priority.

HMRC practice is to allow the farmer to decide whether or not the herd basis rules continue to apply. This is achieved by ignoring the previous election for the purposes of allowing the farmer to make a fresh election: farmers can either make a fresh election or do nothing. Section 123 gives this practice statutory effect.

This change allows the taxpayer to select the basis of taxation.

This change is in the taxpayer's favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 33: TRADING INCOME: SECURITIES HELD AS CIRCULATING CAPITAL: SECTION 129

This change dispenses with the requirement that securities within section 473 of ICTA must be securities to which the company is beneficially entitled.

It brings the income tax and corporation tax codes back into line.

Section 473 of ICTA contains special rules for the tax treatment of certain securities held as circulating capital, the profit on the sale of which would form part of the trading profits of a company. The effect is that neither a profit nor a loss is crystallised on a conversion of the securities.

It is not clear why section 473 of ICTA applies only to securities to which a company is beneficially entitled.

There is no reason to calculate a company's profits from dealing in securities in a fiduciary or representative capacity in a different way from a company's profits from dealing in securities beneficially held by the company.

So section 129 dispenses with the requirement that the company must be beneficially entitled to the shares in question. This means that section 129 applies to transactions by companies acting in a fiduciary or representative capacity as well as to companies dealing on their own behalf.

It also means that section 129 applies to securities in stock lending or sale and repurchase arrangements where beneficial ownership has passed to the company's counterparty but where the company continues to account for profits and losses as if those securities had not been disposed of.

A profit or loss on the conversion of securities to which this change applies is not recognised for tax purposes until the replacement securities are disposed of.

This change affects the timing of the tax liability. It is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 34: TRADING INCOME: TRADERS RECEIVING DISTRIBUTIONS ETC: SECTION 130 AND SCHEDULE 1

This change alters the test for bringing a distribution received from a UK resident company ("a UK distribution"), or a payment representative of such a distribution, into account in calculating the profits of a trade for corporation tax purposes from one based on the underlying shares to one based on the character of the receipt or payment.

It brings the income tax and corporation tax codes back into line.

Section 95 of ICTA sets out the circumstances in which a UK distribution or a payment "representative of" a UK distribution, is brought into account in calculating the corporation tax profits of the company by which the distribution is received or to which the payment is made.

Section 95 of ICTA operates by determining whether the company by which the distribution is received or to which the payment made is a dealer in relation to that distribution. Section 95(2) of ICTA tests whether the company is a dealer by reference to whether the proceeds of a notional sale by the company of the shares in respect of which the distribution is received or the payment made would be taken into account in calculating the profits of the company's trade.

This approach is a legacy of the origin of section 95 of ICTA. Section 95 of ICTA is derived from section 54 of FA 1982. Section 54 of FA 1982 was concerned with the tax treatment of a dealer from whom a company purchased its own shares. In that context it was logical to focus on the shares rather than on the distribution. But this has the problem not only that the sale is theoretical but also that the shares may not be held by the dealer when the distribution is received. It is no longer the logical approach now that section 95 of ICTA applies to all distributions received by share dealers.

So section 130 provides that:

- a UK distribution is brought into account in calculating the profits of a trade if it is a trade receipt; and
- a payment representative of such a distribution is brought into account in calculating the profits of a trade if a deduction for the payment would be disallowed only by section 1305.

Section 208 of ICTA provides that "except as otherwise provided by the Corporation Tax Acts" corporation tax is not chargeable on dividends and other distributions. Section 95(1A) of ICTA disapplies section 208 of ICTA in the case of a UK distribution, or a payment representative of such a distribution, received by a dealer.

Paragraph 2(2)(b) of Schedule 23A to ICTA provides that an amount representative of a dividend on UK shares (a "manufactured dividend") is treated in relation to the company by which it is paid as if it were a dividend on its own shares.

Section 337A(1)(a) of ICTA provides that "subject to any provision of the Corporation Tax Acts expressly authorising a deduction", a company's profits are to be computed "without any deduction in respect of dividends or other distributions". Section 95 of ICTA expressly provides for a payment representative of a UK distribution made by a company which is a dealer to be taken into account in computing the profits of that company.

Section 130 does not refer to a "dealer" (defined in section 95(2) of ICTA). So Schedule 1 to this Act replaces references to that definition. See the entries for section 26(7) of F(No 2)A 2005 and section 121(3) of FA 2006, where the replacement definitions reproduce the exclusion for insurance companies in section 95(2A) of ICTA.

HMRC believe it is highly unlikely that a UK distribution could be a receipt of a trade, or that the payment of an amount representative of a UK distribution could be allowed as a trade deduction, unless the proceeds of any sale of the shares giving rise to the distribution or payment would also be treated as a receipt or allowable expense of that trade. But if this is not the case, the change may in principle be unfavourable to some taxpayers by bringing into account a UK distribution which would otherwise be exempt under section 208 of ICTA and favourable to others by allowing a deduction for a payment representative of a UK distribution which would otherwise be disallowed under section 337A(1) of ICTA.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 35: TRADING INCOME ETC: COMBINE POOLS PAYMENTS RULES: SECTIONS 138 AND 978

This change combines sections 126 of FA 1990 and 121 of FA 1991.

It brings the income tax and corporation tax codes back into line.

Section 138 of this Act does not specify that payments in consequence of the 1990 reduction in pool betting duty must be made for the safety and comfort of football spectators, and that payments in consequence of the 1991 reduction in pool betting duty must be made to the Foundation for Sport and the Arts. Instead payments in consequence of any reduction in pool betting duty for either purpose will qualify.

Lord Justice Taylor's report into the Hillsborough disaster, published on 18 January 1990, recommended that significant capital expenditure should be incurred to improve safety and comfort at football grounds. To facilitate this the rate of pool betting duty was reduced from 42.5% to 40% in FA 1990, in exchange for an agreement that the money saved by pools promoters would be given to the Football Trust 1990, which would use it to implement the Taylor recommendations.

The following year the government agreed to a further reduction of 2.5% in pool betting duty on condition that the money saved was paid to a charitable trust to be set up by the three main pools companies. The trust is called the Foundation for Sport and the Arts. For legal reasons connected with pool betting duty, the Foundation's main purpose is the support of athletic sports and games, but up to one third of its funds may be used to promote the arts.

The objectives of sections 126 of FA 1990 and 121 of FA 1991 are to ensure that the money saved in pool betting duty can flow through to its intended purpose in full, without tax liabilities.

Because the source sections have very similar objectives and consequences, this Act combines them.

In principle a company could divert payments from one destination to the other and still obtain a deduction, but in practice (because the payments are made under agreements with the bodies concerned) this is not possible. Even if it were possible the payments would still be supporting the defined good causes.

Section 978 of this Act adopts the same approach to rewriting section 126(3) of FA 1990 and section 121(3) of FA 1991. The payments made are not treated as annual payments.

The payments covered by this change are allowed as trading deductions. And the payer does not have to deduct income tax from them.

This change is in taxpayers' favour in principle. But is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 36: TRADING INCOME ETC: EXTEND POOLS PAYMENTS TREATMENT TO THE 1995 REDUCTION: SECTIONS 138 AND 978

This change extends the treatment of payments in consequence of reductions in pool betting duty so that it applies to the reduction in pool betting duty made in any year.

It brings the income tax and corporation tax codes back into line.

Pool betting duty was reduced in 1990 and 1991 in exchange for agreements that the money saved would be paid to particular good causes (the Football Trust 1990 and the Foundation for Sport and the Arts, respectively).

Sections 126 of FA 1990 and 121 of FA 1991 were enacted to ensure that the money could flow through to the beneficiaries without tax consequences.

In 1995 pool betting duty was reduced again, with half of the money saved to be paid to the Football Trust and the other half to the Foundation for Sport and the Arts. But no equivalent tax legislation was enacted. In practice the payments are treated in the same way as those made from the 1990 and 1991 reductions.

Section 138 of this Act allows a trading deduction for payments made because of any reduction in pool betting duty. So the 1995 reduction and any further reductions which result in payments being made to the two "good causes" lead to the payments being allowed as a trading deduction.

Section 978 of this Act adopts the same approach to rewriting section 126(3) of FA 1990 and section 121(3) of FA 1991. The payments made are not treated as annual payments.

The payments covered by this change are allowed as trading deductions. And the payer does not have to deduct income tax from them.

This change is in taxpayers' favour in principle. But is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 37: TRADING INCOME: USE PERIOD OF ACCOUNT INSTEAD OF TAX YEAR AS THE BASIS FOR CERTAIN RESTRICTIONS ON RELIEF IN CONNECTION WITH A DEEMED EMPLOYMENT PAYMENT: SECTION 140

This change clarifies the calculation of the restriction of a deduction for a deemed employment payment and of the cap on expenses for partnerships that are treated as making a deemed employment payment.

Paragraph 18 of Schedule 12 to FA 2000 limits the deduction allowed by paragraph 17 of the Schedule in the case of a business carried on "by a partnership". The limit is the amount that reduces the profits of the partnership *for the tax year* to nil. Until 2005, when section 164 of ITTOIA rewrote the income tax rule, the rule was the same for both income tax and corporation tax.

The consequential amendments made by ITTOIA do not affect the wording of the limit, which continues to use "tax year", an expression which is defined only for income tax purposes (see paragraph 17(4) of Schedule 12 to FA 2000 and section 989 of ITA).

The profits of a trade carried on by a company in partnership are calculated as if the trade were carried on by a single company (see section 114(1) of ICTA, rewritten in this Act as section 1259). It is not sensible that a rule for calculating the profits of a company should apply to the profits of a tax year. Consistent with the rule in section 139, this partnership rule refers to the profits of a *period of account*.

Section 140(3) of this Act caps the allowable expenses by reference to the steps of the calculation of the deemed employment payment. That calculation is for a tax year (see section 54 of ITEPA). But the expenses are compared with the expenses of the trade carried on by a company in partnership. As with subsection (2), it is unreasonable to require a company to calculate its profits of a tax year. So the comparison is with the expenses for a period of account.

Changes in the period over which profits are calculated could in principle increase or decrease them by small amounts and so affect the amount of tax payable.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 38: TRADING INCOME: WASTE DISPOSAL: SITE PREPARATION EXPENDITURE: DROP REQUIREMENTS TO MAKE CLAIM AND SUBMIT PLANS AND DOCUMENTS: SECTION 142 AND SCHEDULE 1

This change drops the requirements to make a claim and submit plans and documents when making deductions under section 142.

It brings the income tax and corporation tax codes back into line.

Section 91B of ICTA allows a revenue deduction for capital expenditure on preparing a waste disposal site for use. The expenditure is spread over the life of the site by means of a formula based on the total capacity of the site and the amount of that capacity which has been used.

The company must make a claim for relief under section 91B(1) of ICTA (in such form as HMRC may direct), and submit such plans and documents as HMRC may require.

The requirement to submit plans and documents sits uneasily with Self Assessment – Part 3 of Schedule 18 to FA 1998 requires companies to keep such information and produce it in the event of an enquiry.

The section also drops the requirement to make a claim for relief, with the result that relief is simply a deduction in the company's self-assessment. Once the requirement to submit plans and documents is removed, there seems no reason to require a claim for this particular deduction as opposed to any other.

Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Act removes the reference to section 91B of ICTA in paragraph (a) of that subsection and does not replace it.

The claim under section 91B(1) of ICTA must be made within six years from the end of the accounting period to which it relates (paragraph 55 of Schedule 18 to FA 1998). Removing the need to claim means that companies generally have 12 months from the end of the accounting period in which to include the deduction in their self-assessment. However, mistake claims are available if too much tax has been paid as a result of omitting the deduction from the tax return.

In rare cases (involving the very late issue of a notice to make a return) the time limit for claiming a deduction is extended. In other cases (where there is no mistake in a return) the time limit is shortened.

This change is adverse to some taxpayers and favourable to others in principle but is not expected to have any practical effect.

CHANGE 39: TRADING INCOME: VALUATION OF STOCK: SECTIONS 164 TO 167 AND SCHEDULE 1

This change relaxes the conditions that apply if stock or work in progress is to be valued at the price actually paid when that stock or work in progress is transferred between persons who carry on trades, professions or vocations. It removes an unnecessary distinction between trades, professions and vocations.

It is possible for the same thing to be stock for one taxpayer but work in progress for another. Examples are the "incomplete services" part of stock (see section 100(2)(b) of ICTA, rewritten as section 163(2) of this Act) and the "materials" part of work in progress (see section 183(1) of ITTOIA).

The usual rule is that stock and work in progress are valued when a person ceases to carry on a trade profession or vocation at:

- open market value (stock – section 100(1)(b) of ICTA, rewritten for income tax as section 175(4) of ITTOIA and in this Act as section 164(4)); or
- arm's length value (work in progress – section 101(1)(b) of ICTA, rewritten for income tax as section 184(2) of ITTOIA).

But in each case there is an exception if the stock or work in progress is transferred to a person who carries on, or intends to carry on, a trade, profession or vocation in the United Kingdom and is entitled to deduct the cost of the stock or work in progress in calculating the profits of that trade, profession or vocation. In that case, the transfer takes place for tax purposes at the price actually paid (subject to special rules where the buyer and seller are connected or an election is made).

In the case of work in progress, the "actual price" basis of valuation applies only if the transferee carries on, or intends to carry on, a profession or vocation. This means that work in progress of a profession or vocation which is transferred to a trader (for whom it is trading stock) strictly does not qualify for the "actual price" basis of valuation.

In the case of trading stock, the "actual price" basis of valuation applies only if the transferee carries on, or intends to carry on, a trade. This means trading stock of a trade which is transferred to a person carrying on a profession strictly does not qualify for the "actual price" basis of valuation.

Corporation tax

In the case of trading stock transferred to an individual who carries on a profession or vocation, this Act allows the stock to be valued at the price actually paid (see sections 164 to 167 of the Act). That basis of valuation is not available under section 100(1)(a) of ICTA.

Professions and corporation tax

The reference to corporation tax in section 101 of ICTA was inserted by ITTOIA. As Change 2 explains, companies do not carry on professions for corporation tax purposes. So section 101 of ICTA is not needed for corporation tax and this Act repeals it. Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Act removes the reference to section 101(2) of ICTA in paragraph (a) of that subsection and does not replace it.

Income tax

This Act amends ITTOIA (see Schedule 1 to the Act).

In the case of trading stock transferred to an individual carrying on a profession or vocation, the amendments allow the stock to be valued in accordance with section 176, 177 or 178 instead of section 175(4) of ITTOIA.

In the case of professional work in progress transferred to an individual or a company carrying on a trade, the amendment allows the work in progress to be valued in accordance with section 184(1) instead of section 184(2) of ITTOIA.

Any change in the valuation rules for transfers of stock and work in progress is necessarily favourable to one of the parties to the transfer and adverse to the other. But the overall effect of this change is to give more choice to taxpayers.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

CHANGE 40: TRADING INCOME: DEDUCTIONS FOR UNREMITTABLE AMOUNTS: SECTIONS 172 TO 175

This change gives statutory effect to ESC C34 (tax concessions on overseas debts). In doing this the Act makes a number of changes to the approach in the extra-statutory concession.

It brings the income tax and corporation tax codes back into line.

(1) ESC C34 provides relief for trade debts that cannot be remitted to the United Kingdom. It is similar in scope to section 584 of ICTA, which provides relief for unremittable income arising outside the United Kingdom, including unremittable trade profits. But section 584 of ICTA does not extend to trade debts owed to, or paid to, the company outside the United Kingdom if the profits of the trade arise in the United Kingdom (for example, debts or payments arising from export sales). The extra-statutory concession gives relief for such debts and payments.

Chapter 12 of Part 3 of this Act gives statutory effect to the extra-statutory concession, extending relief for trade debts.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with current practice.

((B) ESC C34 requires the relief to be claimed. Section 173 provides for the relief to be allowed as a deduction in calculating the company's trade profits. In practice this makes little difference to the time limits but it simplifies the procedure for giving the relief.

Paragraph 5(d) of the extra-statutory concession gives the time limits for making the claim. Relief can be claimed no earlier than 12 months after the end of the accounting period in which the unremittable payment was received or the unremittable debt arose. If the Act repeated this time limit a company could not claim the relief before the filing date for the return for the period (assuming a notice to make the return was issued at the normal time). This would be an inconvenience to any company that wanted to file its return before that date.

There is one case in which the time limit for claiming the relief may be extended. The extra-statutory concession requires that the assessment for the accounting period has not become final and conclusive. The corporation tax self assessment equivalent of that is that the time limit for amending the return has not passed. Normally that time limit would expire 12 months after the filing date. Giving the relief as a deduction would allow the company to make a mistake claim up to six years from the end of the accounting period to which the return relates.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

((C) Paragraph 4 of the extra-statutory concession denies any relief for a debt to the extent that the debt is insured. Section 174(2) (restrictions on relief) denies relief only to the extent that an insurance recovery has been received in respect of the debt. Also section 175(2)(f) withdraws relief only to the extent that an insurance recovery has been received in respect of the debt.

Accordingly a limitation on the amount of relief available is relaxed.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 41: TRADING INCOME: DISPOSAL OF KNOW-HOW: RESTORE AN EXPRESS DEFINITION OF MINERAL DEPOSITS: SECTIONS 176 AND 908

This change restores a previous definition of "mineral deposits".

It brings the income tax and corporation tax codes back into line.

The definition of "mineral deposits" in these sections is in substance the definition that applied for the purposes of the definition of "know-how" in the source legislation for section 176 of this Act. That definition applied before certain amendments of Chapter 1 of Part 13 of ICTA were made by CAA.

Section 531 of ICTA makes provision about the tax treatment of certain disposals of know-how. Different provision is made about disposals of know-how that has been used in the course of a trade and other disposals of know-how. The former provision is rewritten in sections 177 and 178 of this Act.

Section 533 of ICTA defines know-how for the purposes of section 531 of ICTA as:

> any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Before certain amendments of ICTA were made by CAA, the following definition applied to the expression "mineral deposits" in that definition:

"mineral deposits" includes any natural deposits capable of being lifted or extracted from the earth and, for this purpose, geothermal energy, whether in the form or aquifers, hot dry rocks or otherwise, shall be treated as a natural deposit.

The history of that definition is as follows. The provisions of section 531 of ICTA derive from section 21 of FA 1968, which included the following definition:

((7) In this section "know-how" means any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery, or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Subsection (9) of that section required the above definition to be construed as if it were contained in Part 1 of the Capital Allowances Act 1968, so that the following definition of "mineral deposits" applied:

"mineral deposits" includes any natural deposits capable of being lifted or extracted from the earth.

That definition was amended by paragraph 2(3) of Schedule 13 to FA 1968, which added the words from "and, for this purpose" onwards.

The relevant provisions were consolidated in 1970 and again in 1988. Section 532 of ICTA originally provided for the definition of "know-how" to be construed as if it were contained in Part 1 of the Capital Allowances Act 1968. A reference to "the 1990 Act" was substituted by CAA 1990. This attracted the definition of "mineral deposits" which is set out above in the fifth paragraph of this note, and applied throughout that Act.

CAA rewrote provisions about know-how allowances that were previously in Chapter 1 of Part 13 of ICTA. In consequence of the repeal of CAA 1990, CAA also amended section 532 of ICTA with the result that it provides for the definition of "know-how" to be construed as if it were contained in the 2001 Act. However, no definition of "mineral deposits" applies for the purposes of CAA as a whole. So the consequential amendment failed to preserve the application of CAA 1990 definition of "mineral deposits" to the remaining provisions of Chapter 1 of Part 13 of ICTA (including those on which sections 176 and 908 are based).

It is noteworthy that a version of the definition of "mineral deposits" is carried forward in CAA to apply to the rewritten material about know-how allowances. See section 452(3) of that Act.

The failure to preserve the application of CAA 1990 definition of "mineral deposits" to the remaining provisions of Chapter 1 of Part 13 of ICTA is believed to have resulted from an oversight. The inclusion of a definition of "mineral deposits" in sections 176 and 908 corrects this error.

The definition of "mineral deposits" in sections 176 and 908 of this Act differs from the definition formerly in section 161(2) of CAA 1990 in that the words "whether in the form of aquifers, hot dry rocks or otherwise" are omitted. The definition of "mineral deposits" in section 452(3) of CAA also omits these words. The omission was made in that Act on the basis that the words are merely illustrative and that leaving them out does not change the legal effect of the definition. They are omitted in this Act for the same reasons. A fuller discussion of this point can be found in Note 46 in Annex 2 to the explanatory notes to CAA.

This change clarifies the law by making it certain that the definition of "mineral deposit" continues to apply for the purposes described above.

This change clarifies the law and removes uncertainty. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 42: TRADING AND PROPERTY INCOME: POST-CESSATION RECEIPTS: REINSTATEMENT OF SECTION 108 OF ICTA: SECTIONS 198 TO 200 AND 286

Section 108 of ICTA allowed a taxpayer to elect to have a post-cessation receipt carried back to the year in which the trade ceased. For income tax it is rewritten as section 257 of ITTOIA.

When ITTOIA was enacted it was thought that section 108 of ICTA applied only for income tax. So the section was repealed.

Until 1996 an election to carry a post-cessation receipt back to the year of cessation resulted in an assessment for the year of cessation. So section 108 of ICTA provided that an assessment for that year could be made even if it was otherwise out of time for assessment. That treatment was inconsistent with (income tax) Self Assessment. So the relief is given in terms of tax (see paragraph 5 of Schedule 1B to TMA). The power to make late assessments was removed by FA 1996.

When Self Assessment for corporation tax was introduced Schedule 1B to TMA ceased to apply for corporation tax (see section 117(1)(a) of FA 1998). Paragraph 58 of Schedule 18 to FA 1998 deals in general terms with claims (such as one under section 108 of ICTA) which affect more than one accounting period. But there is no rule corresponding to the income tax rule in paragraph 5 of Schedule 1B to TMA.

Section 198 gives a company the right to elect to carry back a post-cessation receipt to the accounting period in which it ceased to carry on the trade. Sections 199 and 200 set out the form of the relief, which is modelled on the income tax relief in paragraph 5 of Schedule 1B to TMA.

Section 286 applies the relief to UK property businesses.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 43: PROPERTY INCOME: LEASE PREMIUMS ETC: IDENTIFYING WHEN A COMPANY (NOT THE LANDLORD) TAKES AMOUNTS INTO ACCOUNT AS A RECEIPT IN CALCULATING THE PROFITS OF A PROPERTY BUSINESS: SECTIONS 217, 219, 220 AND 221

This change explicitly identifies the period in which a company (not being the landlord) is required to take account of a receipt which it is treated as receiving in respect of a lease premium (or an amount that is treated as a lease premium).

It brings the income tax and corporation tax codes back into line.

For corporation tax purposes, section 34(1), (4) and (5) of ICTA provide for cases in which a landlord is treated as receiving rent and also for the time at which the landlord is treated as receiving that rent. Section 34(7A) of ICTA then explicitly deals with the period in which that deemed rent must be brought into account.

If section 34(6) of ICTA applies, the landlord is not treated as receiving an amount of rent but a company (not being the landlord) is treated as receiving an equivalent amount as a receipt of a property business. Section 34(7A) of ICTA does not explicitly deal with the period in which the company (not being the landlord) must bring the equivalent amount into account. That is because section 34(7A) of ICTA is expressed in terms of amounts that section 34 of ICTA treats as rent and section 34(6) of ICTA does not expressly treat the company (not being the landlord) as receiving rent.

In practice, receipts under section 34(6) of ICTA are brought into account as if section 34(7A) of ICTA applied to them (in other words at the same time as the landlord would otherwise have had to bring them into account). Sections 217(3), 219(3), 220(3) and 221(3) reflect this practice. The same change was made for income tax in sections 277, 279, 280 and 281 of ITTOIA (see Change 69(A) in ITTOIA).

This change has no implications for the amount of income liable to tax or who is liable for tax on it. In principle it affects the timing of the tax liability but it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 44: PROPERTY INCOME: LEASE PREMIUMS ETC: SUMS PAYABLE INSTEAD OF RENT, OR FOR THE VARIATION OR WAIVER OF A TERM OF A LEASE, FOR PERIODS OF 50 YEARS OR LESS: SECTIONS 219 AND 221

This change explicitly applies the lease premium rules to certain sums paid instead of rent, or for the variation or waiver of a term of a lease, in cases where:

- the period for which the sum is paid, or the variation or waiver has effect, is 50 years or less, and
- the duration of the lease is more than 50 years.

It brings the income tax and corporation tax codes back into line.

For corporation tax purposes, section 34(1) of ICTA treats part (or all) of certain premiums ("CP"), payable in relation to a lease, as rent received by the landlord. In order for section 34(1) to apply to CP the lease in question must be one whose:

> duration…does not exceed 50 years.

Section 34(4) of ICTA is an anti-avoidance provision. It treats certain sums ("CS") payable in lieu of rent by the tenant as if they were CP. This treatment potentially feeds through to section 34(1) of ICTA. But for section 34(1) to apply the duration of the lease must not exceed 50 years. In this respect section 34(4)(a) of ICTA also provides that:

> in computing the profits of the Schedule A business of which the sum payable in lieu of rent is by virtue of this subsection to be treated as a receipt, the duration of the lease shall be treated as not including any period other than that in relation to which the sum is payable.

On one interpretation the deeming in section 34(4)(a) of ICTA does not affect the duration of the lease for the purposes of section 34(1) of ICTA. If this interpretation were correct, then the treatment of CS for a period of one year would differ depending on whether the duration of the lease was 50 years or 51 years. Then in the case of the lease with a duration of 50 years, all of CS could be treated as a rental receipt by the landlord under section 34(1) of ICTA (with the tenant eligible for relief on CS). But in the case of the lease with a duration of 51 years, none of CS could be treated as a rental receipt under section 34(1) of ICTA (and the tenant might not be eligible for relief on CS).

Since the lease premium legislation was introduced in 1963, HMRC have not accepted such an interpretation. Section 219(1)(b) follows, for corporation tax, HMRC's interpretation of section 34(4)(a) of ICTA. The same change was made for income tax in section 279(1)(b) of ITTOIA (see Change 68 in ITTOIA).

Section 34(5) of ICTA is also an anti-avoidance provision. It treats certain sums payable for the variation or waiver of the terms of a lease as if they were CP. This treatment also potentially feeds through to section 34(1) of ICTA. But for section 34(1) to apply the duration of the lease must not exceed 50 years. In this respect section 34(5)(a) of ICTA also provides that:

> in computing the profits of the Schedule A business of which that sum is by virtue of this subsection to be treated as a receipt, the duration of the lease shall be treated as not including any period which precedes the time at which the variation or waiver takes effect, or falls after the time at which it ceases to have effect.

On one interpretation the deeming in section 34(5)(a) of ICTA does not affect the duration of the lease for the purposes of section 34(1) of ICTA. The same considerations apply to this interpretation as have been noted above in relation to section 34(4)(a) of ICTA.

Since the lease premium legislation was introduced in 1963, HMRC have not accepted such an interpretation. Section 221(1)(c) follows, for corporation tax, HMRC's interpretation of section 34(5)(a) of ICTA. The same change was made for income tax in section 281(1)(c) of ITTOIA (see Change 68 in ITTOIA).

This change prevents a company from contending, in certain cases, that a property business receipt does not arise or arises in a smaller amount. But correspondingly a tenant under the lease in question will not face a contention that there is no taxed receipt (or a smaller taxed receipt) by reference to which the tenant may be entitled to relief.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 45: PROPERTY INCOME: LEASE PREMIUMS ETC: SUM PAYABLE TO SOMEONE OTHER THAN THE LANDLORD, OR A PERSON CONNECTED WITH LANDLORD, FOR VARIATION OR WAIVER OF TERM OF LEASE: SECTION 221

This change prevents an amount being treated as a receipt of the landlord's property business, where a sum is payable by the tenant as consideration for the variation or waiver of a term of a lease to somebody other than the landlord or a person connected with the landlord.

It brings the income tax and corporation tax codes back into line.

Section 34(5) of ICTA provides:

Where, as consideration for the variation or waiver of any of the terms of a lease, a sum becomes payable by the tenant otherwise than by way of rent, the lease shall be deemed for the purposes of this section to have required the payment of a premium to the landlord (in addition to any other premium) of the amount of that sum …

The effect of this deeming may be to treat the landlord as receiving an amount by way of rent. This is subject to section 34(6) and (7) of ICTA.

Section 34(6) of ICTA provides that if a payment falls within section 34 (5) of ICTA but is due to a person other than the landlord, the landlord is not treated as receiving rent. And if the other person is a company, section 34(6) of ICTA treats that company as receiving an income receipt equal to the rent that the landlord would otherwise have been treated as receiving under section 34(5) of ICTA.

But section 34(7) of ICTA provides that section 34(6) of ICTA applies only in relation to a payment within section 34(5) of ICTA if the payment is due to a person who is connected with the landlord.

It follows that section 34(5) of ICTA might treat the landlord as receiving rent in cases where the consideration for the variation or waiver is not payable to the landlord (with the tenant potentially receiving relief for the amount of rent the landlord is treated as receiving). This is not the intention of section 34(5) of ICTA. In practice a landlord has not been treated as receiving, nor the tenant entitled to relief for, rental income in such cases. Section 221(1)(b) reflects that practice for corporation tax. The same change was made for income tax in section 281 of ITTOIA (see Change 70 in ITTOIA).

Relief will not be available to a tenant by reference to a property business receipt if, as a result of this change, a property business receipt does not arise to the landlord.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 46: PROPERTY INCOME: LEASE PREMIUMS ETC: ADDITIONAL CALCULATION RULE MAY REDUCE RECEIPTS IN RESPECT OF SUMS PAYABLE FOR VARIATION OR WAIVER OF A TERM OF A LEASE: SECTIONS 221, 227, 228, 229 AND 234

This change permits reductions, under the additional calculation rule, in arriving at the amount of a property business receipt arising in relation to the variation or waiver of a term of a lease.

It brings the income tax and corporation tax codes back into line.

Section 37(2) of ICTA (the additional calculation rule) permits a reduction, in certain cases, in arriving at the amount of a property business receipt that would otherwise be given by section 34 or 35 of ICTA. Section 37(2) of ICTA applies if:

(a) a lease is granted out of, or there is a disposition of, the head lease, and

(b) in respect of that grant or disposition a company would…be treated by virtue of section 34 or 35 as receiving any amount…

Where section 34(5) of ICTA gives rise to a property business receipt the receipt arises in respect of:

the variation or waiver of any of the terms of a lease

So section 37(2) of ICTA does not appear to allow a reduction in arriving at a property business receipt arising because of section 34(5) of ICTA (amount in respect of variation or waiver). But, in practice, such a reduction is allowed.

Sections 221(5), 227(1) and (3), 228(2), 229(2) and 234(1) and (2) explicitly provide for a reduction in the calculation of a receipt under section 221 (sums payable for variation or waiver of terms of lease). The same change was made for income tax in sections 281, 287, 288, 289 and 294 of ITTOIA (see Change 71 in ITTOIA).

Section 295 of ITTOIA (as amended by Schedule 1 to this Act) and section 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. So if, as a result of this change, the relief to which a company is entitled is increased, this may reduce the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Act.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 47: PROPERTY INCOME: LEASE PREMIUMS ETC: RECEIPTS IN RESPECT OF SALES WITH RIGHT TO RECONVEYANCE AND SALE AND LEASEBACK TRANSACTIONS: SECTIONS 224 AND 225

This change provides that a property business receipt does not arise in respect of a sale with a right to a reconveyance (or a sale and lease back transaction) unless the period between the sale and the earliest date of reconveyance (or leaseback) is 50 years or less.

It brings the income tax and corporation tax codes back into line.

Section 36(1) of ICTA provides for a property business receipt to arise where, broadly, an interest in land is sold (for price "A") and the terms of sale provide for the interest to be reconveyed (for lower price "B") to the vendor or someone connected with the vendor. The property business receipt that arises is, in effect, the following percentage of

(A # B)

:

2 × (51 T)%,

where:

T is the number of complete years between the sale and the earliest date of reconveyance (but not greater than 51), if the number of complete years is at least 2, and

T is 1, if the number of complete years is less than 2.

If the earliest date of reconveyance is more than 51 years after the sale, the property business receipt under section 36(1) of ICTA will always be zero. The same result is achieved by an approach under which a property business receipt does not arise if the earliest date of reconveyance is more than 51 years after sale (an approach taken by sections 34 and 35 of ICTA).

Sections 34 and 35 of ICTA adopt 50 years as the interval which determines whether a property business receipt arises. Adopting a similar interval for the purposes of section 36(1) of ICTA is taxpayer favourable.

Exactly the same considerations apply in relation to section 36(3) of ICTA (sale and leaseback) as are set out above in relation to section 36(1) of ICTA.

Sections 224(1)(b) and 225(1)(b) change the law, for corporation tax, by providing an interval of 50 years to determine whether a property business receipt arises in the case of a sale with a right to reconveyance or a sale and leaseback transaction. The same change was made for income tax in sections 284 and 285 of ITTOIA (see Change 72 in ITTOIA).

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 48: PROPERTY INCOME: LEASE PREMIUMS ETC: RELIEF FOR TENANT UNDER TAXED LEASE IF LAND IS OUTSIDE THE UNITED KINGDOM: SECTION 227

This change restores a relief that was incorrectly removed from ICTA by ITTOIA.

It brings the income tax and corporation tax codes back into line.

Section 37(1) of ICTA provides that:

This section applies in any case where in respect of a lease of any premises-

(a) any amount falls to be treated as a receipt of a Schedule A business by virtue of section 34 or 35,…

((c) any amount falls to be treated as a receipt of *a UK property business* by virtue of any of sections 277 to 282 of ITTOIA 2005 (receipts in respect of lease premiums, sums payable instead of rent, for surrender of lease and for variation or waiver of term of lease and assignments),…

That subsection sets out the condition for the availability of the reliefs given by section 37(2) or (4) of ICTA (reduction of later chargeable amount or tenant treated as paying rent). Each of those reliefs applies in calculating the profits of a Schedule A business.

Section 70A(5) of ICTA provides that:

> income from an overseas property business shall be computed for the purposes of Case V of Schedule D in accordance with the rules applicable to the computation of the profits of a Schedule A business.

Section 70A(5) of ICTA therefore extends the reliefs under section 37 of ICTA to land outside the UK.

Where section 37(2) or (4) of ICTA applies in relation to land outside the UK, the reference in section 37(1)(a) of ICTA to a receipt of a Schedule A business must be read as a reference to a receipt of an overseas property business.

Section 37(1)(c) of ICTA was inserted by paragraph 20(2)(b) of Schedule 1 to ITTOIA to provide for relief under section 37 of ICTA where the superior landlord is liable to income tax. But because section 37(1)(c) refers to a UK property business (see italicised words above) it excludes relief in the case where the superior landlord was liable to income tax in respect of a property outside the UK.

The relief corresponding to section 37 of ICTA in sections 287 to 295 of ITTOIA applies to property outside the UK in the same way as to property in the UK.

The reference to a "UK property business" in section 37(1)(c) of ICTA was introduced in error when that paragraph was inserted by ITTOIA. Section 227(4) corrects that error and is in line with the corresponding ITTOIA provision (section 287(4) of that Act, as amended by Schedule 1 to this Act). The change will result in a company receiving relief in circumstances where there is currently no entitlement to relief.

Section 295 of ITTOIA (as amended by Schedule 1 to this Act) and section 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. So if, as a result of this change, the relief to which a tenant is entitled is increased, this may reduce the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Act.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

CHANGE 49: PROPERTY INCOME: LEASE PREMIUMS ETC: LIMITING THE REDUCTIONS IN RECEIPTS UNDER SECTION 228 AND THE DEDUCTIONS FOR EXPENSES UNDER SECTION 232: SECTIONS 227, 228, 229, 230, 231 AND 235

This change concerns the way section 37(9) of ICTA is rewritten for corporation tax.

It brings the income tax and corporation tax codes back into line.

Section 37(9) of ICTA provides:

An amount or part of an amount *shall not be deducted under this* section more than once from any sum, or from more than one sum, and shall not in any case be so deducted if it has been otherwise allowed as a deduction in computing the income of any person for income tax or corporation tax purposes or if it has been deducted under the rule in section 288 of ITTOIA 2005 (the additional calculation rule) in calculating the amount of a receipt of a property business (within the meaning of that Act) under Chapter 4 of Part 3 of that Act

Those words do not fit well with the rest of section 37 of ICTA and their effect on the rest of that section is not entirely clear. The italicised words "An amount" in section 37(9) of ICTA must refer to the amount chargeable on the superior interest ("ACSI" – see section 37(1) of ICTA) because the reliefs under section 37(2) and (4) of ICTA depend on ACSI. But the italicised words "shall not be deducted under this section" are not, strictly speaking, appropriate since neither of section 37(2) or (4) of ICTA is explicitly expressed as providing a deduction.

In construing section 37(9) of ICTA it is relevant to consider the rationale underlying the rest of section 37 of ICTA. Sections 34, 35 and 37 of ICTA broadly deal with one person (landlord/ assignor) who, in relation to a lease, receives a sum from another person (tenant/assignee). Sections 34 and 35 of ICTA may treat a property business receipt (of amount X) as arising to the landlord/assignor. Section 37 of ICTA sets out two ways in which the tenant/assignee (or a successor) may obtain relief, effectively as a property business expense, in respect of X.

The rationale for section 37(9) of ICTA is that the total relief for the tenant/assignee (or successors) under section 37(2) and (4) must not exceed X (as reduced by relief that the tenant/ assignee (or successor) has obtained in respect of X under other provisions such as section 87 of ICTA).

Section 235 makes this rationale explicit for corporation tax. The same change was made for income tax in section 295 of ITTOIA (see Change 73 in ITTOIA).

Section 37(2) and (4) of ICTA is also difficult to construe because neither subsection explicitly says how section 37(9) of ICTA affects the relief for which it provides.

Sections 227(5), 228(3), 229(4), 230(1), (5) and (6) and 231(4) make explicit the effect that section 37(9) of ICTA has on section 37(2) and (4) of ICTA. This is facilitated by the use (in section 228(3)) of the concept of the "unused amount" of a taxed receipt (corresponding to ACSI in ICTA). And providing that, in relation to a taxed receipt, relief under each of section 228, (corresponding to section 37(2) of ICTA) and section 231 (corresponding to section 37(4) of ICTA) must not result in that relief (taken with other relief under those, and other, provisions) of more than the taxed receipt. The same change was made for income tax in sections 287 to 292 of ITTOIA (see Change 73 in ITTOIA).

Section 235 restricts total relief to the taxed receipt in question. A tenant/assignee (or successor) is entitled to relief only if the taxed receipt in question has an "unused amount". Each relief, in relation to the taxed receipt in question, reduces the unused amount of that taxed receipt and therefore the relief available in future to the tenant/assignee (or successor) by reference to that taxed receipt. Making this explicit is, in principle, favourable to a tenant/assignee and unfavourable to a successor because the tenant/assignee's relief arises before that of the successor.

This change is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 50: PROPERTY INCOME: LEASE PREMIUMS ETC: RULES FOR DETERMINING EFFECTIVE DURATION OF LEASE: SECTION 243 AND SCHEDULE 1

This change makes some minor adjustments to the rules for determining the effective duration of a lease.

Section 38(1) of ICTA provides:

In ascertaining the duration of a lease for the purposes of sections 34 to 36-

(a) in any case where --

((i) any of the terms of the lease (whether relating to forfeiture or any other matter) or any other circumstances render it unlikely that the lease will continue beyond a date falling before the expiry of the term of the lease, and

((ii) the premium was not substantially greater than it would have been, on the assumptions required by subsections (3) and (4) below, had the term been one expiring on that date,

the lease shall not be treated as having been granted for a term longer than one ending on that date.

Rule 1 in section 303(1) of ITTOIA is in similar terms.

Section 38(1)(a) of ICTA and rule 1 in section 303(1) of ITTOIA do not prevent the lease being treated as expiring before the date on which it is thought likely that the lease will in fact end. But it is difficult to see what justification there could be for treating a lease as ending before that date.

Accordingly, rule 1 in section 243(1) requires the lease to be treated as ending on the date beyond which it is unlikely that the lease will continue. It will no longer be possible to contend that the lease should be treated as ending before that date. Schedule 1 amends rule 1 in section 303(1) of ITTOIA in line with rule 1 in section 243(1).

Section 38(1)(a) of ICTA and rule 1 in section 303(1) of ITTOIA will give a date falling before the expiry of the lease in question only if:

> the premium was not substantially greater than it would have been … had the term been one expiring on that date.

Section 34(2), (4) and (5) of ICTA deems, in certain cases, amounts to be premiums for the purposes of section 34 of ICTA.

Section 278 of ITTOIA deems, in certain circumstances, an amount to be a premium for the purposes of section 277 of ITTOIA. Sections 279 to 281 of ITTOIA provide, in certain cases, for amounts to be taken into account in a way that is similar to section 277 of ITTOIA's treatment of premiums (but without deeming those amounts to be premiums).

It has been HMRC practice to treat sums deemed to be premiums in section 34 of ICTA as if they were also premiums for the purposes of considering under section 38(1)(a)(ii) of ICTA whether the premium was not substantially greater than it would have been had the term been one expiring on the date in question.

Section 243(3) reflects this practice by providing that "premium" in rule 1 includes such deemed sums. Schedule 1 inserts section 303(2A) of ITTOIA containing a corresponding definition of "premium" for the purposes of rule 1 in section 303(1) of ITTOIA.

This makes rule 1 in section 243(1) and in section 303(1) of ITTOIA less likely to apply because the (larger) premium is less likely to be "not substantially greater" than the premium expected had the term been one expiring on the date in question.

In some cases the question of whether or not there is a property business receipt and, if so, how much depends on the effective duration of the lease. If, as a result of this change, the effective duration of a lease is made longer, a landlord may have a smaller property business receipt than would otherwise have been the case and a tenant may correspondingly be entitled to less relief.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 51: PROPERTY INCOME: FURNISHED HOLIDAY ACCOMMODATION: PERMITTED LONGER-TERM OCCUPATION: SECTION 267

This change alters the period during which, in order to qualify for the special tax treatment of the commercial letting of furnished holiday accommodation, the accommodation must not be occupied for more than 31 days at a time.

It brings the income and corporation tax codes back into line.

Section 504(3) of ICTA provides:

((3) Accommodation shall not be treated as holiday accommodation for the purposes of this section unless–

(a) it is available for commercial letting to the public generally as holiday accommodation for periods which amount, in the aggregate, to not less than 140 days;

(b) the periods for which it is so let amount in the aggregate to at least 70 days; and

(c) for a period comprising at least seven months (which need not be continuous but includes any months in which it is let as mentioned in paragraph (b) above) it is not normally in the same occupation for a continuous period exceeding 31 days.

It is not clear whether a "month" for the purposes of paragraph (c) means a calendar month (in the sense of January, February, etc) or any period of one month. It is also not clear whether any breaks in the period of at least seven months can fall at any time or must divide the period into periods of whole months. The better view seems to be that any period of a month during which the accommodation is commercially let to members of the public as holiday accommodation must not overlap with any period during which it is continuously in the same occupation for more than 31 days.

A further uncertainty is whether, for the purposes of paragraph (c), the time that the accommodation is "let as mentioned in paragraph (b)" is 70 days or (which is the better view) all the time that it is commercially let to the public generally as holiday accommodation.

On the latter reading, section 504(3)(c) of ICTA secures that accommodation is not let as holiday accommodation if it is let for more than 31 days continuously (otherwise than because of circumstances that are not normal). Section 267(4) gives effect to this reading.

This reading also reduces to less than five months the total periods during which the accommodation can be in the same occupation for more than 31 days. This can operate capriciously to extend the period of "at least seven months" where the holiday lettings are spaced out throughout the relevant period (see section 266) and not concentrated in a few months.

In section 267(5), the requirement in section 504(3)(c) of ICTA is relaxed so that the periods for which the accommodation is continuously in the same occupation for more than 31 days must not amount to more than 155 days (the aggregate length of the five longest months) during the relevant period. This means that the period during which any occupation of the accommodation must be on a short-term basis:

- need not be composed of whole months but can be made up of non-consecutive days; and
- is never extended beyond 155 days.

So, where two or three days of a holiday letting fall in a particular month, the requirement in section 267(5) of this Act (unlike section 504(3)(c) of ICTA) does not restrict what can be done with the accommodation during the rest of the month (provided that the condition is satisfied over the relevant period as a whole).

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 52: PROPERTY INCOME: FURNISHED HOLIDAY ACCOMMODATION: PERIOD OVER WHICH LETTINGS ARE AVERAGED: SECTION 268

This change alters the period during which lettings are averaged for the purpose of treating infrequently let property as qualifying holiday accommodation from the accounting period to the relevant period (as defined in section 266).

It brings the income and corporation tax codes back into line.

Subsections (6) to (8) of section 504 of ICTA allow averaging where a taxpayer lets both furnished holiday accommodation and accommodation that would be holiday accommodation if the test in section 504(3)(b) of ICTA were satisfied in relation to it ("under-used accommodation"). The requirement in section 504(3)(b) of ICTA is that the accommodation must be commercially let to members of the public for at least 70 days. Section 504(5) of ICTA says that that requirement, for a particular accounting period must be determined by reference to a twelve month period (called the "relevant period" in section 268). That twelve month period will often coincide with the accounting period. But it may not, an example being when the accommodation is first let as furnished accommodation. Then the relevant period begins on the first day in the accounting period that it is so let.

If the company elects for averaging, however, section 504(7) of ICTA treats the under-used accommodation specified in the election as qualifying holiday accommodation if the average of the number of days during the *accounting period* for which the furnished holiday accommodation and the under-used accommodation was let, is at least 70.

If the relevant period for particular accommodation does not coincide with the accounting period, the accommodation may have been let for more than 70 days during the relevant period but not for more than 70 days during the accounting period. But because the figures averaged in section 504(7) of ICTA are the numbers of days let during the accounting period, specifying the accommodation in an election could not raise the average number of days of letting during that period above 70.

In rewriting section 504(7) of ICTA, section 268(4) provides that the average is to be taken by reference to days during the "relevant period".

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 53: PROPERTY INCOME: RENT RECEIVABLE IN CONNECTION WITH A SECTION 39(4) CONCERN WHERE THE RENT IS PAID IN KIND: SECTION 270 AND SCHEDULE 1

This change concerns repealing section 119(2) of ICTA without rewriting it.

It brings the income tax and corporation tax codes back into line.

Section 119 of ICTA makes provision about rent payable in respect of any land or easement "used, occupied or enjoyed in connection with any of the concerns specified in section 55(2)". Section 55 of ICTA includes mines, quarries, certain industrial concerns, canals, docks, markets, bridges, ferries and railways.

Section 119(1) of ICTA provides for the rent from such easements to be charged under Schedule D but it does not specify under which Case of Schedule D the rent is to be charged.

Section 119(2) of ICTA provides for the rent to be taxed under Schedule D Case III if the rent is paid in produce of the concern. If section 119(2) does not apply, the rent is charged under a provision in the table in section 834A of ICTA. The table in section 834A is inserted by Part 1 of Schedule 1 to this Act, and is a list of places where some of the Schedule D Case VI charges are rewritten.

When section 119 of ICTA was introduced as section 34 of FA 1934 the lessee was required to deduct income tax when paying rent to the lessor. This was achieved by treating the rent as a royalty paid in respect of the user of a patent. But it would be impractical to deduct income tax if the rent were paid in kind. So what is now section 119(2) charged rent paid in kind under Schedule D Case III. This avoided the requirement to deduct income tax because these rents are not a category of income from which tax is deducted. Since the requirement to deduct income tax from rents taxable under section 119 of ICTA was repealed a separate charge on rents paid in kind is no longer required.

Section 119 of ICTA is rewritten in Chapter 7 of Part 4 of this Act. The charge under Chapter 7 does not distinguish rents that are paid in produce. This represents a change from the position under ICTA. The rewrite of the charge under Schedule D Case III has been absorbed into the rewrite of the charge under Schedule D Case VI (see the table in section 834A of ICTA).

There is no difference between Schedule D Cases III and VI in the basis of assessment.

There may be a minor difference in the deductions that are allowed in calculating the income. Section 70(1) of ICTA provides that:

> income shall be computed under Cases I to VI of Schedule D on the full amount of the profits or gains or income arising in the period … without any other deduction than is authorised by the Corporation Tax Acts

No deduction is allowed under Schedule D Case III. Although Schedule D Case VI does not specify that any deductions may be allowed the word "profits" implies a calculation under which expenses are deducted from the income.

In practice it is likely that most income to which section 119(2) of ICTA applies is covered by section 121 of ICTA (rewritten as section 272 in this Act). That section provides for specific deductions to be made in taxing mineral rents and royalties. In the event that rewriting the charge under Schedule D Case III according to the rules of Schedule D Case VI allows any taxpayer to claim any deduction that would not otherwise be allowable the amounts involved are likely to be small.

A further minor difference is that the income charged under Chapter 7 of Part 4 of this Act is subject to the loss regime in section 396 of ICTA. In the unlikely event that the deductions allowable exceed the rent charged under Chapter 7 the loss can be set against other income charged under a provision in the table in section 834A of ICTA. The more likely case is that losses on other income taxed under such a provision by the current law can be set against this income. But losses under those provisions are uncommon, as are rents paid in kind.

This change allows the deduction of amounts that are not deductible under the source legislation.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 54: PROPERTY INCOME: DEDUCTION OF MANAGEMENT EXPENSES OF OWNER OF MINERAL RIGHTS: OMISSION OF CONDITION THAT EXPENSES ARE "NECESSARILY" INCURRED: SECTION 272

This change concerns the omission of the requirement that the allowable expenses of managing mineral rights are incurred "necessarily".

It brings the income tax and corporation tax codes back into line.

Section 121(3) of ICTA makes provision for expenses of management and supervision to be deducted from amounts chargeable to corporation tax in respect of mineral rents and royalties. The section requires that the expenses are disbursed "wholly, exclusively and necessarily".

Section 121(3) of ICTA is rewritten as section 272. That section does not reproduce the condition that the expenses must be "necessarily" incurred. There is no evidence as to how this test is applied in practice but it is not obvious how it could be enforced. The extensive body of case law on the meaning of expenses being incurred "necessarily" applies to income formerly taxed under Schedule E (now taxed as employment income under ITEPA). That case law establishes that each and every holder of the office or employment would have to incur the expense.

That is not a test that could be sensibly applied to income taxed under Schedule D Case VI. It is not a test that could be sensibly applied to income taxed under Part 4 of this Act. It is most unlikely that the "necessarily" restriction can be applied in practice and this section recognises this by omitting "necessarily".

This change removes a potential obstacle to a successful claim for relief.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 55: PROPERTY INCOME ETC: PRIORITY OF THE CHARGE ON TRADE PROFITS: THE "CROWN OPTION": SECTIONS 287 AND 982 AND SCHEDULE 1

This change gives priority to the charge on trade profits if an item of income is both a trade receipt and potentially within the receipts of an overseas property business in Part 4 or within a charge to tax in Part 10 of this Act.

In the source legislation taxable income is allocated to different Schedules. The charges under these Schedules are mutually exclusive.

In addition, a small number of charges (non-schedular charges) are imposed outside the schedular system.

The scope of Schedule D is set out in section 18 of ICTA. The effect of that section (and the relevant case law) is that Schedule D is the residual Schedule. If income meets the conditions to be taxed under Schedule D and the conditions to be taxed under ITEPA or another Schedule of ICTA it is taxed under the alternative and not under Schedule D.

But there is no order of priority between Cases I, III and V of Schedule D. In the event of income falling within more than one of those cases it has long been accepted that HMRC have the option to choose under which case the income should be taxed.

The "Crown Option" was recognised for corporation tax in paragraph 84 of Schedule 18 to FA 1998. This was done, not so much to provide explicit statutory authority for the option, but to explain how it should operate under Self Assessment. That paragraph refers to the case where an amount may fall within Case I or within Case III or V of Schedule D. In such a case, an officer of the Board may determine which case shall apply as the basis of charge for an accounting period. But the paragraph does not set out on what basis the officer's determination is made.

HMRC's guidelines for making the determination are published in paragraph 14035 of the Business Income Manual. The income is taxed under Schedule D Case I and not under Schedule D Case III or V.

This Act deals with the Crown Option by providing for an order of priority between the Parts if income is capable of being taxed under more than one Part.

Section 287 provides that if income is capable of being taxed under Part 4 of this Act as profits of an overseas property business and under Chapter 2 of Part 3 of this Act as trade profits it is taxed under Part 3. ICTA taxes the profits arising from an overseas property business under Schedule D Case V so section 287 gives effect to the Crown Option for trades carried on wholly or partly in the United Kingdom (and to section 70A(1) of ICTA for trades carried on wholly abroad).

Section 982(1) gives priority to Chapter 2 of Part 3 of this Act if income falls within both Chapter 2 of Part 3 and Chapter 2, 5 or 6 of Part 10 of this Act. This gives effect to the Crown Option for income within Part 10 of this Act that is taxed in ICTA under Schedule D Cases III or V. It applies the same approach to trades carried on wholly abroad as is applied to trades carried on wholly or partly in the United Kingdom. This is consistent with the law (see sections 21A and 70A of ICTA) that the profits of both types of trade should be calculated on the same basis.

Chapters 7 (annual payments not otherwise charged) and 8 (income not otherwise charged) of Part 10 of this Act include income charged under Schedule D Case III or V. But in both cases the income within these Chapters is income that cannot be taxed under another provision. So a specific rule ceding priority to Part 3 of this Act is not needed.

Schedule 1 to this Act repeals sections 12AE and 31(3) of TMA and paragraph 84 of Schedule 18 to FA 1998.

In principle, this change is favourable to some taxpayers and adverse to others because it allocates income to a specific head of charge. That head of charge may produce a different amount of income to be brought into charge or may facilitate the claiming or relieving of losses or other reliefs that are not available under the other charge. The rules applicable to income within Part 3 are generally regarded as more flexible and favourable than those applying to the heads of charge which would have applied but for this change.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 56: LOAN RELATIONSHIPS: REFERENCES TO CONNECTIONS BETWEEN A COMPANY AND ANOTHER PERSON TO BE REWRITTEN AS APPLYING TO CONNECTIONS BETWEEN TWO COMPANIES: SECTIONS 348, 361, 468, 469 AND 470.

This change rewrites references to a company connected with a person so as to refer to a connection between two companies.

Section 87 of FA 1996

Section 87 of FA 1996 provides for the amortised cost basis to be used when bringing into account credits and debits on loan relationships when there is a connection between the creditor company and *a person* standing in the position of the debtor or between a debtor company and *a person* standing in the position of a creditor.

Section 87(3) explains what is meant by a connection between a company and another person for the purposes of section 87. The definition is only in terms of the person being a second company. This was not always the case. Section 87(3)(c) originally included the case of a participator of the debtor or creditor company or an associate of the participator until that paragraph was repealed by FA 2002. The definition of "participator" in section 417 of ICTA can include an individual.

The most likely interpretation is therefore that "person" in section 87(1) and (3) of FA 1996 means "company". Section 87 is rewritten accordingly. The far less likely interpretation is that section 87(3) only provides the definition where the other person is a company and that it is up to the courts to interpret what is meant by connection in section 87(1) where the person is an individual. Section 839 of ICTA, which provides a definition of "connected persons" including connected persons who are not companies, only applies where the section itself is applied (see section 839(1)). It is not applied by section 87 of FA 1996 although it is so applied elsewhere in the loan relationship provisions.

Section 88 of FA 1996

Section 88 of FA 1996 provides exceptions to the connection provision in section 87 of FA 1996.

Section 88(1) provides that a connection between a creditor company and the *person* standing in the position of debtor in the exempt circumstances set out in section 88 is disregarded for the connection provisions of section 87. Although section 88(5) provides a refinement of that rule for the debtor company *if* the person standing in the position of a debtor is also a company, it is not clear how the person in subsection (1) who is the debtor could be other than a company, since section 87, as explained above, now only provides connection rules between companies. Section 88(1) and (5) is therefore rewritten as applying to debtor companies only.

Section 88(2) excludes cases where, broadly, loan relationships are treated as trading assets. But paragraphs (e) and (f) of that subsection do not allow the exclusion where the asset representing the loan relationship has, under certain conditions, been in the beneficial ownership of "connected persons".

Section 88(4)(b) explains what is meant by a connected person having the beneficial ownership of assets by applying the meaning of a connection given by section 87 of FA 1996. "Connected person" here is therefore also rewritten as referring to a connected company.

Paragraph 4A of Schedule 9 to FA 1996

Paragraph 4A of Schedule 9 to FA 1996 provides for the deemed release of a loan (and hence a charge on the debtor company) where the creditor company acquires the loan from a second person for an amount less than the carrying value in the accounts of the debtor company. Under sub-paragraph (2)(d) this provision does not apply where there is a connection between the new creditor company and the *person* from whom it acquired that debt. Sub-paragraph (8) provides the meaning for the purposes of the paragraph of connection between a company and another person. In both instances the other person is a company.

It seems probable therefore that "person" in paragraph 4A(2)(d) refers to a company only. Indeed, the effect of paragraph 4A is that no charge arises from a released debt where a loan is passed between group companies.

The far less likely interpretation is that paragraph 4A(8) of Schedule 9 to FA 1996 only provides the definition where the other person is a company and that it is up to the courts to interpret what is meant by connection in paragraph 4A(2)(d) where the person is an individual. Paragraph 4A(2)(d) is therefore rewritten as being only of relevance where the person is a company.

If the courts decided that "connected persons" in sections 87 and 88 of FA 1996 included individuals the rewrite of those sections would extend the circumstances where the amortised cost basis was compulsory. This could be favourable or unfavourable to the taxpayer depending on the effects of applying that particular basis of accounting. If it were held that "person" in paragraph 4A of Schedule 9 to FA 1996 included an individual this would reduce the circumstances when there was a deemed release by the creditor company of its rights under the loan relationship which one would expect to be taxpayer favourable.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with current practice.

CHANGE 57: LOAN RELATIONSHIPS ETC: AMORTISED COST BASIS AND CONNECTED COMPANIES: FAIR VALUE TO APPLY IN THE CASE OF RESET BONDS AND SHARES WITH GUARANTEED RETURNS: SECTIONS 349 AND 534

This change gives precedence to fair value accounting where a reset bond or a share which is an interest-like investment would normally attract the amortised cost basis of accounting as a result of the connected companies provisions.

Section 87(2) of FA 1996 requires debits and credits on a loan relationship to be accounted for on an amortised costs basis where there is a connection between the creditor and debtor company. This is rewritten in section 349.

Sections 88A(4) of FA 1996 requires debits and credits on a loan relationship where the rate of interest is reset to be determined on the basis of fair value accounting (rewritten in section 454). Sections 91A(3) and 91B(3) of FA 1996 (rewritten in section 534) also require credits to be determined on the basis of fair value accounting where shares with interest-like returns are treated as loan relationships.

This change gives precedence to the fair value basis where a conflict between the two methods of accounting arises, the more specific rule taking precedence over the more general rule.

The tax effect will depend on the circumstances of the taxpayer and the effects of fair value accounting on the loan relationship or deemed loan relationship.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 58: LOAN RELATIONSHIPS: DEFICITS ON LOAN RELATIONSHIPS REFERABLE TO BASIC LIFE ASSURANCE AND GENERAL ANNUITY BUSINESS: CHANGE IN BASIC RULE SO THAT DEFICIT SET OFF AGAINST

INCOME AND GAINS OF DEFICIT PERIOD INSTEAD OF BEING CARRIED FORWARD: SECTION 388

This changes the default rule for setting off deficits on loan relationships referable to basic life assurance and general annuity business so that such deficits are set off against income and gains of the deficit period instead of being carried forward and treated as expenses in later accounting periods.

Under paragraph 4(4) of Schedule 11 to FA 1996, if a claim is not made under either paragraph 4(2) to set off the deficit against income and gains in the deficit period, or paragraph 4(3) to carry the deficit back and set it off against eligible profits in earlier accounting periods, then the deficit is carried forward to the next accounting period. No claim is required to carry the deficit forward.

This change secures that no claim is required to set off the deficit against income and gains within the deficit period. If a deficit remains after setting off the deficit against eligible income in the deficit period, the excess is carried forward without a claim unless a claim is made to carry it back. (A claim is still required if the company wants to carry the deficit back to earlier accounting periods.)

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

CHANGE 59: LOAN RELATIONSHIPS: FUNDING BONDS: CHARGE TO TAX AS INTEREST: SECTIONS 299 AND 413

This change replaces a theoretical but unlikely charge to tax under Schedule D Case VI with a charge under the loan relationships legislation where funding bonds are issued and it is impractical to retain any bonds on account of income tax.

This change reproduces Change 82 in ITTOIA and so brings the income tax and corporation tax codes back into line.

Section 582(1) of ICTA generally treats the issue of funding bonds as a payment of interest and they are taxed accordingly. But there is one situation where funding bonds are charged to tax under Schedule D Case VI, rather than as interest. Section 582(2)(b) and (2A) of ICTA provides that where it is “impracticable” to retain bonds the recipient is instead chargeable to tax under Schedule D Case VI.

It would, however, be extremely unusual for a Case VI charge to arise on a company. Under section 930(1), 933 and 934 of ITA a company or authority is not obliged to deduct tax where the company beneficially entitled to the income is resident in the United Kingdom or, if not resident, the payment is within the charge to corporation tax under section 11 of ICTA. The only likely instance of a Case VI charge arising on a company liable to corporation tax (and hence the loan relationships regime) under section 582 is where tax is deductible on interest because it is paid other than by a company or authority. The only obvious example is a payment of a United Kingdom public revenue dividend under section 892 of ITA and public revenue dividends are unlikely to give rise to funding bonds.

Section 582(3A) of ICTA provides that the provisions of section 582 override the provisions of Chapter 2 of Part 4 of FA 1996 and thus the rules in section 582 apply where that treatment differs from treatment under the loan relationships regime.

As section 582(1) of ICTA treats funding bonds as a payment of interest for all purposes of the Corporation Taxes Acts, applying a different charge under Schedule D Case VI in just one situation has no particular logic and adds an unnecessary complication. As explained above, a Case VI charge is extremely unlikely to arise in the first place. So the separate Case VI charge is not reproduced. Section 413(2) ensures that all issues of funding bonds are charged to tax as interest, irrespective of the circumstances in which they are issued.

Loss relief against this income for losses previously arising under Schedule D Case VI has not been preserved given the unlikelihood of a Case VI charge. The exemption from tax for income charged under Schedule D Case III and which is applied for charitable purposes (section 505(1)(c)(ii) of ICTA) applies as a result of this change.

A tax disadvantage would arise if the taxpaying company had what would have been in the source legislation a Schedule D Case VI loss to bring forward or carry sideways and which could not be otherwise relieved. But since the likelihood of the Case VI charge arising under section 582 is so remote this can be virtually discounted.

A tax advantage could arise in the case of a charity where income, previously charged under Schedule D Case VI in the source legislation and therefore excluded from exemption, is not under the rewritten provision so excluded. But the likelihood of this occurring is equally remote. A tax advantage might also arise in that non-trading deficits on a loan relationship are available for set off against income within the rewritten provision and which was previously charged under Case VI income and against which such deficits could not be set.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with current practice.

CHANGE 60: RELATIONSHIPS TREATED AS LOAN RELATIONSHIPS ETC: MEANING OF OFFSHORE FUNDS FOR QUALIFYING INVESTMENTS TEST: SECTIONS 489 AND 587

This change clarifies the meaning of "offshore fund" in paragraphs 4 and 8 of Schedule 10 to FA 1996 for the purposes of the "non-qualifying investments test" (known as the "qualifying investments test" in Part 6 of this Act (relationships treated as loan relationships etc)).

Paragraph 4 of Schedule 10 to FA 1996 provides for a company's "relevant interests in an offshore fund" to be treated as a right under a creditor relationship where the fund fails to satisfy the non-qualifying investments test: broadly where more than 60% of the holdings of the fund by value represent investments that would be loan relationships if held directly by the company.

"Offshore fund" is not directly defined for the purposes of paragraph 4 of Schedule 10 to FA 1996, but the meaning of "relevant interest in an offshore fund" for the purposes of paragraph 4 is given by paragraph 7 of the same Schedule. It is defined as a material interest in an offshore fund for the purposes of Chapter 5 of Part 17 of ICTA *or an interest which would be such an interest on the assumption that the unit trust schemes and arrangements referred to in section 756A(1)(b) and (c) of ICTA were not limited to collective investment schemes*. Section 756A(1) of ICTA (which is subject to sections 756B and 756C of that Act), gives the meaning of "offshore fund" for the purposes of Chapter 5 of Part 17 of ICTA and requires that offshore funds should be collective investment schemes. But the definition of "relevant interest in an offshore fund" in paragraph 7 extends that meaning.

The "non-qualifying investments test" referred to in paragraph 4(1) is in paragraph 8 of Schedule 10 to FA 1996. Paragraph 8(7F) requires "offshore fund", for the purpose of the test, to have the same meaning as in Chapter 5 of Part 17 of ICTA, but it does not mention the assumption in paragraph 7(1)(b) of Schedule 10 that unit trust schemes and arrangements referred to in section 756A(1)(b) and (c) of ICTA need not be limited to collective investment schemes. So it is unclear if that extension to non-collective investment schemes applies.

The definition in paragraph 8(7F) applies to offshore funds held by the investing company, that is, the same offshore fund and the same company as are referred to in paragraph 4(1) (to which the definition in paragraph 7 refers) since the definition in paragraph 8(7F) also applies for the interpretation of "assets of an offshore fund". That expression occurs in paragraph 8(5)(b), which in turn gives the meaning of "investments of an offshore fund" for the purposes of paragraph 8(1) ("investments of the … fund"). This is the same offshore fund referred to in paragraph 4(1).

Paragraph 7(1)(b) and (2) of Schedule 10 provides that for the purposes of paragraph 4 of Schedule 10 an interest is a "relevant interest in an offshore fund" (and therefore falls within

paragraph 4(1)(a)) if it would be a "material interest in an offshore fund" assuming the arrangements in section 756A(1)(b) and (c) of ICTA were not limited to collective investment schemes. Therefore it appears that the clear legislative intent is that such interests are subject to paragraph 4 if the fund "fails to satisfy the non-qualifying investments test" in paragraph 4(1)(b), so that the debits and credits brought into account for the purposes of corporation tax as respects the company's interest in the fund are determined on the basis of fair value accounting.

If, when FA 2004 added paragraph 8(7F) to Schedule 10, the intention had been that the narrow definition in paragraph 8(7F) was to apply without the extension implied by paragraph 7(1)(b) and (2) and so that extension was to be ineffective, FA 2004 would have repealed paragraph 7(1)(b) and (2), and there would have been mention of this intention in the commentary on the Finance Bill 2004. So it appears that the better interpretation is that the wider definition of an offshore fund given by the application of the assumption in paragraph 7(2) was meant to apply throughout and therefore it is applied by section 489 for the whole of Chapter 3 of Part 6 of this Act and the definition of assets of an offshore fund in section 493 is glossed accordingly.

Section 587 in Part 7 of this Act (derivative contracts) refers also to a holding that is "a material interest in an offshore fund" and applies the meaning of that phrase in section 489. This change therefore applies also for the purposes of that section.

This is a minor change in the law as it will prevent the taxpayer from arguing the contrary view that the assumption in paragraph 7(2) does not apply.

Adopting the wider definition of what is an offshore fund potentially brings more investments within the possibility of being qualifying investments and therefore makes it more probable that holdings in the unit trust or offshore fund with the investments are subject to the loan relationship provisions. Whether being subject to the loan relationship provisions is adverse or beneficial depends on the circumstances of the taxpayer.

This change is in principle adverse to some taxpayers and favourable to others. But it is in line with the original legislation before amendment and with the intention of the amended legislation.

CHANGE 61: RELATIONSHIPS TREATED AS LOAN RELATIONSHIPS ETC: POWER TO CHANGE INVESTMENTS THAT ARE QUALIFYING INVESTMENTS: SECTION 497

This change extends the power in paragraph 8(8) of Schedule 10 to FA 1996 for the Treasury to amend paragraph 8 of that Schedule to extend or restrict the investments of a unit trust scheme or offshore fund that are qualifying investments, so that it also covers investments of open-ended investment companies ("OEICs").

Paragraph 4 of Schedule 10 to FA 1996 treats a company's holdings in unit trust schemes or offshore funds as rights under a loan relationship of the company if the schemes or funds fail the test set out in paragraph 8 of that Schedule. The test is failed when the market value of the scheme's or fund's "qualifying investments" exceeds 60% of the market value of all its investments. Paragraphs 4 and 8 of Schedule 10 are modified by regulation 95 of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) so that they apply similarly to holdings in OEICs.

However, paragraph 8(8) of Schedule 10 gives power for paragraph 8 to be amended by order so as to extend or restrict the investments only of unit trust schemes or offshore funds that are qualifying investments and not those of OEICs. A similar effect might be achieved using the regulation-making power in section 17(3) of F(No.2)A 2005 to modify paragraph 8 in relation to OEICs.

Chapter 3 of Part 6 of this Act rewrites Schedule 10, incorporating the modifications relating to OEICs. In rewriting paragraph 8(8) in section 497 of this Act, the opportunity has been taken to extend the power in that paragraph to cover investments of OEICs, as well as unit trust funds and offshore funds, so that a single instrument can be used to extend or restrict the qualifying investments of all three investment vehicles.

Extending or restricting the investments of OEICs that are qualifying investments could be beneficial or adverse to a company with holdings in OEICs. But since the same effect could be obtained by making regulations under section 17(3) of F(No 2)A 2005, the change does not extend the overall scope of the Treasury's powers.

This change has no implications for the amount of tax paid, who pays it or when. It affects only administrative matters.

CHANGE 62: RELATIONSHIPS TREATED AS LOAN RELATIONSHIPS ETC: INDUSTRIAL AND PROVIDENT SOCIETY PAYMENTS TREATED AS INTEREST UNDER LOAN RELATIONSHIP: SECTION 499

This change provides that share interest and loan interest of a registered industrial and provident society and share interest of an agricultural co-operative society are treated as trading income where the company is a party to the respective shares or loan for the purposes of a trade.

In the source legislation income from loan relationships is charged under Schedule D Case I if the relationship is used for the purposes of a trade (see section 80(2) of FA 1996) and otherwise under Schedule D Case III (see section 80(3) of that Act).

Section 486(1) of ICTA provides that, notwithstanding anything in the Tax Acts, share or loan interest payable by a registered industrial and provident society is to be treated as interest under a loan relationship of the society. Section 486(4) of ICTA requires any share or loan interest paid by such a society to be chargeable under Schedule D Case III.

"Share interest" is defined in section 486(12) of ICTA to include dividends or other sums payable to a shareholder by reference to shareholding in the society. "Loan interest", which is also defined in that section, would fall within the loan relationships provisions (Chapter 2 of Part 4 of FA 1996) regardless of section 486 of ICTA. However, section 486(4) of ICTA arguably has the effect of charging such interest under Case III only, but the matter is unclear as the words "Notwithstanding anything in the Tax Acts" only occur in section 486(1) of ICTA and the point arises as to whether section 486(4) is overridden by section 80 of FA 1996, which would give Chapter 2 of Part 4 of FA 1996 precedence.

Section 81(4) of FA 1996 excludes share capital from being treated as a debt and hence from being a loan relationship. It seems that the wording of section 486(1) of ICTA does not require the shareholding itself to be treated as a loan relationship. For that to be the case the definition of "share" in section 103 of FA 1996 would need amendment in the same way that it is amended to exclude building society shares which, as a result, are treated as loan relationships. (Section 477A(3) of ICTA, which is not unlike section 486(1), merely requires building society dividends to be treated as liabilities arising under a loan relationship but does not extend the deeming provision to the shareholding.)

Section 486(9) of ICTA requires section 486(1) (but not subsection (4)) to have effect as if references to an industrial and provident society include a reference to an agricultural co-operative society, which complicates the matter still further.

The resulting situation appears to be as follows.

IPSs other than agricultural cooperative societies

All interest which, regardless of section 486 of ICTA, would fall to be brought into account under Chapter 2 of Part 4 of FA 1996 ("natural interest"), other than interest in respect of loan relationships of a co-operative society is chargeable under that Chapter but (arguably) solely as Schedule D Case III income.

All dividends etc which are only treated as income under a loan relationship by virtue of section 486(1) of ICTA are chargeable under Chapter 2 of Part 4 of FA 1996 but solely as Schedule D Case III income. Regardless of whether section 486(4) of ICTA applies to such income or not, there is no underlying loan relationship to fall within section 80(2) of FA 1996 and the income is chargeable under Case III by virtue of section 80(3) of FA 1996. Crown

Option cannot apply in this case since the charge can only be to Schedule D Case III. (Crown Option is the right given by paragraph 84 of Schedule 18 to FA 1998 to an officer of Revenue and Customs to choose between different cases of Schedule D.)

Agricultural co-operative societies

All natural interest paid by an agricultural co-operative society is chargeable under Chapter 2 of Part 4 of FA 1996 as a payment under a loan relationship. The interest is chargeable under Schedule D Case III by virtue of section 80(3) of FA 1996 unless the underlying loan relationship is held for the purposes of a trade, in which case the income is chargeable under Case I of that Schedule by virtue of sections 80(2) and 82(2) of FA 1996. The interest does not fall within section 486(4) so there is no obligatory Case III charge under that section.

All dividends paid by an agricultural co-operative society are chargeable under Chapter 2 of Part 4 of FA 1996 as payments under a loan relationship. The dividends do not fall within section 486(4) of ICTA so there is no obligatory Case III charge under that section. But, since there is no underlying loan relationship to fall within section 80(2) of FA 1996, the income is chargeable under Case III by virtue of section 80(3) FA 1996.

The effect of section 499 is that the Schedule D Case III charge in section 486(4) of ICTA is ignored and the existence of an underlying loan relationship that may be held for the purposes of a trade is assumed.

Whether a company pays more or less tax as a result of this change will depend on a number of factors, for example whether it has trading losses brought forward to reduce what will, as a result of this change, be a trading credit. In most cases the change is not expected to result in any tax difference.

This change is in principle adverse to some taxpayers and favourable to others but is expected to be favourable in most cases.

CHANGE 63: DERIVATIVE CONTRACTS: AMENDMENT OF REFERENCES TO A "RELEVANT HOLDING" IN A COLLECTIVE INVESTMENT SCHEME IN RELATION TO CERTAIN RELEVANT CONTRACTS TREATED AS DERIVATIVE CONTRACTS: SECTIONS 587 AND 601

This change clarifies the meaning of references to a "relevant holding" in unit trust schemes, open-ended investment companies and offshore funds in determining whether a relevant contract is a derivative contract.

Paragraph 36 of Schedule 26 to FA 2002 treats as a derivative contract a relevant contract to which a company is a party in an accounting period, that is not otherwise a derivative contract for the purposes of that Schedule, if its "underlying subject matter consists wholly or partly of a holding which is, in that period, a relevant holding". The paragraph does not directly define "relevant holding" for the purposes of this rule. Instead, paragraph 36(3) of that Schedule provides that "for the purposes of this paragraph a person holds a relevant holding in an accounting period if, at any time in that period, he holds…" and there follows a list of what such a holding may comprise. The reference here to a "person" is at odds with the reference in paragraph 36(1)(b) of that Schedule to a holding of which the underlying subject matter of a relevant contract consists.

The source legislation was modelled on a similar provision for loan relationships (see paragraph 4(1) of Schedule 10 to FA 1996). The reference there is to a holding held by a company. In adopting the model in paragraph 4 of Schedule 10 to FA 1996, the reference to a holding of a legal person was retained in error.

Section 587(3), which rewrites paragraph 36(3) of Schedule 26 to FA 2002, gives a meaning of "relevant holding", for the purposes of subsection (1) of that section, that brings matters back into alignment. It defines the case where "the underlying subject matter of a contract consists wholly or partly of a relevant holding in an accounting period". That wording matches the phrase

"its underlying subject matter consists wholly or partly of a relevant holding in that period" in subsection (1).

This change also applies to section 601, which determines the accounting basis to be used in determining the credits and debits to be brought into account in relation to a relevant holding mentioned in section 587.

This change provides a clarification of the law which is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 64: DERIVATIVE CONTRACTS: AMENDMENT OF A CONDITION TO BE SATISFIED TO DETERMINE WHETHER THE UNDERLYING SUBJECT MATTER OF A RELEVANT CONTRACT IS "EXCLUDED PROPERTY" FOR THE PURPOSES OF PART 7: SECTION 591

This change adds acquiring a plain vanilla contract to the circumstances that are relevant to the contract satisfying condition A in section 591. The circumstances in question are those in which a company carrying on life assurance business becomes a party to such a contract.

Paragraph 3 of Schedule 26 to FA 2002 sets out conditions to be satisfied if a relevant contract is to be a derivative contract for the purposes of that Schedule. ("Relevant contract" is defined in paragraph 2(2) of that Schedule as an option, a future or a contract for differences.) But paragraph 4 of Schedule 26 to FA 2002 excludes a relevant contract from contracts that are derivative contracts for the purposes of that Schedule if, although the relevant contract meets the conditions in paragraph 3 of that Schedule, its underlying subject matter consists wholly of property within specified excluded types of property. One such type is certain shares in a company or rights of a unit holder under a unit trust scheme, if the relevant contract satisfies a condition in paragraph 4(2A), (2B), (2C), (2CA) or (2D) of Schedule 26 to FA 2002.

The condition in paragraph 4(2A) of Schedule 26 to FA 2002 includes that the relevant contract is a plain vanilla contract "entered into" by a company carrying on life assurance business. (A "plain vanilla contract" is defined in paragraph 2(2B) of Schedule 26 to FA 2002 as a relevant contract other than one to which the company is treated as being a party by virtue of a provision mentioned in paragraph 2(2A) of that Schedule.) But the conditions in paragraph 4(2B), (2C) and (2CA) of Schedule 26 to FA 2002 refer to the circumstance in which the relevant contract is "entered into or acquired". That is, the condition can be met in circumstances where the company in question was not a party to the contract when it was made but became a party to the contract at a later point, say by the assignment to it of the assignor's rights and liabilities under the contract.

There is no reason in relation to the condition in paragraph 4(2A) of Schedule 26 to FA 2002 to distinguish between a case in which a company enters into a contract and one in which it acquires the contract. It is not HMRC's practice to make any such distinction. Section 591(2), which rewrites paragraph 4(2A) of Schedule 26 to FA 2002, therefore refers to a plain vanilla contract "entered into or acquired" by a company carrying on life assurance business. This brings it into line with the conditions in paragraph 4(2B), (2C) and (2CA) of Schedule 26 to FA 2002 that are also rewritten in section 591.

Because of this change some relevant contracts may cease to be derivative contracts for the purposes of this Part, in which case profits and losses from the contract are not charged by virtue of this Part and may be subject to a more favourable regime (say, the charge on chargeable gains).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 65: DERIVATIVE CONTRACTS: CREDITS AND DEBITS IN RESPECT OF CAPITAL EXPENDITURE: DEBITS NOT TO BE BROUGHT INTO ACCOUNT: SECTION 604

This change clarifies the rule that prevents certain debits in respect of a derivative contract taken to profit and loss being brought into account under Part 7 of this Act. The rule applies if a related debit has already been brought into account under that Part notwithstanding that it was treated as capital expenditure under generally accepted accounting practice.

Paragraph 17A of Schedule 26 to FA 2002 sets out the general rule that the amounts to be brought into account by a company for the purposes of that Schedule are those that, in accordance with generally accepted accounting practice, are recognised in determining the company's profit or loss for the accounting period in question. Paragraph 17B of that Schedule provides that amounts so "recognised" are those recognised for accounting purposes in certain accounts or statements of the company.

Paragraph 25 of Schedule 26 to FA 2002 varies the general rule for a credit or debit that is treated in the company's accounts as an amount brought into account in determining the value of a fixed capital asset or project. A credit or debit so treated falls outside the meaning of amounts recognised in determining the company's profit or loss for the period. Paragraph 25 of Schedule 26 to FA 2002 provides that, notwithstanding the accounting treatment, the credit or debit is brought into account in the same way as a credit or debit to which paragraph 17A of Schedule 26 to FA 2002 refers. (There is an exception for certain debits taken into account under Schedule 29 to FA 2002 (intangible fixed assets)).

If a company decides to write down the value of the asset to which a debit within this paragraph has been added, or to create a reserve for the amortisation or depreciation of that asset, a debit will be taken to profit and loss. Such a debit would, but for the prohibition in paragraph 25(4) of Schedule 26 to FA 2002, be brought into account in the same way as credits and debits to which paragraph 17A of Schedule 26 to FA 2002 refers.

Paragraph 25 of Schedule 26 to FA 2002 matches paragraph 14 of Schedule 9 to FA 1996. Paragraph 25(4) and paragraph 14(4) were inserted in identical terms by Schedule 10 to FA 2004 (see paragraphs 56 and 33 respectively of that Schedule). A debit in respect of the writing down of the asset, or the creation of an amortisation or depreciation reserve, is not brought into account under Schedule 26 to FA 2002 (or Chapter 2 of Part 4 of FA 1996 in the case of a loan relationship) if attributable to the debit that is brought into account by the main rule in paragraph 25 of Schedule 26 to FA 2002 (paragraph 14 of Schedule 9 to FA 1996 in the case of a loan relationship). But the wording of paragraph 25(4)(b), in so far as it refers to "the interest component of the asset", has no application to the regime for derivative contracts. Such interest is only taken into account under the regime for loan relationships in Chapter 2 of Part 4 of FA 1996. The change dispenses with the redundant words to leave the rule in terms appropriate to derivative contracts.

This change amends the scope of a rule prohibiting a deduction. Whether that amendment results in further disallowance or an easing of disallowance (or any difference) depends largely on how the company in question interpreted the provision in assessing its liabilities. In practice, it is likely to have no tax effect.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

CHANGE 66: DERIVATIVE CONTRACTS: PRIORITY OF PROVISIONS WHEN A COMPANY CEASES TO BE UK RESIDENT AND CEASES TO BE A MEMBER OF A GROUP: SECTIONS 609 AND 610

This change deals with the deemed assignment and reacquisition of rights and liabilities under a derivative contract on a company ceasing to be UK resident, or the rights and liabilities in question ceasing to be held for the purposes of a permanent establishment in the United Kingdom of a non-UK resident company. The deeming does not apply if such a deemed

assignment and reacquisition would otherwise occur at the same time as the company leaves a group after replacing another group member as a party to the contract. It corrects a mismatch between the rules for derivative contracts and those for loan relationships as they deal with the same circumstances.

Paragraph 22A of Schedule 26 to FA 2002 applies if a company ceases to be resident in the United Kingdom or rights and liabilities under a derivative contract of a non-UK resident company cease to be held or owed for the purposes of a United Kingdom permanent establishment. In either case, the company is deemed to have assigned the rights and liabilities under its derivative contracts (or those no longer so held or owed) for a consideration equal to the fair value of the rights and liabilities, and to have reacquired them for the same amount. Paragraph 22A of Schedule 26 to FA 2002 is rewritten in sections 609 and 610 of this Act.

Paragraph 30A of Schedule 26 to FA 2002 deems the same assignment and reacquisition to occur, in respect of a derivative contract, if either of two circumstances applies after one member of a group has replaced another as a party to that contract, as a result of a transaction or series of transactions within paragraph 28(2)(a) or (b) of Schedule 26 to FA 2002, so as to trigger paragraph 28(3) of that Schedule. The circumstances are that the transferee company ceases to be a member of that group of companies either, firstly, solely because of an "exempt distribution", that is, a distribution that is exempt by virtue of section 213(2) of ICTA (demergers), or, second, for any other reason. In the first case, the deemed assignment and reacquisition is triggered by and at the time of a "chargeable payment" within the meaning of section 214(2) of ICTA within five years of the company leaving the group. In the second case, the deemed assignment and reacquisition occur when the company leaves the group. Paragraph 30A of Schedule 26 to FA 2002 is rewritten in sections 630 to 632 of this Act.

Paragraph 10A of Schedule 9 to FA 1996, rewritten in sections 333 and 334 of this Act, is the equivalent for loan relationships of paragraph 22A of Schedule 26 to FA 2002. Paragraph 12A of Schedule 9 to FA 1996, rewritten in sections 344 to 346 of this Act, is the equivalent for loan relationships of paragraph 30A of Schedule 26 to FA 2002.

Both paragraph 22A and paragraph 30A of Schedule 26 to FA 2002 may apply at the same time (for example, a company may cease to be UK resident at the time it ceases to be a member of the group because it moves its residence abroad on being bought by a new parent who is non-UK resident). Paragraph 10A(1A) of Schedule 9 to FA 1996 avoids the same duplication in respect of loan relationships by disapplying that paragraph if paragraph 12A of that Schedule applies and the cessation mentioned in one paragraph occurs at the same time as the cessation mentioned in the other.

There is no reason for the two regimes to apply different rules in these circumstances. Sections 609 and 610 therefore include the equivalent of paragraph 10A(1A) of Schedule 9 to FA 1996, mirroring the rewrite of that provision in sections 333 and 334. This change brings the two regimes into line.

This change clarifies the order of priority of the operation of the provisions in question. It may, in cases where section 631 or 632 applies instead of section 609 or 610, defer the point at which the deemed assignment and reacquisition, and therefore the resulting incidence of a tax charge, occurs.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 67: DERIVATIVE CONTRACTS: MEANING OF "IMPAIRMENT LOSS" FOR THE PURPOSES OF THE MEANING OF "CARRYING VALUE": SECTION 702

This change provides a meaning for the term "impairment loss" which is used in providing the meaning of "carrying value" in section 702 of this Act.

Paragraph 54(1) of Schedule 26 to FA 2002 provides that "carrying value", where that term is used in that Schedule, is to be construed in accordance with paragraph 50A(3A) and (3B)

of that Schedule. Paragraph 50A of Schedule 26 to FA 2002 brings into account under that Schedule an adjustment on a company changing to international accounting standards. Sub-paragraph (3A) provides that, for the purposes of that paragraph, the "carrying value" of a contract includes amounts recognised for accounting purposes in relation to a derivative contract in respect of a number of items, including "impairment losses (including provisions for bad or doubtful debts)".

The term "impairment loss" is not defined in Schedule 26 to FA 2002. It is arguable that the reference in subparagraph (3A) to "amounts recognised for accounting purposes" brings with it the meaning of that term provided by generally accepted accounting practice. For example, paragraph 6 of International Accounting Standard 36 says: "impairment loss is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount." And there are similar but not identical references to impairment losses in other standards. The term could therefore be included in section 710 of this Act (other definitions) beside a number of other terms taken from generally accepted accounting practice which have the meaning they have for accounting purposes.

However, section 103(1) of FA 1996 provides a definition of "impairment loss" for the purposes of Chapter 2 of Part 4 of that Act (loan relationships). That Chapter includes Schedule 9 to FA 1996 which has a number of paragraphs dealing specifically with impairment losses (for example, paragraphs 5ZA to 6C). Paragraph 19A of that Schedule deals with the adjustment to be made for the purposes of that Chapter on a change of accounting policy. That paragraph is drafted in very similar terms to paragraph 50A of Schedule 26 to FA 2002. It also includes the equivalent of paragraph 50A(3A) of Schedule 26 to FA 2002, with a mention of impairment losses, so that the definition in section 103(1) of FA 1996 applies.

As the provisions for derivative contracts deal with this matter in an equivalent manner to the provisions for loan relationships, it adds consistency in the construction of such equivalent provisions to adopt the definition of "impairment loss" in section 103(1) of FA 1996 for the purposes of paragraph 50A(3A) of Schedule 26 to FA 2002. That definition (together with the subsidiary definition of "impairment" in section 103(1) of FA 1996) has therefore been rewritten in section 702(4).

This change provides a clarification of the law which is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 68: UNPAID REMUNERATION OF EMPLOYEES: PAYMENT MADE AFTER RETURN SUBMITTED BUT WITHIN 9 MONTHS OF THE END OF THE PERIOD OF ACCOUNT: SECTIONS 867, 1250 AND 1289 AND SCHEDULE 1

This change drops the requirement to make a claim for a deduction for remuneration paid after the return is submitted but within nine months of the end of the period of account in which it is charged.

This change brings the income tax and corporation tax codes back into line in rewriting section 43 of FA 1989. And it is adopted for consistency in rewriting parallel rules in section 44 of FA 1989 and paragraph 113 of Schedule 29 to FA 2002.

Sections 43(5) and 44(5) of FA 1989 deal with profit calculations made within nine months of the end of the period of account. Paragraph (a) of each subsection requires the assumption that any remuneration unpaid at the time of the calculation will not be paid by the end of that nine month period. That means the proposed remuneration cannot be deducted in making the calculation. Paragraph (b) of each subsection provides an adjustment procedure that applies when the remuneration is paid after the calculation is made but before the end of the nine month period. If a claim is made within two years of the end of the period of account the calculation may be adjusted.

There is a parallel rule in paragraph 113(5) of Schedule 29 to FA 2002 which applies to the intangible fixed assets regime.

This change brings the adjustment procedure into line with the normal Self Assessment rules and deals with the adjustment as an amendment to a return. Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Act removes the reference to section 43(5) of FA 1989 in paragraph (b) of that subsection and does not replace it.

The change alters the time available for making the adjustment from two years after the end of the period of account in every case to a date that depends on the length of the period of account.

Paragraph 15(4)(a) of Schedule 18 to FA 1998 gives the time limit for making amendments to corporation tax returns. It is 12 months from the filing date for the relevant return.

Corporation tax returns are required for accounting periods. The end of a period of account will always end an accounting period. In the normal case where the company has a 12 month period of account the change makes no difference to the time limit for "claiming" the relief. The filing date is 12 months after the accounting date and the date for amending the return is 12 months after that. This is the same time limit as those in sections 43(5) and 44(5) of FA 1989.

In fact, the time limit for "claiming" the relief is unaffected if the period of account is no longer than 18 months.

Example One

A notice to file for the 12 months ended 31 December 2005 is issued in January 2006. This accounting period is included in a period of account that runs from 1 January 2005 to 30 June 2006. The filing date for the accounting period is 30 June 2007 and the amendment date 30 June 2008. This is two years after the end of the period of account.

The time limit for "claiming" the relief will be reduced only if the period of account is longer than 18 months. The filing date for the first accounting period in such a period of account is 12 months after the 18-month point. The time limit for amending the return is 12 months after that filing date. This will be less than two years after the end of the period of account.

Example Two

A notice to file for the 12 months ended 31 December 2005 is issued in January 2006. This accounting period is included in a period of account that runs from 1 January 2005 to 31 December 2006. The filing date for the accounting period is 30 June 2007 and the amendment date 30 June 2008. This is less than two years after the end of the period of account (31 December 2008).

A company is unlikely to be disadvantaged by the change. In Example Two the company would have to submit its return before 30 June 2007 (the filing date) at a time when the remuneration was unpaid. The remuneration would then have to be paid on or before 30 September 2007. Under the change the company would still have nine months to "claim" the relief (compared with 15 months under section 43(5)(b) or 44(5)(b) of FA 1989).

In practice periods of account longer than 18 months are unusual and nearly all companies affected by the provision claim the deduction in their original return.

This change puts the method of allowing relief on the same basis as that in paragraph 6 of Schedule 24 to FA 2003, rewritten in section 1295.

Schedule 24 to FA 2003 is a similar provision to section 43 of FA 1989. It denies a deduction for amounts charged in respect of employee benefit contributions unless the benefits are provided within nine months of the end of the period in respect of which they are charged.

Paragraph 6 of Schedule 24 to FA 2003 deals with the case in which the return is made before the end of the nine month period. Unlike section 43(5) of FA 1989 it does not require a claim. It provides merely that the calculation can be adjusted. This is the most appropriate way of dealing with the point under Self Assessment.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

CHANGE 69: MISCELLANEOUS INCOME: BENEFICIARIES' INCOME FROM ESTATES IN ADMINISTRATION: SET OFF OF EXCESS OF ALLOWABLE ESTATE DEDUCTIONS IN THE FINAL TAX YEAR OF THE ADMINISTRATION PERIOD: ABSOLUTE INTERESTS: SECTION 943

This change provides for any amounts that are allowable against the aggregate income of the estate in calculating the residuary income of the estate in the "final tax year" (the tax year in which the administration period ends), but cannot be so allowed because they exceed that income, to be set off against the amount in respect of which the beneficiary with an absolute interest is taxable or, if there is more than one such beneficiary, for a just and reasonable part to be set off.

It brings the income tax and corporation tax codes back into line.

Section 697(1A) of ICTA provides that where the deductions for any year exceed the aggregate income of the estate, the excess shall be carried forward and treated as an allowable deduction in the following year. Clearly, this is not possible in the tax year in which the administration period ends. In practice, however, excess deductions may be set off against any residuary income of the estate which has not been paid out. (This is often necessary since personal representatives may incur a high proportion of expense on the estate towards the end of the administration period, for example, because of the billing of legal or accountancy fees at the end.)

In rewriting section 697(1A) of ICTA, section 943(3) reflects that practice by providing for a company's basic amount of estate income for the final accounting period (that is, the company's share of the residuary income of the estate that has not yet been paid out) to be reduced by the excess deductions. If there is more than one absolute interest in the residue of the estate at the end of the administration period a just and reasonable part of the excess is subtracted.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 70: MISCELLANEOUS INCOME: BENEFICIARIES' INCOME FROM ESTATES IN ADMINISTRATION: EXCLUSION OF INCOME FROM SPECIFIC DISPOSITIONS AND INCOME FROM CONTINGENT INTERESTS FROM THE AGGREGATE INCOME OF THE ESTATE: SECTIONS 947 AND 949

This change excludes income from specific dispositions and income from contingent interests from the aggregate income of an estate (which is used to compute the residuary income of an estate and hence affects the amount of estate income that is chargeable to tax where a person has an absolute interest in the estate) and from the deductions made in determining the residuary income of the estate.

It brings the income tax and corporation tax codes back into line.

The aggregate income of the estate is defined in section 701(8) of ICTA as:

> the aggregate income from all sources [for the tax year in question] of the personal representatives of the deceased as such, treated as consisting of –
>
> (a) any such income which is chargeable to United Kingdom income tax by deduction or otherwise, such income being computed at the amount on which tax falls to be borne for that year;
>
> (b) any such income which would have been so chargeable if it had arisen in the United Kingdom to a person resident and ordinarily resident there, such income being computed at the full amount thereof actually arising during that year, less such deductions as would have been allowable if it had been charged to United Kingdom income tax;

(c) any amount of income treated as arising to the personal representatives under section 410(4) of ITTOIA 2005 (stock dividends) that would be charged to income tax under Chapter 5 of Part 4 of that Act if income arising to personal representatives were so charged (see section 413 of that Act);

(d) in a case where section 419(2) of that Act applies (release of loans to participator in close company: debts due from personal representatives), the amount that would be charged to income tax under Chapter 6 of Part 4 apart from that section; and

(e) any amount that would have been treated as income of the personal representatives as such under section 466 of that Act if the condition in section 466(2) had been met (gains from contracts for life insurance);

but excluding any income from property devolving on the personal representatives otherwise than as assets for payment of the debts of the deceased.

Property that is the subject of a specific disposition is available for the payment of the deceased's debts and so is not excluded. However, under section 697(1)(b) of ICTA "the amount of any of the aggregate income of the estate for [a tax year] to which a person has on or after assent become entitled by virtue of a specific disposition either for a vested interest during the administration period or for a vested or contingent interest on the completion of the administration" is deductible from the aggregate income of the estate for that year in calculating the amount of the residuary income of an estate for that year. The Scottish version of this provision omits the words "on or after assent" and the words following "specific disposition": see section 702(b) of ICTA. But the inclusion of the words "on or after assent" for the rest of the United Kingdom means that much of the income of the specific disposition will form part of the aggregate income. The result is that the measure of the income taken to be available to residuary beneficiaries is inflated.

In practice, HMRC allow all income from specific dispositions to be deducted from the aggregate income of the estate in calculating the residuary income of the estate for the year of assent and later years. But it is considered simpler for it merely to be excluded from what counts as the aggregate income and not to be deducted from it. Accordingly, the definition of "the aggregate income of the estate" in section 947 of this Act contains an exclusion for all income from specific dispositions to which a person is or may become entitled at subsection (5)(a). In consequence, the deduction for this income in section 697(1)(b) of ICTA and its adaptation for Scotland in section 702(b) of ICTA have not been rewritten.

Since income tax is treated as having been paid on this income, any reduction in the income taken to be available to beneficiaries as a result of this change will result in:

- corporate beneficiaries who pay tax at the main corporation tax rate paying less tax; but
- those not liable to corporation tax, or liable to tax at the small companies' rate, not being able to reclaim so much tax.

This change is adverse to some taxpayers and is favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 71: MISCELLANEOUS INCOME: BENEFICIARIES' INCOME FROM ESTATES IN ADMINISTRATION: REMOVAL OF THE REQUIREMENT FOR INTEREST TO BE ANNUAL AND A CHARGE ON RESIDUE TO BE DEDUCTIBLE IN CALCULATING THE RESIDUARY INCOME OF THE ESTATE: SECTION 949

This change removes the requirements for interest to be annual and a charge on residue in order to be deductible from the aggregate income of the estate in calculating the residuary income of the estate.

It brings the income tax and corporation tax codes back into line.

The deductions that are allowable in ascertaining the amount of the residuary income of an estate for an income tax year are set out in section 697(1)(a) and (b) of ICTA. Section 697(1)

(a) of ICTA refers to "the amount of any annual interest, annuity or other annual payment [for the year] which is a charge on residue …". There is a definition of "charges on residue" in section 701(6) of ICTA which is adapted for Scotland in section 702(d) of ICTA.

So far as the requirement for the interest to be annual is concerned, historically tax legislation has distinguished between short interest (which was not usually deductible) and annual or yearly interest (which was usually deductible). FA 1969 abolished the general relief for interest paid by taxpayers. However, specific provision was made for relief to continue to be allowed in respect of interest on borrowings for certain purposes. Annual or yearly interest continued to be significant as there was a requirement that tax was deducted from certain payments of yearly interest. But under current law interest, whether short or annual, may be deducted as an expense in computing the profit or loss of a trade for tax purposes if incurred wholly and exclusively for business purposes. (This is subject to certain restrictions on the deduction of annual interest paid to a person not resident in the United Kingdom and there is still a requirement to deduct tax in certain circumstances in relation to annual interest under section 874 of ITA, for example, where the payment is to a person whose usual place of abode is outside the United Kingdom.)

The other requirement in section 697(1)(a) of ICTA is that the payment of annual interest must be a charge on residue. "Charges on residue" are defined in section 701(6) of ICTA as certain specified liabilities properly payable out of the estate, as well as interest payable in respect of them. The definition is wide enough to include all interest ever likely to be paid by personal representatives, so the requirement that the payment is a charge on residue is otiose for interest.

Therefore, section 949(2)(a) of this Act, which rewrites section 697(1)(a) of ICTA, omits the requirements for interest to be annual and a charge on residue before it can be deducted from the aggregate income of the estate to calculate the residuary income of the estate. As a consequence, all interest paid by the personal representatives will be deductible, except for interest on unpaid inheritance tax which is expressly disallowed by section 233(3) of IHTA.

Since income tax is treated as having been paid on this income, any reduction in the income taken to be available to beneficiaries as a result of this change will result in:

- corporate beneficiaries who pay tax at the main corporation tax rate paying less tax; but
- those not liable to corporation tax, or liable to tax at the small companies' rate, not being able to reclaim so much tax.

This change is adverse to some taxpayers and is favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 72: MISCELLANEOUS INCOME: BENEFICIARIES' INCOME FROM ESTATES IN ADMINISTRATION: AMOUNTS GROSSED UP USING BASIC RATE: REDUCTION IN SHARE OF RESIDUARY INCOME OF ESTATE: SECTION 951

This change provides that the basic rate of income tax is used to gross up the sums paid before the completion of the administration of an estate (or sums payable on the completion of the administration of the estate) to a beneficiary with an absolute interest in the estate, for the purposes of determining whether the beneficiary has been charged to tax on more income than the beneficiary has enjoyed and adjusting the tax payable by it accordingly.

Section 697(2) of ICTA provides that where:

- the total of a beneficiary's shares of the residuary income of an estate for all years in which the beneficiary held an absolute interest exceeds,
- the total sums paid or payable to that beneficiary during or at the end of the administration period ("benefits received"),

that excess is deducted from the beneficiary's share of the residuary income of the estate in the year the administration is completed. Any excess which cannot be deducted in that year is deducted from the beneficiary's share for the previous year and so on.

To determine the benefits received, section 697(3) of ICTA provides that the sums paid (or payable) are taken to be such amounts as would, after the deduction of income tax for the year of assessment in which they were paid, be equal to those sums. That is, they are grossed up.

When 697(3) of ICTA was rewritten for income tax purposes in section 668(5) of ITTOIA, as a result of section 4(1) of ICTA the amount of income tax was taken to have been deducted at the "basic rate".

Section 4(1) of ICTA provided that any provision requiring, permitting or assuming the deduction of income tax from any amount, or treating income tax as having been deducted from or paid on any amount, should, subject to any provision to the contrary, be construed as referring to deduction or payment of income tax at the basic rate in force for the relevant year of assessment.

Section 4(1) of ICTA was repealed by ITA 2007 and was not rewritten as a general rule.

This change provides that the basic rate is to be used when amounts are grossed up for the purpose of this section. It brings the income tax and corporation tax codes back into line, and restores the law to the position before section 4(1) of ICTA was repealed.

Current practice is that the benefits received are grossed up at the basic rate and therefore this change will make no difference in practice.

Whether this change is advantageous or not depends on how section 697(3) of ICTA would be interpreted in the absence of section 4(1) of ICTA. The change is advantageous if a grossing up rate of more than the basic rate would be applied, and disadvantageous if a lower rate would be applied or no grossing up could be done.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 73: MISCELLANEOUS INCOME: BENEFICIARIES' INCOME FROM ESTATES IN ADMINISTRATION: HOW REDUCTION IN SHARE OF RESIDUARY INCOME OF ESTATE UNDER SECTION 697(2) AND (3) OF ICTA OPERATES FOR SUCCESSIVE ABSOLUTE INTERESTS: SECTION 954

This change relates to the reduction in the share of the residuary income of the estate required where the amounts paid during or payable at the end of the administration period in respect of an absolute interest are less than the share of the residuary income for all tax years, and clarifies how the reduction is to be made in cases where the absolute interest has been held successively.

It brings the income tax and corporation tax codes back into line.

Under section 697(2) of ICTA on the completion of the administration of an estate in which a company has an absolute interest, a comparison is made between the aggregate benefits received in respect of that interest and the aggregate for all years of the residuary income of the company having that interest. If the aggregate of the benefits is less than the aggregate of the residuary income, the amount of the shortfall is to be applied in reducing the company's residuary income for the tax year in which the administration is completed. If that does not exhaust the amount of the shortfall, the remainder is used to reduce the previous tax year's residuary income, and so on for earlier tax years. (Section 697(2) of ICTA is rewritten in section 951.)

Section 697(4) of ICTA provides that if a different person had an absolute interest in the residue at any time in the administration period "the aggregates mentioned in [section 697(2) of ICTA] shall be computed in relation to those interests taken together". This is too vague to indicate how the reduction is to be made under section 697(2) of ICTA where there is more than one person with a share of the residuary income of the estate available to be reduced.

One possibility would be for the reduction to be apportioned in some way between the absolute interest holders. But it is not at all obvious how such an apportionment would work because section 697(2) of ICTA requires the excess for the final tax year of the administration period to be used to reduce the last absolute interest holder's residuary income in the previous tax year.

So it is not apparent whether that would have to be done before any other person's reduction was made. The other holder or holders of the interest may have held it several tax years before the final year.

Section 954(6) and (7) of this Act provide for the reduction to be made in these circumstances. Section 954(6) provides that the last absolute interest holder's share of the residuary income should be reduced first. If there is still an excess of residuary income over the gross amount of all sums paid during or payable at the end of the administration period after going through all the years in which the final holder had the interest, the excess is then applied to the residuary income of the previous holder for the last tax year in which that person had the interest and then to earlier tax years (and earlier absolute interest holders as appropriate) working backwards.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 74: MISCELLANEOUS INCOME: BENEFICIARIES' INCOME FROM ESTATES IN ADMINISTRATION: REQUIREMENT FOR APPORTIONMENTS WHERE THE PARTS OF THE RESIDUARY ESTATE IN WHICH SUCCESSIVE INTERESTS SUBSIST DO NOT WHOLLY CORRESPOND: SECTION 959

This change introduces a requirement for just and reasonable apportionments to be made in cases involving successive interests in the residuary estate where the part of the residuary estate in which a succeeding interest subsists does not wholly correspond with the part in which the preceding interest subsisted.

It brings the income tax and corporation tax codes back into line.

The taxation of successive interests in the residue of an estate is dealt with in section 698 of ICTA. Section 701(11) of ICTA provides that where different parts of the estate are the subject of different residuary dispositions, Part 16 of ICTA has effect in relation to each of those parts with the substitution for references to the estate of references to that part of the estate. (This is rewritten as a general rule for the interpretation of this Chapter in section 934(3) of this Act.) But there is no provision for situations where the residuary estate in which a later holder acquires an interest was not all subject to the interest held by a previous holder or is only a part of the residuary estate in which a previous holder held an interest.

Section 959 of this Act provides that in such cases such apportionments as are just and reasonable are to be made. As the apportionment depends on the facts of each case, this change could result in a favourable or adverse outcome for any particular taxpayer.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 75: INVESTMENT INCOME: FOREIGN DIVIDEND COUPONS: CHARGE ON INCOME TREATED AS ARISING FROM FOREIGN HOLDINGS: SECTION 974

This change clarifies two points in rewriting section 18(3B) of ICTA. First, that a "bank in the United Kingdom" means a bank's office in the United Kingdom, whether the bank is resident in the United Kingdom or abroad. Second, that a "dealer in coupons in the United Kingdom" means a coupon dealer carrying on business in the United Kingdom, whether the dealer is resident in the United Kingdom or abroad.

This change reproduces Change 103 in ITTOIA and so brings income tax and corporation tax back into line.

Section 18(3B) of ICTA provides that a charge under Schedule D Case V arises on the sale or other realisation of coupons for foreign dividends by a "…bank in the United Kingdom…" which pays over the proceeds or carries them to an account. This is interpreted by HMRC to mean the office in the United Kingdom of a bank, whether that bank is incorporated in the United Kingdom or abroad. Similarly, a sale of such coupons to a "… dealer in coupons in

the United Kingdom …" is taken to mean a coupon dealer carrying on business in the United Kingdom, whether resident in the United Kingdom or abroad.

Section 974 is based principally on section 18(3) and (3B) of ICTA. It treats income as arising from foreign holdings where the proceeds of sale of a dividend coupon attached to the holding are (a) paid over or otherwise realised by a bank in the United Kingdom, or (b) arise from a sale to a coupon dealer in the United Kingdom by someone other than a bank or coupon dealer. So subsection (3) of the section refers to "… a bank's office in the United Kingdom…" and subsection (4) refers to a person "… dealing in coupons in the United Kingdom …" in rewriting section 18(3B) of ICTA.

Where section 18(3B) of ICTA does not apply, then section 730 of ICTA may apply to charge the foreign dividends to corporation tax. An alternative interpretation to "in the United Kingdom" may, depending on circumstances, take a sale of coupons out of one of those ICTA provisions and into another. Whether or not more or less tax is paid as a result of being taxed under section 974 of this Act or section 730 of ICTA depends on the taxpayer's own circumstances.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 76: RELIEF FOR EMPLOYEE SHARE ACQUISITIONS: RECOVERY OF RELIEF GIVEN IN RESPECT OF APPROVED SHARE INCENTIVE PLANS (SIPS): SECTIONS 986, 990, 992, 993 AND 998

This change deals with the withdrawal of relief given in respect of an approved SIP.

Schedule 4AA to ICTA gives relief for the costs of setting up an approved SIP, contributions to a plan trust and the provision of shares awarded to employees under the SIP. It is rewritten in Chapter 1 of Part 11 of this Act.

Paragraphs 10, 11 and 12 of Schedule 4AA to ICTA withdraw relief in certain circumstances.

If relief is withdrawn, Schedule 4AA to ICTA treats the company as receiving a trading receipt equal to the withdrawn relief. If the business is a property business the effect of section 21A of ICTA is to treat the company as receiving a receipt of the property business equal to the withdrawn relief (because section 85B of ICTA, which provides that Schedule 4AA shall have effect, is in Chapter 5 of Part 4 of ICTA and that Chapter is listed in section 21A(2) of ICTA). If relief is withdrawn under paragraph 11 of Schedule 4AA and the company is carrying on an investment or insurance business, paragraph 13 of Schedule 4AA provides for an amount to be taxed under Schedule D Case VI.

But paragraph 13 of Schedule 4AA to ICTA does not apply to the case where a deduction under paragraph 9 of Schedule 4AA is withdrawn under paragraph 10(1) or 10(8) or paragraph 12 of Schedule 4AA.

The purpose of this change is to clarify and make more consistent the way in which withdrawn relief is treated. This is done in section 986 of this Act, which deals with the treatment of amounts treated as received under Chapter 1 of Part 11 of this Act when relief is withdrawn. The following sections in this Act also treat a company as receiving a an amount equal to the withdrawn relief: sections 990(4) and (5), 992(4) and (6), 993(2) and (4) and 998(3) and (4). This amount is treated as received when the event withdrawing the relief occurs. In the source legislation it is treated as arising in the period of account in which the event occurs.

If the company is carrying on a trade or property business the amount is treated as a receipt of that trade or business, see section 986(2) of this Act.

If the company has ceased to carry on the trade or property business the amount is treated as a post-cessation receipt, see section 986(3). This clarifies the existing law which does not expressly deal with the case of a trading receipt received after the trade has ceased.

If the company is not carrying on, or has not carried on, a trade or property business the amount is one to which the charge to corporation tax on income is applied, see section 986(4). This

includes not only the amount that is taxed under Schedule D Case VI by paragraph 13 of Schedule 4AA to ICTA but also an amount which paragraphs 10 and 12 of Schedule 4AA treat as a trading receipt even though the company is not carrying on a trade.

This change clarifies and standardises the law on the basis of generally accepted practice. To that extent this change removes in principle the right of a taxpayer to assert that the generally accepted practice is unlawful.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 77: ADDITIONAL RELIEF FOR RESEARCH AND DEVELOPMENT: APPLIES FOR CORPORATION TAX ONLY: SECTIONS 1044, 1045, 1063, 1068, 1074, 1087, 1092 AND 1149

This change makes clear that the additional relief for expenditure on research and development (including vaccine research) and for expenditure on the remediation of contaminated land applies only for corporation tax.

Research and development

Schedule 20 to FA 2000 and Schedules 12 and 13 to FA 2002 apply only to companies. See the respective paragraphs 1(1) of each Schedule. The source legislation does not say that the relief given by those Schedules is restricted to a company liable to corporation tax. This leaves open the possibility that the reliefs are available to a company liable to income tax. Such a company would carry on a trade in the United Kingdom other than through a permanent establishment in the United Kingdom.

It is most unlikely that such a company would meet the qualifying conditions for relief but there are other more direct indicators that the reliefs are available only to companies liable to corporation tax.

First, the legislation is drafted in terms of "accounting periods" and that is a term that is defined only for corporation tax. See paragraph 1(1) of each Schedule and section 12 of ICTA.

Second, Parts 9A, 9BA and 9C of Schedule 18 to FA 1998 provide that claims to each relief must be made in the company tax return; that is, the company's return of its corporation tax liability. There is no equivalent provision for income tax.

Third, paragraph 19 of Schedule 20 to FA 2000 and paragraph 19 of Schedule 13 to FA 2002 restrict the carrying forward of a loss that has been surrendered in return for the payment of a tax credit. There is no equivalent provision for income tax.

Schedule 20 to FA 2000 and Schedules 12 and 13 to FA 2002 are rewritten in Part 13 of this Act (additional relief for expenditure on research and development) and repealed by Schedule 1. Section 1044(1), and other sections in Part 13, provide that the relief applies only for corporation tax.

Contaminated land

The change that additional relief is available only to companies liable to corporation tax also applies to the additional relief that is available under section 1149 for expenditure on the remediation of contaminated land.

Paragraph 13 of Schedule 22 to FA 2001 provides that a company may deduct 150% of its qualifying land remediation expenditure from the profits of a Schedule A business or a trade carried on by the company. This paragraph does not limit the relief to corporation tax, but should only apply to corporation tax for the same reasons as those mentioned above for research and development. The change makes it clear that the additional relief applies only for corporation tax.

This change removes the possibility of entitlement to relief for companies subject to income tax.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 78: ADDITIONAL RELIEF FOR RESEARCH AND DEVELOPMENT: R&D THRESHOLD: SECTIONS 1050, 1064, 1075 AND 1097

This change makes a small adjustment to the calculation of the total qualifying R&D expenditure threshold where a company has an accounting period that is shorter than 12 months.

Schedule 20 to FA 2000 and Schedule 12 to FA 2002 provide relief for companies which have incurred qualifying expenditure on research and development. Schedule 13 to FA 2002 provides relief for companies which have incurred qualifying expenditure on vaccine-related research. These reliefs are rewritten in Chapters 2, 3, 4, 5 and 7 of Part 13 of this Act.

The source legislation in paragraph 1(1) of Schedule 20 to FA 2000, paragraphs 1(1) and 7(1) of Schedule 12 to FA 2002 and paragraph 1(1) of Schedule 13 to FA 2002 states that a company is entitled to relief for an accounting period if the company's qualifying expenditure for that period is not less than #10,000 or, if the accounting period is less than 12 months, such amount as bears to #10,000 the same proportion as the accounting period bears to 12 months. While the effect of the source legislation is generally understood, it is not explicit how it should be applied to particular circumstances. The legislation requires that the short accounting period be compared arithmetically to a 12 month period (the "normal" length of an accounting period). But not all 12 month periods are the same. What is the correct comparative period of 12 months? What should happen when that 12 month comparative period includes an extra day because it is a leap year?

In the cases affected by this change, the use of an arithmetical formula in which the denominator is based on a standardised number of days in a year removes any uncertainty in this regard. The number of days in the actual accounting period is divided by 365 to obtain the relevant proportion to apply to the threshold amount in order to find the adjusted threshold. So there is no need to consider which is the correct comparison period of 12 months when more than one such period could be appropriate.

In a leap year, the source legislation lowers by £27 the £10,000 threshold in sections 1050, 1064, 1075 and 1097 of this Act. Dividing by 365 in all cases, when 366 days might have been the appropriate number for substitution into the denominator, gives a slightly higher R&D threshold for the purposes of these sections.

This change assists taxpayers because it provides certainty and clarity. But in limited circumstances it will raise slightly the qualification threshold, thereby denying relief where relief might otherwise have been available.

This change is adverse to some taxpayers in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 79: ADDITIONAL RELIEF FOR RESEARCH AND DEVELOPMENT ETC: MEANING OF "STAFFING COSTS": SECTIONS 1123 AND 1170

This change relates to the rewrite of paragraph 5(1) of Schedule 20 to FA 2000 (relief for expenditure on research and development) and paragraph 5(1) of Schedule 22 to FA 2001 (relief for expenditure on contaminated land). The effect of the change is that the definitions of "staffing costs" in sections 1123 and 1170 of this Act apply to money earnings and reimbursed expenses. (Note that "employee costs", which is the expression used in Schedule 22 to FA 2001, is rewritten in section 1170 as "staffing costs" because the terms of the definition are identical to the terms used in defining "staffing costs" in section 1123.)

Schedule 20 to FA 2000 allows a small or medium-sized enterprise to claim additional relief for qualifying expenditure on research and development that is related to its trade. "Staffing costs" (as defined in paragraph 5 of Schedule 20 to FA 2000) is one of the categories of qualifying expenditure. The same definition is applied in Schedules 12 and 13 to FA 2002.

In relation to contaminated land, Schedule 22 to FA 2001 allows a company to claim additional relief for qualifying expenditure on the remediation of contaminated land used for the purposes of a trade or UK property business. "Employee costs" (as defined in paragraph 5 of Schedule 22) is one of the categories of qualifying expenditure.

When these Schedules were introduced, paragraph 5(1)(a) of each Schedule defined staffing costs and employee costs respectively as:

> the emoluments paid by the company to directors or employees of the company, including all salaries, wages, perquisites and profits whatsoever other than benefits in kind.

This language drew on the definition of "emoluments" in section 131 of ICTA. The only difference is that section 131 of ICTA omitted the words "other than benefits in kind". Section 131 of ICTA identified the emoluments on which an employee was charged to income tax under the former head of charge, Schedule E.

Schedule E was rewritten in ITEPA. The charge on emoluments became part of the charge on employment income. The word "emoluments" is outdated and was replaced in ITEPA by "earnings". The charge on employment income is made up of a number of different elements and the meaning of "earnings" in ITEPA goes wider than the definition of "emoluments" in section 131 of ICTA.

References to emoluments in legislation not being rewritten in ITEPA were amended by that Act so as to align them with the new definition of earnings. This included the references in paragraph 5(1)(a) of Schedule 20 to FA 2000 and paragraph 5(1)(a) of Schedule 22 to FA 2001. Paragraphs 245 and 258 of Schedule 6 to ITEPA substituted the following:

(a) The earnings paid by the company to directors or employees of the company

Paragraphs 245 and 258 of Schedule 6 to ITEPA also inserted the following definition of "earnings":

> earnings or amounts treated as earnings which constitute employment income (see section 7(2)(a) or (b) of the Income Tax (Earnings and Pensions) Act 2003)

There were two problems with this amendment.

First, it was unnecessary. The definition in section 131 of ICTA applied in determining the tax charge on the employee receiving the payment. It identified an amount that constituted income in the hands of the employee. Over the years it has been the subject of a significant amount of judicial comment, particularly the meaning of "perquisites and profits whatsoever".

The definitions in paragraph 5(1)(a) of Schedule 20 to FA 2000, and paragraph 5(1)(a) of Schedule 22 to FA 2001, apply to determine the amount of an expense in the hands of the company. Although the language is the same, the definitions were independent of the definition in section 131 of ICTA because that definition was from the standpoint of the employee. None of the supporting structure of Schedule E that influenced the interpretation of the definition applies to Schedule 20 to FA 2000 or Schedule 22 to FA 2001. There was no need to change the definition in Schedule 20 and Schedule 22 to mirror the rewrite of Schedule E.

Second, inadvertently it expanded the definition so that it included benefits in kind. These came in through the reference to amounts treated as earnings in section 7(2)(b) of ITEPA. The definition of those amounts in section 7(5)(b) of ITEPA includes payments under the benefits code.

This error was corrected in paragraph 7 of Schedule 17 to FA 2004. That Schedule made a number of minor amendments to, or connected with, ITEPA. The aim of the Schedule was to restore the pre-ITEPA position with minimal differences. It did this in paragraph 5(1) of Schedule 20 to FA 2000 and paragraph 5(1) of Schedule 22 to FA 2001 by reinstating the original definition.

The difficulty with the original definition is partly that words such as "emoluments" and "perquisites" are outdated and partly that aspects of the definition are not clear. It is not certain that terms defined to regulate the income tax position of an employee have or should have the same meaning where the same term is used to regulate the corporation tax position of an employer company. In particular it is not clear what the phrase "profits whatsoever" means when looked at from the position of the employer making the payment. It is not possible to pay an amount of profit. Profit is a concept that applies to the person who receives the payment.

The reference to emoluments in paragraph 5(1)(a) of Schedule 20 to FA 2000 is rewritten in section 1123. The reference to emoluments in paragraph 5(1)(a) of Schedule 22 to FA 2001 is rewritten in section 1170. The exclusion by the source legislation of benefits in kind limits the meaning to amounts paid in money.

Both sections 1123 and 1170 rewrite the reference to emoluments in two parts:

- earnings paid in money (subsection (2)); and
- reimbursed expenses (subsection (3)).

"Earnings" is not defined so it has its ordinary meaning. It covers salaries, wages, commissions, bonuses and tips. It covers such payments whether paid regularly or otherwise. This covers part of the rewrite of "perquisites and profits whatsoever".

"Reimbursed expenses" covers the balance of the rewrite of "perquisites and profits whatsoever". It applies to cash reimbursements of expenses but not to expenses reimbursed in a non-cash form such as car and fuel benefits. This follows from the exclusion by the source legislation of benefits in kind.

In sections 1123(2) and (3) and 1170(2) and (3), the phrase "because of … employment" is used instead of the ITEPA phrase "by reason of employment". The intended effect is that interpretations developed in relation to ITEPA, which might not be appropriate in this corporation tax context, cannot simply be read across into this definition. The phrase takes its ordinary meaning. There must be a relevant payment, and on ordinary principles, that payment must have been made because of the fact of employment of that director or employee.

The requirement that the expenses are paid by the director or employee comes because paragraph 5(1)(a) of Schedule 20 to FA 2000 and paragraph 5(1)(a) of Schedule 22 to FA 2001 apply to "profits whatsoever". There is no profit to the director or employee unless he or she has incurred a personal liability that is then relieved by the company. So it would not apply to expenditure incurred by the director or employee using a company credit card (a card linked to the company's bank account) because the cost is borne by the company (the company is liable), not the director or employee.

This change modernises the language of the law without changing the meaning of the law. This change also clarifies the law on the basis of generally accepted practice. To that extent this change removes in principle the right of a taxpayer to assert that the generally accepted practice is unlawful.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 80: EXPENSES OF MANAGEMENT: CREDIT UNIONS: SECTION 1218

This change makes clear that a credit union cannot be the subject of a charge to tax on a FISMA repayment or an industrial development grant under Part 16 of this Act.

Section 487(4) of ICTA provides that a credit union is not a company with investment business *for the purpose of section 75 of ICTA.* As a result, such a company cannot have expenses of management deducted under section 75. And it follows that there can be no charge on a "reversal amount" under section 75B of ICTA.

But the charge under section 76B of ICTA on a repayment under FISMA is not dependent on there having been a previous deduction under section 75. It is arguable that the rule in section 487(4) of ICTA is not wide enough to remove the possibility of a charge under section 76B.

In the unlikely event that a credit union receives an industrial development grant it is similarly arguable that section 487(4) of ICTA does not remove the charge under section 93(1) of ICTA.

Section 1218(2) of this Act takes credit unions completely outside the rules in Part 16. So there can be no charge under the rules in Chapter 5 of that Part.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 81: EXPENSES OF MANAGEMENT: SECTION 1221

This change clarifies the relationship between:

- the rules in section 75(4) of ICTA that an expense must be in respect of the company's investment business and not for an unallowable purpose; and
- other rules that expenses are to be treated as expenses of management.

In the case of expenses that are to be treated as expenses of management, there is a distinction between:

- rules that simply treat expenditure as an expense of management; and
- rules that go to on to say that expenditure is, as a result, *deductible under section 75*.

The rules in the first category leave the expenditure to meet the tests in section 75(4) of ICTA. Section 1221 of this Act preserves this position for rules such as that in section 1244 of this Act (rewriting section 79 of ICTA).

The rules in the second category apparently override the rules in section 75(4) of ICTA. Section 1221(2) and (3) of this Act make this clear.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 82: EXPENSES OF MANAGEMENT: CESSATION OF BUSINESS: SECTIONS 1240 AND 1242 AND SCHEDULE 1

This change clarifies the deduction timing rule in cases where an investment business ceases.

Before FA 2004 a company claiming management expenses had to be one "whose business consists wholly or mainly in the making of investments" (part of the definition of "investment company" in section 130 of ICTA, used in section 75(1) of ICTA). So it was likely that when the business ceased to be carried on there would be an end of an accounting period in accordance with section 12(3)(e) of ICTA.

The timing rules in sections 90(1)(ii) and 579(3A) of ICTA make the payments referable to the "accounting period ending on the last day on which the … business was carried on". If an accounting period ends on that day, the rule is straightforward.

Since FA 2004 management expenses are available to a company with investment business. Such a company may carry on other activities, such as a trade. So it is not necessarily the case that the cessation of the investment business triggers the end of an accounting period.

These sections cater for the possibility that an accounting period does not end with the cessation of the investment business: they refer to the accounting period *in which* the investment business ceases. If an accounting period does in fact end with the cessation of the investment business, there is no change in the law.

This change applies also to the corresponding rule for expenses of insurance companies in sections 76ZG and 76ZI of ICTA (inserted by Schedule 1 to this Act).

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

CHANGE 83: CAR OR MOTOR CYCLE HIRE: SECTION 1251 AND SCHEDULE 1

This change clarifies the operation of section 578A of ICTA in three areas.

Corporation tax: expenses of management

Two rules, which partly overlap, restrict the amount that can be charged to tax when the amount of a deduction for management expenses has been reduced under section 578A(3) of ICTA and a credit reversing the expenses is later brought into account.

If there is a rebate or release of a debt, the "reversal amount" within section 75B(3) of ICTA is "so much of the debit as represents the expenses of management". The amount which "represents the expenses of management" is restricted under section 578A(3) of ICTA. So the amount treated as the "reversal amount" under section 75B(3) cannot exceed that restricted amount (£75 in the example below).

Section 578A(4) seems to duplicate this restriction. It also imposes a stronger restriction in a case where a rebate represents only part of the original deduction (see below). But in the context of management expenses, section 578A(4) applies only in relation to rebates, not releases of debts.

It is not entirely clear how section 578A(4) of ICTA should be reconciled with the competing rule given by section 75B of ICTA.

Section 1251(4) of this Act makes clear that the restriction is the same as the one made under section 1251(2). The section also makes clear what happens if the rebate or release of a debt represents only part of the original deduction.

EXAMPLE

Car hire charge	100
Restriction (25%)	25
Allowed	75
Rebate	60

It is clear that the charge on the rebate should be restricted by 25% to 45.

It is similarly uncertain how section 578A of ICTA interacts with section 76 of ICTA (expenses of insurance companies). In section 76ZN of ICTA (inserted by Schedule 1 to this Act) subsection (3)(a)(ii) caters for the possibility that the release of a debt for car hire may be a "reversal" within section 76(7) of ICTA. In that case, this rule ensures that the reversal is restricted by the appropriate fraction.

Income tax: receipt of a "rebate"

Section 578A(4) of ICTA applies if there is:

- a rebate; or
- a release of a debt,

in connection with an expense that has been restricted under the section. Section 56(4) of this Act rewrites the rule for corporation tax. But section 48(4) of ITTOIA seems to apply only to

the release of a debt: although the introductory words of subsection (4) refer to a rebate, the main part of the rule refers only to debts released. Schedule 1 to this Act amends section 48(4) of ITTOIA so that it applies also to rebates (which are brought into account as a receipt of the trade without a special rule).

Income tax: "corresponding provisions"

Section 578A of ICTA applies to:

- a trading deduction;
- a management expense; and
- an expense of an insurance company.

A rebate or release of a debt is restricted under subsection (4) however the original deduction was given. Sections 56(3) and (5) and 1251(3) and (5) of this Act make this clear by referring to a "corresponding provision". But section 48(4) of ITTOIA deals only with the case where the original deduction (as a trading expense) was restricted under that section. Schedule 1 to this Act amends section 48(3) of ITTOIA, and introduces a new subsection (4A), so that it applies also to deductions previously given as a management expense or as an expense of an insurance company.

Summary

The corporation tax change merely clarifies the law. The income tax changes restrict a charge to tax in cases where ITTOIA may not give the restriction.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 84: PARTNERSHIPS: REINSTATEMENT OF SECTION 111(10) OF ICTA: SECTION 1258

This change makes clear that the rule in section 1258 of this Act (that a firm is not a separate entity for tax purposes) applies to a firm carrying on any business, whether or not that business is a trade.

It brings the income tax and corporation tax codes back into line.

Section 111(1) of ICTA provides that a partnership is not to be treated as an entity separate and distinct from the partners. The subsection refers to a trade or profession carried on in partnership.

Before section 111 was amended by ITTOIA subsection (1) applied to all businesses, not just trades and professions. The extension to all businesses was lost when subsection (10) was repealed by ITTOIA.

But sections 114 and 115 of ICTA set out the rules for calculating the profits of a firm. Those sections apply to all businesses, not just trades and professions. So it is doubtful whether the absence of the rule in section 111(10) has any consequences.

The broadening of the rule brings more companies into it. Whether this is favourable or adverse to those companies depends on the particular circumstances.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 85: DISTRIBUTIONS AND PARTNERSHIPS: SCHEDULE 1

This change makes it clear that section 114(1)(a) of ICTA does not apply to payments received by companies carrying on a business in partnership.

Section 114(1) of ICTA requires that the profits of a trade etc carried on in partnership should be calculated as if the trade etc were carried on by a company (the "deemed company" in section 1261). In calculating those profits, section 114(1)(a) provides that "references to distributions shall not apply".

It is clear from the context that this rule applies to payments made *by* the firm. So there is no question of a payment of, say, interest being treated as a distribution by the firm under section 209 of ICTA and being disallowed in calculating the firm's profit.

There is a theoretical possibility that the rule in section 114(1)(a) of ICTA also applies to payments *to* the firm. In that case, the rule in section 208 of ICTA (which removes distributions by a United Kingdom resident company from the charge to corporation tax) would not apply and the distributions received would be a receipt of the firm's trade etc.

This is not how the rule is interpreted in practice. So section 1260(2) deals only with payments *by* the firm. But there is an indication in the Real Estate Investment Trust rules that section 114(1)(a) of ICTA does apply to payments to a firm: section 121(4) of FA 2006 provides that section 114(1)(a) of ICTA "does not disapply subsection (1)". That subsection charges some distributions to tax as if they were receipts of a property business. HMRC's view is that section 121(4) of FA 2006 is unnecessary because section 114(1)(a) of ICTA does not in any case affect section 121(1) of FA 2006.

Schedule 1 to this Act repeals section 121(4) of FA 2006.

Treating section 114(1)(a) of ICTA as applying to payments received by a firm would increase the tax liabilities of its partners. So the removal of the possibility of that treatment reduces those liabilities.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 86: PARTNERSHIPS: ALLOCATION OF FIRM'S PROFITS BETWEEN PARTNERS: SECTIONS 1263 AND 1264

This change legislates the practice in paragraph 72245 of the HMRC Business Income Manual.

It brings the income tax and corporation tax codes back into line.

Section 114(2) of ICTA provides that a partner's share of the profits or losses of a trade carried on in partnership is to be determined "according to the interests of the partners". It offers no guidance on how this is to be done.

Some partnership agreements provide for an initial allocation of profits (often in the form of a salary or interest on capital) to some partners before the balance is allocated on the basis of a percentage share in the profits.

For instance, three partners may agree to allocate profits of 250,000 as follows:

Partner	***A***	***B***	***C***	***Total***
Salary	50,000	50,000		100,000
Balance (30/30/40)	45,000	45,000	60,000	150,000
Total	95,000	95,000	60,000	250,000

But, if the profits were only 90,000, the position would be:

Partner	***A***	***B***	***C***	***Total***
Salary	50,000	50,000		100,000

Partner	***A***	***B***	***C***	***Total***
Balance (30/30/40)	(3,000)	(3,000)	(4,000)	(10,000)
Total	47,000	47,000	(4,000)	90,000

Section 114(2) of ICTA deals in this case with an allocation of the trade *profits*. So the answer for partner C cannot be a loss. HMRC practice, supported by decisions by the Special Commissioners, is to re-allocate C's "loss" to the other partners, so that in the example both A and B are allocated 45,000 of the trade profits. C's share is nil.

A similar position can arise if the result for the firm is a loss. A share of that loss under section 114(2) of ICTA cannot be a profit.

Section 1263 of this Act sets out how a profit is to be allocated between partners, so that no partner's share is a loss. Section 1264 of this Act sets out the corresponding rule for the case where the overall result is a loss.

Whether the new statutory rules for apportioning profits result in an adverse or favourable result for particular partners depends upon the particular circumstances.

This change is in principle adverse to some taxpayers and favourable to others but it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 87: PARTNERSHIPS: RESIDENT PARTNERS AND DOUBLE TAXATION AGREEMENTS: SECTION 1266 AND SCHEDULE 1

This gives statutory effect to the HMRC practice of giving a narrow interpretation to the word "affect" in section 115(5A) of ICTA.

It brings the income tax and corporation tax codes back into line.

The business profits article of the United Kingdom/Jersey double taxation agreement exempts the profits of a Jersey firm from United Kingdom tax. In the case of Padmore v CIR (1989), 62 TC 352 CA[10], the Court of Appeal decided that the exemption covered the share of the profits arising to a United Kingdom resident partner. The rules in section 115(5) to (5B) of ICTA were enacted in 1987 to remove the exemption.

It was intended that the 1987 legislation should do no more than remove the exemption claimed in the Padmore case. The words used in section 115(5A) of ICTA are "do not affect any liability to corporation tax". On the face of it, these words could deny the partner any relief, including tax credit relief, under a double taxation treaty.

Subsection (2) of section 1266 of this Act makes it clear that it is only the partner's chargeability to tax that is preserved, overriding any provision to the contrary in a double taxation treaty. No other effect of the treaty is overridden.

The amendment of section 59 of TCGA in of Schedule 1 to this Act makes a similar clarification in relation to relief under double taxation arrangements for capital gains tax and for corporation tax on chargeable gains.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 88: PARTNERSHIPS: CHANGE OF BASIS: SCHEDULE 1

This change concerns the charge on a change of basis by a firm carrying on a property business.

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ICTA and FA 2002

The change of basis rules in section 64 of, and Schedule 22 to, FA 2002 apply to property businesses because the rules are specifically applied by section 21B of ICTA. In the case of a property business carried on in partnership section 111(10) of ICTA (before it was repealed by ITTOIA) and section 114(1) of ICTA (for corporation tax) set out how each partner's share of the income from a property business is determined.

In addition paragraph 13 of Schedule 22 to FA 2002 sets out how to calculate each partner's share of an adjustment charge.

ITTOIA

Section 860 of ITTOIA rewrites paragraph 13 of Schedule 22 to FA 2002 for income tax. It is expressed to apply to trades. The extension of the rules in the partnership Part of ITTOIA to non-trade businesses (see section 847(2) of that Act) does not apply to section 860. So for income tax there is no explicit rule about how to deal with the partners' share of adjustment income in a property business.

This Act

Section 1267 of this Act applies explicitly to property businesses and rewrites the FA 2002 rules (as applied by section 21B of ICTA). Schedule 1 to this Act amends section 860 of ITTOIA to fill the gap left by ITTOIA and to bring the income tax and corporation tax codes back into line.

The change does not affect the total amount charged to income tax on a change of basis. It makes more certain what each partner's share of that amount is. If a partner was able to take advantage of any uncertainty in ITTOIA and argue that the partner's share should be less than that previously prescribed by ICTA and FA 2002, the change in this Act is adverse to that partner. But in that case the change is necessarily favourable to the other partners.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

CHANGE 89: PARTNERSHIPS: SALE OF PATENT RIGHTS: SECTIONS 1271 AND 1272 AND SCHEDULE 1

This change explains how section 558 of CAA applies if there is a change of membership of a firm.

Under section 524(1) of ICTA an amount of tax is charged on the seller in instalments over a number of accounting periods. Section 525(3) of ICTA applies "where … a charge falls to be made on two or more persons jointly as being the persons for the time being carrying on a trade …".

It is clear from section 558 of CAA that the intention is that the present partners should step into the shoes of the seller of the patent rights. But it is not clear how this should work in practice. In particular, it is not clear:

- how such a charge is to be converted into a charge that falls on the persons for the time being carrying on the business;
- by what mechanism the corporation tax charged under section 524 of ICTA is to be replaced by the charges (to income tax or corporation tax) that are appropriate to the persons for the time being carrying on the business; or
- how the spreading of the charge should work given that individuals may become liable for tax that was originally charged by reference to accounting periods and companies may become liable for tax that was originally charged by reference to tax years.

The change clarifies the effect of the legislation by filling in these gaps.

The same clarification is made by amendments to sections 861 and 862 of ITTOIA (see Schedule 1 to this Act).

Whether this particular basis is adverse or favourable to any particular taxpayer in comparison with any other theoretical basis will depend upon the specific circumstances.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 90: UNREMITTABLE INCOME: CONDITIONS FOR GRANTING RELIEF: SECTION 1274

This change broadens one condition and removes another condition for claims for relief in respect of unremittable income under section 584 of ICTA. The corresponding change was made for income tax by section 841 of ITTOIA (see Change 135 in Annex 1 to the explanatory notes for that Act).

This change brings the income tax and corporation tax codes back into line.

Section 584 of ICTA provides for relief for companies taxed on income arising outside the United Kingdom, where the income cannot be remitted to the United Kingdom and certain conditions are met. Section 584(1)(a) and (2)(b) of ICTA refers to income which cannot be remitted to the United Kingdom because of the laws of the overseas territory, any executive action of its government or the impossibility of the company obtaining foreign currency in the overseas territory "notwithstanding any reasonable endeavours on its part".

(1) It could be argued that there cannot be an inability to transfer due to the impossibility of obtaining foreign currency in that territory if foreign currency is in fact obtainable there (regardless of whether it may be transferred to the United Kingdom). Section 1274(3)(c) of this Act removes the possibility of that narrow interpretation being taken. It requires an inability to transfer because of the impossibility of obtaining in the territory currency "that could be transferred to the United Kingdom". The reference to that currency being foreign has been dropped as misleading. If local currency can be obtained that cannot be transferred to the United Kingdom, the case is likely to fall within section 1274(3)(a) or (b), but there is no point in excluding it from paragraph (c).

(2) The condition about "reasonable endeavours" in section 584(2) of ICTA is not rewritten in this Act. It is regarded as adding little to the requirements of section 584(1)(a) ICTA. If, by reasonable endeavours, the taxpayer company could transfer the income to the United Kingdom, the test in section 584(1)(a) of ICTA of its being prevented from transferring it must not be met, and there would then be no inability to transfer *because of* local law, government action or the impossibility of obtaining foreign currency as required under section 584(1)(a) of ICTA.

This change increases the range of income in respect of which relief for unremittable income may be available.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 91: UNREMITTABLE INCOME: WITHDRAWAL OF RELIEF: ECGD PAYMENTS RECEIVED: SECTION 1276

This change involves the withdrawal of relief in respect of unremittable income on the making of an Export Credit Guarantee Scheme payment in respect of the income. The corresponding change was made for income tax by section 843 of ITTOIA (see Change 141 in Annex 1 to the explanatory notes for that Act).

This change brings the income tax and corporation tax codes back into line.

Section 584 of ICTA provides a relief from income tax where a company's income arising outside the United Kingdom is charged on the basis of the income arising in the accounting

period, but that income cannot be transferred to the United Kingdom because of circumstances outside the company's control ("unremittable income"). Section 584(2) of ICTA provides that if such a company makes a claim in respect of overseas income which:

- is unremittable; and
- it will continue to be prevented from transferring to the United Kingdom, notwithstanding any reasonable endeavours on its part,

the amount of the income is to be left out of account in charging income from that source.

However, under section 584(2A) of ICTA, if on any date "paragraph (a) or (b) of subsection (2) above ceases to apply" the income is treated as arising on the date of the change and is charged to tax for the accounting period in which that date falls.

Section 584(5) of ICTA modifies the operation of the relief where a payment is made under the Export Credit Guarantee Scheme in respect of the unremittable income. Section 584(5) of ICTA provides that "…to the extent of the payment, the income shall be treated as income to which paragraphs (a) and (b) of subsection (2) above do not apply (and accordingly cannot cease to apply)". This makes it clear that no claim can be made, but not whether relief already given may be withdrawn or, if it may, whether the charge to withdraw the relief is to be made for the accounting period in which the income first arose, or the accounting period in which the Export Credits Guarantee Department payment ("ECGD payment") is made.

This lack of clarity appears to be an unintentional result of amendments made by paragraph 33 of Schedule 20 to FA 1996, which substituted the present subsections (2) and (2A) of section 584 of ICTA for the original subsection (2) and amended subsection (5) in consequence. Those amendments, which were part of the changes made to facilitate Self Assessment for income tax, built on the changes already made by F(No 2)A 1987 for the introduction of "Pay and File" for corporation tax. (Prior to ITTOIA, section 584 of ICTA applied for both income tax and corporation tax.)

Before the FA 1996 changes section 584(2) of ICTA provided not only that account would not be taken of the income to the extent that the claimant showed "to the satisfaction of the Board that conditions [corresponding to those in paragraphs (a) and (b) in the present subsection (2)]" were satisfied with respect to it, but also that "on the Board ceasing to be satisfied that those conditions are satisfied" such assessments etc were to be made as were necessary to take account of the income and of any tax payable in the overseas territory in respect of it "according to their value at the date when in the opinion of the Board those conditions cease to be satisfied with respect to it".

The original section 584(5) of ICTA provided that, to the extent of the Export Credit Guarantee Scheme payment, the income should be treated as income "with respect to which the conditions mentioned in subsection (2) above are not satisfied (and accordingly cannot cease to be satisfied)". So it plainly had the effect that not only could no claim be made, but the Board would be bound to be satisfied that the income had ceased to be unremittable – or perhaps had never been unremittable – and so it could be assessed. It was never very clear what date was to be used for the value of the income and the foreign tax. But presumably the only date that could be used was the date when the Board had to cease to be satisfied, that is the date of the payment.

There is no good reason for the treatment of income which is no longer unremittable to vary according to whether circumstances have changed or an ECGD payment has been made. So the apparent change in the effect of section 584(5) of ICTA introduced by FA 1996 appears to have been completely unintentional. In practice, the income is taxed in the accounting period in which the ECGD payment is made. Therefore section 1276(4) and (5) of this Act, which rewrites section 584(5) of ICTA, provides for the income to be taxed in that accounting period, and accordingly for the income and any tax payable in respect of it in the place where it arises to be taken into account for corporation tax purposes at that date.

This change withdraws or prohibits relief by reference to the payment of an Export Credit Guarantee Scheme payment in addition to, rather than solely by virtue of, the income becoming remittable.

This change is adverse to some taxpayers in principle. But it is in line with the original legislation before amendment and with the intention of the amended legislation. And it is expected to have no practical effect as it is in line with current practice.

CHANGE 92: GENERAL EXEMPTIONS: SAVINGS CERTIFICATES: UNAUTHORISED PURCHASES INVOLVING MULTIPLE CERTIFICATES: SECTIONS 1281 AND 1282

This change enables multiple savings certificates to be regarded as authorised in part where an unauthorised number of certificates have been purchased, and so confers exemption on the income from the part that is so regarded.

The Treasury limit the number of savings certificates of any particular issue that a person is permitted to purchase. The limits are stated in the prospectus for each issue.

The income from savings certificates is exempt from corporation tax under section 46 of ICTA. However, the exemption only applies to certificates purchased within the permitted limits. Section 46(3) of ICTA provides that the exemption does not apply to savings "... certificates ... purchased ... in excess of *the amount* which a person is for the time being authorised to purchase ...". It is not entirely clear how this would work in the case of multiple certificates. (These are certificates which represent a number of individual unit certificates.)

For example, if the maximum number of certificates permitted is 100, X holds 80, and then purchases a multiple certificate of 50, section 46(3) of ICTA appears to prevent the exemption from applying to the second multiple certificate. However, in practice, the second certificate is treated as 50 individual certificates, so that 20 would be treated as authorised and 30 as unauthorised.

Sections 1281(2) and 1282(4) of this Act reflect this practice by providing that certificates are authorised "so far as" their acquisition was not prohibited by regulations made by the Treasury limiting a person's holding or, in the case of Ulster Savings Certificates, such regulations made by the Department of Finance and Personnel.

The change provides an exemption where it could otherwise be argued that no exemption is due.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 93: GENERAL CALCULATION RULES: EXCEPTIONS FROM THE DISALLOWANCE OF EXPENDITURE ON BUSINESS ENTERTAINMENT AND GIFTS IN CALCULATING THE PROFITS OF NON-TRADE AND NON-PROPERTY BUSINESSES: SECTIONS 1298 TO 1300

This change extends an exception made in calculating profits of a business which is a trade or property business to non-trade and non-property businesses.

It brings the income tax and corporation tax codes back into line.

Section 577 of ICTA (business entertaining expenses) prohibits the deduction of business entertaining expenditure in calculating profits chargeable to tax under Schedule D. Profits chargeable to tax under Schedule D include not only profits of a trade, profession or vocation, whether chargeable under Case I, II or V of that Schedule, but also profits chargeable under other Cases of that Schedule. Section 21A(2) of ICTA applies section 577 of ICTA to the computation of income under Schedule A.

Section 577(8) of ICTA extends the restriction of expenses to those incurred in the provision of gifts.

There are a number of exceptions from the restriction under section 577(1) or (8) of ICTA. Subsection (9) makes an exception for "expenditure incurred in making a gift to a body of persons or trust established for charitable purposes only" and two named bodies are treated as such a body of persons for this purpose. This exception applies only in "computing profits under Case I or II of Schedule D".

So the exception provided by section 577(9) of ICTA does not apply to businesses other than trades, professions and vocations or property businesses.

It is not HMRC policy, despite the words of section 577(9) of ICTA, to make a distinction in the application of the exception between trades and property businesses and other businesses. Sections 1298 to 1300 of this Act extend the benefit of the exception in principle to those other businesses.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 94: GENERAL CALCULATION RULES: EXCEPTIONS TO THE RULE RESTRICTING DEDUCTIONS FOR BUSINESS GIFTS: SECTION 1300

This change provides for the monetary limit on the cost of gifts excluded from the general rule prohibiting a deduction for such expenses (see section 1298 of this Act) to be increased by Treasury order.

It brings the income tax and corporation tax codes back into line.

Section 1300(3) of this Act is based on section 577(8)(b) of ICTA. The £50 limit in section 577(8)(b) of ICTA (previously £10) was inserted with effect in relation to accounting periods beginning on or after 1 April 2001 by section 73 of FA 2001 in line with an increase in the corresponding VAT provision made by Treasury order.

Section 577(8)(b) of ICTA was rewritten as it applied to employees by section 358(3)(b) of ITEPA. Section 716(2) of ITEPA provides that the Treasury may by order increase, or further increase, the sum specified in various provisions in ITEPA including the £50 limit in section 358(3)(b) of ITEPA.

Section 577(8)(b) of ICTA was rewritten as it applied to income tax on trades, professions and vocations by section 47 of ITTOIA. (Section 47 of ITTOIA is applied to other businesses for income tax purposes by sections 272 and 867 of ITTOIA.) Section 47 of ITTOIA provides that the Treasury may by order increase, or further increase, the £50 limit in section 47(3)(b) of ITTOIA.

Section 1300 of this Act brings the mechanism for changing the limit for corporation tax purposes into line with ITEPA, ITTOIA and the VAT provisions.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

CHANGE 95: GENERAL CALCULATION RULES: APPORTIONMENT ETC OF MISCELLANEOUS PROFITS AND LOSSES TO ACCOUNTING PERIOD: SECTION 1307

This change modifies the application of section 72 of ICTA so that it applies to certain income within Schedule D Case V as well as Case VI. The corresponding change was made by for income tax by section 871 of ITTOIA (see Change 147 in Annex 1 to the explanatory notes for that Act).

This change brings the income tax and corporation tax codes back into line.

Section 72(1) of ICTA permits the apportionment of profits or losses for the purposes of Schedule D Cases I, II or VI if accounts have been made up for a period which is not coterminous

with the accounting period. Section 72 of ICTA is applied by section 21A of ICTA for the purpose of calculating the profits of a Schedule A business.

Although section 72 of ICTA is expressed to apply in the case of profits or gains chargeable under Schedule D Cases I, II and VI only, it applies also to income from a trade chargeable to tax under Schedule D Case V. Section 70(2) of ICTA applies the rules applicable to Schedule D Case I in computing such Schedule D Case V income. Section 52 of this Act (apportionment etc. of profits and losses to accounting period) applies the rule in section 72 of ICTA to all trades, whether income from the trade falls within Schedule D Case I or Case V.

Section 1307 of this Act applies the rule in section 72 of ICTA for the purpose of calculating income charged under provisions listed in section 834A of ICTA (inserted by Schedule 1 to this Act). Subsection (2) of section 1307 disapplies section 834A(3) of ICTA, which excludes income chargeable under Chapter 8 of Part 10 of this Act from the tables in that section so far as the income arises from a source outside the United Kingdom. This ensures that section 1307 extends to income within Schedule D Case V as well as income within Case VI.

This change increases the range of income to which the apportionment provisions may apply.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 96: OTHER GENERAL PROVISIONS: DEFINITION OF "CARAVAN": SECTION 1314

This change provides a single definition of "caravan" and is based on section 29(1) of the Caravan Sites and Control of Development Act 1960 and section 13(1) of the Caravan Sites Act 1968.

It brings the income and corporation tax codes back into line.

The change is relevant to sections 43, 207, and 248.

For the purposes of paragraph 3 of Schedule A (see section 15(1) of ICTA) "caravan" has the meaning given by section 29(1) of the 1960 Act. Paragraph 3 is re-written in section 207. The same definition is attracted by paragraph 4 of Schedule A (re-written in section 248).

Subsection (1) of section 1314 of this Act reproduces the effect of section 29(1) of the 1960 Act; and subsection (2) reproduces the effect of section 13(1) of the 1968 Act. The section does not, however, reproduce the effect of section 13(2) of the 1968 Act (which provides that a structure mentioned in section 13(1) (a twin-unit caravan) is not a caravan if its dimensions exceed specified limits). Neither the 1960 Act nor the 1968 Act extend to Northern Ireland. However, the Caravans Act (Northern Ireland) 1963 contains the same definition for Northern Ireland as is contained in section 29(1) of the 1960 Act.

It is not clear whether the 1968 Act modifications apply for the purposes of paragraphs 3 and 4 of Schedule A in ICTA. First, it is likely that Parliament intended that only one definition of "caravan" was to apply throughout the United Kingdom. But the 1968 Act does not extend to Northern Ireland. As the substance of the definitions in the 1960 Act (which applies to Great Britain) and in the Northern Ireland Act of 1963 are the same, a reference to the definition in the 1960 Act would be enough to secure a uniform definition.

Second, paragraph 3(2) of Schedule A in ICTA provides that "caravan" has the meaning "given by" section 29(1) of the 1960 Act. Section 13 of the 1968 Act modifies the operation of Part 1 of the 1960 Act (rather than the section 29(1) definition). Because the definitions in section 29(1) apply "in" Part 1 of the 1960 Act it is therefore not certain whether the modifications made by the 1968 Act have been attracted.

Section 1314 resolves these doubts by reproducing only section 13(1) of the 1968 Act. Consequently it does not matter whether a twin-unit caravan can be lawfully moved on a highway when assembled. For the purposes of Schedule A (rewritten as property income in this Act) it is also immaterial if the twin-unit caravan exceeds the dimensions specified in

section 13(2) of the 1968 Act: property income treatment seems more appropriate the bigger the structure.

This change extends the meaning of "caravan" which may result in a more beneficial tax treatment.

The changes are in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 97: REPEAL OF SECTION 74(1)(K) OF ICTA: DISALLOWANCE OF DEDUCTION FOR AVERAGE LOSS: SCHEDULE 1

This change omits the prohibition of a deduction for "any average loss beyond the actual amount of loss after adjustment" in section 74(1)(k) of ICTA.

It brings the income tax and corporation tax codes back into line.

The rule in section 74(1)(k) of ICTA applies to the practice in shipping and aviation of sharing between all parties with a financial interest in a vessel and its cargo the financial loss incurred where *part* of a vessel or its cargo is jettisoned, lost or damaged in an attempt to save the vessel, the crew and passengers or the rest of the cargo.

The term "average loss" refers to the share of the loss allocated to each party. The term "actual amount of loss after adjustment" reflects the possibility that loss adjusters will be involved in determining the actual loss for insurance purposes.

The loss after adjustment may not be known for some years after the loss has occurred. Under section 74(1)(k) of ICTA, the tax position for the accounting period in which the loss occurred should strictly be kept open until the adjusted figure is known.

Generally accepted accountancy practice in such cases is to make a provision in the accounts for the period in which the loss occurs and review the provision in later years so that over time the total deduction matches the loss suffered. Dispensing with section 74(1)(k) allows the taxpayer to follow generally accepted accountancy practice by bringing the timing of the deduction into line with the accounts.

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to circumstances. Any overall tax effect is likely to be negligible.

CHANGE 98: [NOT USED IN THIS ACT]

CHANGE 99: REPEAL OF SECTIONS 586 AND 587 OF ICTA: SCHEDULE 1

This change concerns the repeal of sections 586 and 587 of ICTA.

Section 586 of ICTA was enacted in 1940 and denies relief for payments made in connection with certain war damage indemnity schemes. Section 587 of ICTA was enacted in 1941 and denies relief for certain payments in respect of war injuries of employees.

Both sections apply only if the United Kingdom is in a declared state of war and were a response to the particular circumstances of the Second World War. Because of the very high rates of taxation during the war (seen most clearly in the case of Excess Profits Tax at 100%) these payments could often be made entirely at the Exchequer's expense. The likelihood of the sections becoming operative and accurately reflecting policy at that time is remote. Sections 586 and 587 are for all practical purposes obsolete.

Both sections apply only for corporation tax. They were effectively repealed for income tax by the consequential amendments made by paragraphs 247 and 248 of Schedule 1 to ITTOIA.

This change completes the repeal of a prohibition on relief for all tax purposes.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect.

CHANGE 100: REPEAL OF SECTION 695(6) OF ICTA: SCHEDULE 1

This change relates to the omission of section 695(6) of ICTA, which requires that where relief is given to a company with a limited or discretionary interest in a foreign estate for United Kingdom income tax borne by the income of the estate, the company's income should include an amount corresponding to the relief.

It brings the income tax and corporation tax codes back into line.

Section 695(5) of ICTA enables a beneficiary of a foreign estate who is entitled to a limited interest in the residue of the estate and is charged to tax for an accounting period in respect of income from the estate to claim relief if any of the aggregate income of the estate has borne United Kingdom income tax for a relevant year of assessment. Section 698(3)(b) of ICTA applies this also to beneficiaries who are charged in respect of income paid from the estate under a discretion.

Section 695(6) of ICTA (which is also applied by section 698(3)(b) of ICTA) provides that where the relief is given "such part of the amount in respect of which [the beneficiary] has been charged to corporation tax as corresponds to the proportion mentioned in [section 695(5) of ICTA] shall be deemed to represent income of such amount as would after deduction of income tax be equal to that part of the amount charged". (The proportion referred to is the proportion that the amount of the beneficiary's income that has borne United Kingdom income tax, less the tax, bears to the amount of the aggregate income of the estate, less United Kingdom income tax.) The meaning of this provision, which originated while surtax was still charged, is now obscure, and it is particularly difficult to see how it could operate in the context of Self Assessment for corporation tax. Consequently, in practice it tends to be ignored. Therefore it is not being rewritten in this Act.

This change is beneficial to the taxpayer because the amount of the relief given under section 695(5) of ICTA to a beneficiary does not count as the beneficiary's income and so the beneficiary's income is reduced.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

CHANGE 101: REPEAL OF SECTION 817 OF ICTA: SCHEDULE 1

This change concerns the repeal of section 817 of ICTA.

Section 817 of ICTA can trace its origins back almost unchanged to the 1803 Income Tax Act. The general clarifications it provides may have served some useful purpose in the early years of income tax. But they are no longer required.

The section is a profit calculation rule. It applies in "arriving at the amount of profits or gains". It does not apply to deductions made after those profits have been calculated. The scope of the word "profits" is not clear. Section 817 of ICTA is not included in the definition of "profits" in section 6 of ICTA. Given the restrictions in section 38 of TCGA, section 817 of ICTA could have no application to the calculation of chargeable gains even if it were thought capable of applying to that element of the corporation tax profit.

Section 817 of ICTA appears to apply to the calculation of the income element only of corporation tax profits.

The primary purpose of the section is set out in subsection (1)(a). This provides that no deduction is allowed in calculating the profits unless the deduction is "expressly enumerated in the Corporation Tax Acts". This Act and those parts of the corporation tax code that are not yet rewritten set out what deductions are to be allowed in calculating the various types of profit. There is no need for a general rule that says no other deductions are to be allowed.

Subsection (1)(b) denies a deduction for an annuity or other annual payment from which income tax is deducted and which is paid out of the profits. A payment made out of the profits pre-supposes that the profits have been calculated. Such a rule can have no application in calculating the amount of the profits.

Subsection (2) denies a deduction for a loss of capital or a loss in a trade or office or profession. In this Act the treatment of capital is dealt with in the rules that set out how to calculate profits from different sources. There is no method of calculation that would allow a deduction for a trade loss in calculating the profit from another trade or source. It is not clear what is meant by a loss in an office. If it means an excess of expenses over income again there is no method of calculation that would allow a deduction for this negative amount in calculating the profit from another source.

Section 817 was repealed for income tax by the amendments made by paragraph 327 of Schedule 1 to ITTOIA.

This change completes for all tax purposes the repeal of a rule restricting deductions.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 102: REPEAL OF PARAGRAPH 5 OF SCHEDULE 30 TO ICTA: SCHEDULE 1

This change concerns the repeal of paragraph 5 of Schedule 30 to ICTA.

Paragraph 5 of Schedule 30 to ICTA is a transitional measure that relates to the pre-1963 version of Schedule A. Under that version of Schedule A, a company which owned the property from which it carried on a trade was allowed a Schedule D Case I deduction equal to the amount of the Schedule A charge on the property. The right to the deduction was removed when Schedule A moved from a charge on the annual value of the property to a charge on the rent received.

At that time companies were liable to income tax not corporation tax. Timing differences between Schedule D Case I and Schedule A could result in a loss of relief if the company ceased to occupy the property for the purposes of the trade in a period in which it did not also cease to carry on the trade. FA 1963 introduced a deduction to compensate for this loss of relief. It is based on the relief that would have been given for the years 1963-64 and 1964-65 and is allowed in calculating the trade profits for the accounting period in which the company ceases to carry on the trade.

In theory it is still possible to claim the relief but given the passage of 45 years and the effects of inflation it is unlikely any new claims will be made on or after 1 April 2009. For this reason paragraph 5 of Schedule 30 to ICTA is redundant and can be repealed.

Paragraph 5 was repealed for income tax by the amendments made by paragraph 352 of Schedule 1 to ITTOIA.

This change completes the repeal for all tax purposes of a relieving provision.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect.

CHANGE 103: REPEAL OF SECTION 63 OF FA 1999: TREATMENT OF TRANSFER FEES UNDER PRE-1999 CONTRACTS: SCHEDULE 1

This change concerns the repeal of section 63 of FA 1999.

Section 63 of FA 1999 provides for transitional relief for football and other sports clubs on the introduction of new accounting standards for intangible assets in 1997 and 1998.

Before introduction of the new accounting standards transfer fees etc were charged to the club's profit and loss account in the year in which they were due. Under the new accounting standards sums paid for players are spread over the life of the player's contract.

Without section 63 of FA 1999 the value of the unexpired part of an existing contract at the date the new accounting standard is adopted would be transferred to the balance sheet and charged to tax as income. Relief for that amount would then be spread over the remaining life of the contract.

Section 63 of FA 1999 gives transitional relief by providing that for tax purposes the requirements of the new accounting standards can be ignored for any contracts entered into before the beginning of the first accounting period in which the club adopted the new accounting standard.

The new accounting standards are effective for accounting periods ending on or after 23 December 1998. So section 63 of FA 1999 applies only to contracts entered into before 1999.

In most cases a footballer's contract will last three or four years. Contracts may be shorter in the case of a veteran player or longer in the case of a promising young player. But it is unlikely that any contracts to which section 63 of FA 1999 could apply will still be in force when this Act comes into effect on 6 April 2009. For this reason, section 63 FA 1999 is redundant and can be repealed.

This change has no implications for the amount of income liable to tax or who is liable for tax on it. It affects (in principle but not in practice) only when tax is paid.

CHANGE 104: AMENDMENTS OF CAA: SCHEDULE 1

The consequential amendments made by this Act have brought to light some minor errors in the corresponding consequential amendments made by ITTOIA.

This Act is drafted on the basis of a company starting or ceasing to carry on a trade etc, rather than on the basis of a trade etc commencing or being discontinued. So sections 114(1)(c) (partnership changes) and 337(1)(a) (successions) of ICTA are not specially rewritten. Instead the effects of partnership changes and successions are set out in the main rules where they are relevant.

Some rules that are not rewritten by this Act rely on section 114 or 337 of ICTA. So they are consequentially amended. A similar exercise was undertaken in ITTOIA. In amending the following rules in CAA it has come to light that the amendments made by ITTOIA may not have preserved the law as it was before ITTOIA.

Sections 108, 112 and 115 of CAA

Before ITTOIA section 108(1)(b) of CAA said "the disposal is not an occasion on which the qualifying activity is treated as continuing under any of the relevant provisions of ICTA". That condition can be satisfied if there is a disposal of the plant and machinery without a change in the persons carrying on the qualifying activity.

The condition in section 108(1)(b)(i), as substituted by ITTOIA, can only be satisfied if there is a change in the persons carrying on the qualifying activity.

The amendments of section 108 made by this Act, so far as relating to income tax, aim to reverse the inadvertent change in the law that resulted from the amendment made by ITTOIA.

There is also a need to reverse changes of a similar nature, again so far as relating to income tax, that resulted from the amendments by ITTOIA of sections 112 and 115 of CAA.

Section 263 of CAA

In subsection (1A)(b) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Act removes the reference.

The conditions in subsection (1A) are expressed as alternatives but they are intended to operate independently: paragraph (a) in the case of income tax; and paragraph (b) in the case of corporation tax. The replacement subsections (1)(c), (1A) and (1B) clarify the way the rules work.

Before amendment by ITTOIA the income tax rule did not apply to businesses (such as "special leasing") which are neither a trade nor a property business. The new subsection (1B) preserves the position for corporation tax. The replacement subsection (1A) reverses a change made by ITTOIA.

Section 265 of CAA

In subsection (1A)(b) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Act removes the reference.

The conditions in subsection (1A) are expressed as alternatives but they are intended to operate independently: paragraph (a) in the case of income tax; and paragraph (b) in the case of corporation tax. The replacement subsections (1)(b), (1A) and (1B) clarify the way the rules work.

Before amendment by ITTOIA the income tax rule did not apply to businesses (such as "special leasing") which are neither a trade nor a property business. The new subsection (1B) preserves the position for corporation tax. The replacement subsection (1A) reverses a change made by ITTOIA.

Section 558 of CAA

In subsection (1)(c)(ii) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Act makes the necessary correction.

Section 559 of CAA

In subsection (1A)(b) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Act removes the reference.

The conditions in subsection (1A) are expressed as alternatives but they are intended to operate independently: sub-paragraph (a) in the case of income tax; and sub-paragraph (b) in the case of corporation tax. The replacement subsections (1)(b), (1A) and (1B) clarify the way the rules work.

Section 577 of CAA

Following the repeal of sections 114(1) and 337(1) of ICTA (and the corresponding income tax rule in section 113(1) of ICTA) there is no longer any rule that *treats* an event as the equivalent of the setting up, commencement or discontinuance of a trade etc. The new subsections (2A) to (2C) set out how the rules work. Subsection (2B) sets out the income tax rule that should have been inserted by ITTOIA.

It is difficult to predict how the courts would interpret these provisions for income tax following the ITTOIA amendments. In general, treating an event as a cessation of a trade etc changes the tax liabilities of those carrying on the trade etc before and after the event: a reduction for one is balanced by an increase for the other.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

CHANGE 105: QUALIFYING HIRE CAR OR MOTOR CYCLE: SECTION 49(2)(B) OF ITTOIA: SCHEDULE 1

This change concerns the definition of "qualifying hire car or motor cycle" for the purposes of section 48 of ITTOIA in section 49(2)(b) of ITTOIA. It corrects a minor error in ITTOIA.

It brings the income and corporation tax codes back into line.

Section 48 of ITTOIA restricts the amount which can be deducted in calculating the profits of a trade for income tax purposes in respect of the cost of the hire of a car or motor cycle with a retail price (when new) of more than £12,000 *other than* "a qualifying hire car or motor cycle".

Section 49 of ITTOIA defines various terms used in section 48 of ITTOIA.

Section 49(2)(b) of ITTOIA defines "a qualifying hire car or motor cycle" as a car or motor cycle which:

((b) is hired under a hire-purchase agreement under which there is an option to purchase exercisable on the payment of a sum equal to not more than 1% of the retail price of the car when new.

The income tax rule in section 48 of ITTOIA was formerly in section 578A of ICTA. The definition of "qualifying hire car" in section 49(2)(b) of ITTOIA was formerly in section 578B(2)(a) of ICTA.

Section 578B(2)(a) of ICTA, as it applied for income tax, referred to "an option to purchase exercisable on the payment of a sum equal to not more than 1% of the retail price of the car when new". But because section 578B(1) of ICTA provided that "references to a car … include a motor cycle", the option to purchase in the case of a motor cycle had to be exercisable for a sum equal to 1% of the retail price *of the motor cycle*.

Instead of defining "car" so as to include motor cycle, sections 48 and 49 of ITTOIA refer to "a car or motor cycle" where appropriate. But the reference to the retail price of the motor cycle when new was omitted in error from the definition of "qualifying hire car" in section 49(2) of ITTOIA.

This change corrects that error. It removes any doubt as to the amount for which an option to purchase must be exercisable for a motor cycle to qualify for exemption from the restriction in section 48 of ITTOIA.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

CHANGE 106: DERIVATIVE CONTRACTS: CONTRACTS WHICH BECAME DERIVATIVE CONTRACTS ON 16 MARCH 2005: ASSUMPTION IN RESPECT OF CONSIDERATION ON DEEMED DISPOSAL: SCHEDULE 2

This change clarifies what accounting period is relevant to the calculation of the deferred capital gain to be brought into account when a company ceases to be a party to a contract that became a derivative contract as from 3.00pm on 16 March 2005.

Paragraph 4A of Schedule 26 to FA 2002 provides for a chargeable gain or allowable loss to be brought into account when a company ceases to be a party to a relevant contract (an option, future or contract for differences) that became a derivative contract on 16 March 2005 but was a chargeable asset immediately before then. "Chargeable asset" is defined in paragraph 4A(4) of that Schedule as one where a gain on its disposal would be a chargeable gain for the purposes of TCGA.

A contract to which paragraph 4A applies became a derivative contract on 16 March 2005 as a result of amendments to the definition of a derivative contract in Part 2 of Schedule 26 to FA 2002 introduced by the Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2005 (SI 2005/646).

The assumed consideration, for the purposes of the calculation of the gain or loss to be brought into account under paragraph 4A of Schedule 26 to FA 2002, is an amount "equal to the value (if any) given to the contract in the accounts of the company at the end of the company's accounting period immediately before *its first new period*". Neither in paragraph 4A nor anywhere else in Schedule 26 to FA 2002 is there any guidance as to what a company's "first new period" is. The

term occurs, in connection with provisions applying to derivative contracts, only in Schedule 28 to FA 2002 (transitional provisions on the implementation of Schedule 26 to that Act). It is defined for that purpose in paragraph 7 of Schedule 28 to FA 2002 as "its first accounting period to begin on or after" 1 October 2002, that is, the day that Schedule 26 to FA 2002 came into force.

The amendments made by the Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2005 (SI 2005/646) have effect in relation to periods of account beginning on or after 1 January 2005 and ending on or after 16 March 2005. If a company makes up its accounts to, say, 31 December, its accounting period ended 31 December 2005 will be the first accounting period to which paragraph 4A of Schedule 26 to FA 2002 can apply. Logically, the chargeable gain (or allowable loss) to be brought into account under the paragraph should therefore be that which had accrued immediately before that period began, that is, at the end of the accounting period ended 31 December 2004. The consideration used in the calculation of the gain (or loss) will therefore be the value of the contract in the company's accounts at 31 December 2004, even though the deemed disposal date is 16 March 2005. If a company makes up its accounts to, say, 30 September, the first accounting period to which the paragraph applies is that beginning on 1 October 2005. The accrued chargeable gain (or allowable loss) to be brought into account will therefore be calculated by reference to the value shown in the accounts at 30 September 2005 (but again the deemed disposal date is 16 March 2005). If the company made up accounts for a period of a few weeks early in 2005, the second leg of the commencement rule for the amendments made by the Order, that the first period to which the amendments apply must end on or after 16 March 2005, ensures that the amendments do not have effect in relation to an accounting period ending before they came into effect. "First new period" means in effect the first accounting period to which the amendments made by the Order apply.

This change repairs an omission in the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2005 (SI 2005/646). It gives certainty for the calculation of the chargeable gain or allowable loss to be brought into account under paragraph 4A of Schedule 26 to FA 2002. The application of Schedule 26 to FA 2002 to accounting periods of the company in respect of the contract in question begins with the period immediately following that identified for the purposes of finding the consideration relevant to the calculation under paragraph 4A of Schedule 26 to FA 2002.

In principle, this change is favourable to some and adverse to other taxpayers as it may identify an amount of consideration for the calculation of the deferred chargeable gain or allowable loss that differs from the amount an alternative reading of "first new period" would identify. But it is unlikely to affect significantly the aggregate profits chargeable to tax in respect of the relevant contract, whether as a chargeable gain or as credits and debits arising on a derivative contract, as regards any company to which it applies.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

ANNEX 2: EXTRA-STATUTORY CONCESSIONS, CASE LAW AND LIST OF REDUNDANT MATERIAL NOT REWRITTEN

This Annex is in three parts:

- Table 1: a list of ESCs (and one Statement of Practice) that are rewritten in the draft Bill;
- Table 2: a list of sections which involve enacting case law principles; and
- Table 3: a list of provisions that are redundant in whole or in part and are omitted by the draft Bill.

TABLE 1

The following ESCs and Statement of Practice are rewritten in the draft Bill.

ESC etc	*Description*	*See Annex 1*
C34	Tax concessions on overseas debts	Change 40
C36	Treatment of income from caravan sites where there is both trading and associated letting income	Change 4
Sp11/81	Redundancy payments: cessation of part of a trade	Change 17

TABLE 2

The following table sets out the sections which involve giving statutory effect to principles derived, wholly or mainly, from case law.

Topic	*Section*
UK company distributions: Strand Options and Futures Ltd v Vojak, 76 TC 220 CA[11]	1285

TABLE 3

The omission of provisions which are redundant in whole or in part is an integral part of the rewrite process.

But, for ease of reference, those omissions worthy of specific explanation are listed in the table below. The table also sets out where those explanations can be found.

Redundant provision	*Topic*	*See commentary on section etc*
TMA s.19(2)	Lease premiums etc — information on Case VI charges	Schedule 1
TMA ss.12AE and 31(3)	Legislating the “Crown Option”	Schedule 1
TMA s.90(1)(b) and (2)	Interest on unpaid corporation tax	1303
ICTA s9(2A) and (6)	Computation of income: application of income tax principles	969
ICTA s.11(2)(part)	Permanent establishments	19

11 STC [2004] 64
11 STC [2004] 64

Redundant provision	***Topic***	***See commentary on section etc***
ICTA s.12(2)(a)(part)	Accounting periods	9
ICTA s.12(8)	Accounting periods	Overview of Chapter 2 of Part 2
ICTA s.18(3A): Schedule D Case III(b)(i)(part),(ii)	Annual payments	977
ICTA s.18(3B) to (3E)(part)	Sale of coupons	Overview of Chapter 6 of Part 10
ICTA s.24(6)(a)	Definition of "lease"	256
ICTA s.40(1),(2),(3) (part), (4), (4A)	Apportionment of sale proceeds	259
ICTA s.70(1)	Basis of assessment	8
ICTA s.74(1)(c)	Private expenses – rent	54
ICTA s.74(1)(d)(part)	Trade tools	68
ICTA s.74(1)(da)	CAA: integral features	60 and 263
ICTA s.74(1)(f)(part)	Interest	Schedule 1
ICTA s.74(1)(g)	Improvements	53
ICTA s.74(1)(h)	Notional interest	Schedule 1
ICTA s.74(1)(m)	Annuities	Schedule 1
ICTA s.85	Approved profit sharing schemes	1000
ICTA s.86(5)(d)	Seconded employees	Schedule 1
ICTA s.92	Regional development grants	Schedule 1
ICTA s.93(2)(a)(part), (b)	Industrial development grants	102
ICTA s.95(1C)	Dealers in securities	130
ICTA s.101	Valuation of work in progress	Schedule 1
ICTA s.104(3)	Post-cessation receipts	Overview of Chapter 15 of Part 3
ICTA s.105(1)(part), (3)(part)	Post-cessation receipts – capital allowances	197
ICTA s.110(3),(4),(5)	Post-cessation receipts	Overview of Chapter 15 of Part 3
ICTA s.116(5)	Transfer of relief	1260
ICTA s.337A(2)(b)	Computation of income: intangible fixed assets	Schedule 1
ICTA s.399(1B)	Dealings in commodity futures etc: withdrawal of loss relief	Schedule 1
ICTA s.491(9),(11)(part)	Mutual concerns – examples dropped	101
ICTA s.695(6)	Beneficiaries income from estates in administration	961

Redundant provision	***Topic***	***See commentary on section etc***
ICTA s.698(1)(part)	Aggregate income of an estate	947
ICTA s.699A(1)(b)	Untaxed sums in income of an estate	963
ICTA s.700(5)(part)	Statements relating to estate income	967
ICTA s.701(6), (7)	Charges on residue	947
ICTA s.826(5A)	Interest payable	Schedule 1
ICTA Sch.5 para.3(4)(b)	Herd basis – replacement of animals	114
ICTA Sch.5 para.7(part)	Herd basis – working animal rule	110
ICTA Sch.5 para.9(part)	Herd basis – working animal rule	110
FA 1988 Sch.7(part)	Company residence	15
FA 1988 Sch.12(part)	Building societies	Schedule 1
TCGA s. 158(part)	Meaning of “trade” etc	Schedule 1
TCGA s. 201(2)	Mineral leases: royalties	Overview of Chapter 7 of Part 4
FA 1995 s.126(7A)(part)	Non-residents	Schedule 1
FA 1994 s.250	Supplementary provisions on companies treated as non-UK resident	18
FA 1996 s.81(6)	Currency other than sterling	303
FA 1996 s.103(1AA)(b)	Other profits, gains or losses	475
FA 1996 Sch.8 para.3(2)(a)(ii)	Carry back of deficits	462
FA 1996 Sch.9 para.12H(2)(b)	Transparent entities	429
FA 1996 Sch.9 para.19A(4C)	Change of accounting policy: beginning of later period	318
FA 1996 Sch.10 paras.8(6A), 8(6B)	Class of shares of an open-ended investment company	495
FA 1996 Sch.10 para.8(7C)(b)	Non-qualifying investments test	493
FA 1996 Sch.11 para.4(2)(a) (part)	Insurance profits and gains	388
FA 2000 s.46(2A)(part)	Charitable company exemptions	Schedule 1
FA 2000 s.50	Approved profit sharing schemes	1000
FA 2000 Sch.20 para 3(2)	Research and development	1052, 1053
FA 2000 Sch.20 para 24	Research and development	1054
FA 2001 Sch.22 para.1(4)(a)	Contaminated Land	1147
FA 2001 Sch.22 para.30	Contaminated Land	1179
FA 2002 Sch 12 para.4(5)	Research and development	1077
FA 2002 Sch 12 para.5(5)	Research and development	1078
FA 2002 Sch 12 para.9(4)	Research and development	1066

Redundant provision	***Topic***	***See commentary on section etc***
FA 2002 Sch 12 para.10(4)	Research and development	1067, 1071, 1072
FA 2002 Sch 12 para.10B(c)	Research and development	1071
FA 2002 Sch 13 para.3(4)	Research and development	1101
FA 2002 Sch 13 para.7(5)	Research and development	1102
FA 2002 Sch.26 para. 2A(2)(b) (part)	Derivative contracts	586
FA 2002 Sch.26 para. 4(2B)(a) (part), (2C)(a)(part) and (2CA) (a)(part)	Derivative contracts	591
FA 2002 Sch.26 para. 12(4) (part)	Derivative contracts	582
FA 2002 Sch.26 para. 29(4)	Derivative contracts	636
FA 2002 Sch.26 para. 34	Derivative contracts	637
FA 2002 Sch.26 para. 38(2)(a) (part) and (3)	Derivative contracts	637
FA 2002 Sch.26 para. 38A(2) (a)(part) and (3)	Derivative contracts	638
FA 2002 Sch.26 para. 41	Derivative contracts	Overview of Chapter 6 of Part 7
FA 2002 Sch.26 para. 45C(2)	Derivative contracts	643
FA 2002 Sch.26 para. 45D(3)	Derivative contracts	645
FA 2002 Sch.26 para. 45F(3)	Derivative contracts	648
FA 2002 Sch.26 para. 45G(1B)	Derivative contracts	650
FA 2002 Sch.26 para. 45J(5)(a) (part)	Derivative contracts	653
FA 2002 Sch.26 para. 45JA(4) (part)	Derivative contracts	666
FA 2002 Sch.26 para. 53(2) (part)	Derivative contracts	578
FA 2002 Sch.26 para 54(1) (part)	Derivative contracts	710
FA 2002 Sch.29 para.32(4)	Intangible fixed assets	748
FA 2002 Sch.29 para.132(2) to (4)	Intangible fixed assets	Schedule 1
FA 2002 Sch.29 para.141	Intangible fixed assets	Schedule 1
FA 2003 Sch.23 para.20(3)	Other relief for employee share acquisitions	1009
FA 2008 Sch.13 para.6(1)	Company gains from investment life insurance contracts	566