

*These notes refer to the Income Tax Act 2007 (c.3)  
which received Royal Assent on 20 March 2007.  
These notes are published in three volumes.*

# **INCOME TAX ACT 2007**

## **EXPLANATORY NOTES – VOLUME 1 (INTRODUCTION AND SECTIONS 1 TO 461)**

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## INTRODUCTION

1. These explanatory notes relate to the Income Tax Act 2007 (c.3) which received Royal Assent on 20 March 2007. 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 its contents. So if a section or part of a section does not seem to require 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 Income Tax Act 2007 is to rewrite the income tax legislation that has not so far been rewritten so as to make it clearer and easier to use.

6. The Act covers:

- the basic provisions about the charge to income tax, income tax rates, the calculation of income tax liability and personal reliefs;
- various specific reliefs, including relief for losses, the enterprise investment scheme, venture capital trusts, community investment tax relief, interest paid, gift aid and gifts of assets to charities;

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- specific rules about settlements and trustees, manufactured payments and repos, accrued income profits, tax avoidance and deduction of tax at source; and
- general income tax definitions.

7. 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 established practice.

## **BACKGROUND**

### ***The Tax Law Rewrite project***

8. 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.

9. 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.

10. The project team was given the task of rewriting the United Kingdom's existing primary direct tax legislation. 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 HMRC employees, private sector tax professionals and parliamentary counsel including (as head of the drafting team) a senior member of the Parliamentary Counsel Office.

### ***Steering Committee***

11. The work of the project is overseen by a Steering Committee, chaired by the Rt Hon the Lord Newton of Braintree OBE DL (who took over from the Rt Hon the Lord Howe of Aberavon CH QC at the beginning of 2006). The membership of the Steering Committee as at 31 October 2006 was:

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

Dr John Avery Jones CBE

Adam Broke

Baroness Cohen of Pimlico

Ian Dewar

Mike Eland CB

The Rt Hon Michael Jack MP

Eric Joyce MP

District Judge Rachel Karp

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David Swaine

Professor John Tiley CBE

***Consultative Committee***

12. 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 2006 was:

Mark Nellthorp	Chairman
Derek Allen	Institute of Chartered Accountants of Scotland
Brian Atkinson	100 Group
Adam Broke	Special Committee of Tax Law Consultative Bodies
Colin Campbell	Confederation of British Industry
Taha Dharsi	London Chamber of Commerce and Industry
Mary Fraser	Association of Chartered Certified Accountants
Malcolm Gammie CBE QC	The Law Society of England and Wales
Julian Ghosh	Revenue Bar Association
Keith Gordon	Chartered Institute of Taxation
Terry Hopes	Institute of Chartered Accountants in England and Wales
Isobel d’Inverno	Law Society of Scotland
Simon McKie	Institute of Chartered Accountants in England and Wales
Francis Sandison	The Law Society of England and Wales
Simon Sweetman	Federation of Small Businesses
Michael Templeman	Institute of Directors
Wreford Voge	Chartered Institute of Taxation
Professor David Williams	Office of the Social Security Commissioners
Mervyn Woods	Confederation of British Industry

***Consultation***

13. 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.

14. This consultation took the form of a series of papers which publish clauses in draft. There were 30 of these, published between April 2004 and October 2005. A draft Bill was published for consultation in February 2006. And two further papers on provisions in FA

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2006 were published in July 2006. All these documents were made available on the Tax Law Rewrite website.

15. In addition to formal consultation, the project presents its papers to the Committees to inform the Committees and seek their views on particular issues. The project has also consulted on an informal basis with specialists in particular subject areas. For example, there have been regular meetings of the VCS (venture capital schemes) rewrite group during the development of the EIS and VCT Parts of the Act. This is a small group of practitioners (who represent a number of professional bodies), policy and technical specialists from HMRC and members of the project.

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

Anne Wilson

Anthony Davis

Association of Charitable Foundations

BDO Stoy Hayward LLP

Boodle Hatfield

British Bankers' Association

Building Societies Association

Chartered Institute of Taxation

Charity Commission

Charity Law Association

Charles King-Farlow

Charles Pocock

Christine Harpin

City of Westminster & Holborn Law Society

Colin Campbell

Confederation of British Industry

David F Williams

Deloitte & Touche LLP

Department for Constitutional Affairs

Department of Finance and Personnel for Northern Ireland

Department for Social Development in Northern Ireland

Ernst & Young LLP

Euroclear

Francis Sandison

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Freshfields Bruckhaus Deringer  
George Harrison  
Helen Billing  
Horwath Clark Whitehill LLP  
Investment Management Association  
Institute of Chartered Accountants in England and Wales  
Institute of Chartered Accountants of Scotland  
James Kessler QC  
John Avery Jones  
John Clark  
John Jeffrey-Cook  
Ken Moody  
KPMG LLP  
Law Society of England and Wales  
London Investment Banking Association  
London Society of Chartered Accountants  
Lovells  
Low Incomes Tax Reform Group  
Mark Whitehouse  
Mazars LLP  
Office of the Legislative Counsel, Northern Ireland  
PricewaterhouseCoopers LLP  
Sayer Vincent  
Society of Trust and Estate Practitioners  
Terry Hopes  
Wedlake Bell  
Wellcome Trust

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

## **INCOME TAX ACT 2007**

### 17. The Act:

- applies for income tax, continuing the general approach of previous rewrite Acts of separating income tax and corporation tax legislation;

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- contains the basic provisions of income tax, such as the charge to income tax, tax rates, how a person's income tax liability is calculated, personal reliefs, and general definitions which apply for income tax purposes;
  - deals with various specific reliefs, including reliefs for losses, the enterprise investment scheme, venture capital trusts, community investment tax relief, interest paid, gift aid and gifts of assets to charities;
  - broadens the picture by filling in the rest of the income tax picture, in particular in relation to settlements and trustees, avoidance and deduction of tax at source; and
  - will take the place of ICTA as the main Act about income tax, complemented by ITEPA and ITTOIA (which dealt with the charges to income tax on employment, pension, trading and other income).
18. The Act has 1035 sections and 4 Schedules.
19. The sections are arranged as follows:
- Part 1: Overview*
  - Part 2: Basic provisions*
  - Part 3: Personal reliefs*
  - Part 4: Loss relief*
  - Part 5: Enterprise investment scheme*
  - Part 6: Venture capital trusts*
  - Part 7: Community investment tax relief*
  - Part 8: Other reliefs*
  - Part 9: Special rules about settlements and trustees*
  - Part 10: Special rules about charitable trusts etc*
  - Part 11: Manufactured payments and repos*
  - Part 12: Accrued income profits*
  - Part 13: Tax avoidance*
  - Part 14: Income tax liability: miscellaneous rules*
  - Part 15: Deduction of income tax at source*
  - Part 16: Income Tax Acts definitions etc*
  - Part 17: Definitions for purposes of Act and final provisions*
20. The Schedules are:
- Schedule 1: Minor and consequential amendments*
  - Schedule 2: Transitionals and savings*
  - Schedule 3: Repeals and revocations*

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*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 (and similarly CAA 1968)
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
ICTA 1970	the Income and Corporation Taxes Act 1970
IHTA	the Inheritance Tax Act 1984
ITEPA	the Income Tax (Earnings and Pensions) Act 2003
ITTOIA	the Income Tax (Trading and Other Income) Act 2005
MOD	manufactured overseas dividend
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

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## **COMMENTARY ON SECTIONS**

### **Part 1: Overview**

#### **Section 1: Overview of Income Tax Acts**

23. This section provides an overview of the location of the main legislation dealing with income tax. It is new.

#### **Section 2: Overview of Act**

24. This section provides an overview of the Act. It is new.

### **Part 2: Basic provisions**

#### ***Overview***

25. This Part contains basic provisions about the charge to income tax.

#### **Chapter 1: Charges to income tax**

#### ***Overview***

26. This Chapter sets out the provisions of the Income Tax Acts where the main charges to income tax are to be found and contains basic rules about the annual nature of income tax.

#### **Section 3: Overview of charges to income tax**

27. This section is based on section 1(1) of ICTA.

28. *Subsection (1)* lists the principal provisions that contain charges to income tax, which are all in ITEPA and ITTOIA.

29. *Subsection (2)* makes it clear that there are also charges to income tax in other legislation. The main ones are shown, but the list is not exhaustive.

#### **Section 4: Income tax an annual tax**

30. This section is based on sections 1(2), 2(2) and 832(1) of ICTA.

31. Section 2(1) of ICTA, which provides for the due proportion of income tax to be charged for every fractional part of one pound, has not been rewritten as it is otiose.

#### **Section 5: Income tax and companies**

32. This section provides that income of companies that is liable to corporation tax is not charged to income tax. It is based on sections 6(2) and 11(1) of ICTA.

33. In brief, a company's income (other than income arising to it in a fiduciary or representative capacity) is within the charge to corporation tax if:

- the company is UK resident; or
- the company is non-UK resident and:
  - (a) the income is trading income arising through or from a permanent establishment in the United Kingdom of the company; or
  - (b) the income arises from property or rights used by, or held by or for, the permanent establishment.

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See the commentary on section 835 in relation to the residence of companies.

## **Chapter 2: Rates at which income tax is charged**

### **Overview**

34. This Chapter sets out all the rates of income tax and provides rules about the rates of tax at which income is charged. It is based on sections 1, 1A, 1B and 686(1A) of ICTA.

35. Two main principles are at work:

- first, the rate of tax depends on the type of income concerned; and
- second, income may be subject to progressively higher rates of tax depending on the overall amount of income of the person concerned.

36. The second principle applies only to individuals (subject to a special rule about the first £1,000 of trustees' trust rate income in Chapter 6 of Part 9 of this Act).

### **Section 6: The starting rate, basic rate and higher rate**

37. This section sets out the main rates at which income tax is charged. It is based on section 1(2) of ICTA.

38. With some exceptions, notably savings and dividend income (see sections 12 and 13), any income of an individual is taxed at either the starting rate, the basic rate or the higher rate, depending on the level of the individual's income.

39. *Subsection (2)* specifies that the main rates are determined each year by Parliament.

40. Other rates at which income tax is charged do not have to be specified by Parliament annually and are instead set out in the sections signposted by *subsection (3)*.

### **Section 7: The savings rate**

41. This section sets out the savings rate of income tax. It is based on section 1A(1B) of ICTA.

42. The "savings rate" is a new name for what is called "the lower rate" in the source legislation.

### **Section 8: The dividend ordinary rate and dividend upper rate**

43. This section sets out these two rates of income tax that apply to dividend income. It is based on section 1B(2) of ICTA.

### **Section 9: The trust rate and dividend trust rate**

44. This section sets out the two rates of income tax that apply, in particular, to accumulation or discretionary income of trustees. It is based on section 686(1A) of ICTA.

45. The "trust rate" is a new name for what is called "the rate applicable to trusts" in the source legislation.

### **Section 10: Income charged at the starting, basic and higher rates: individuals**

46. This section sets out that the three main rates of income tax charged on the income of individuals are charged in three slices. It is based on section 1(2) of ICTA.

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47. The first slice (*subsection (1)*) is income up to the starting rate limit – the starting rate band. The second slice (*subsection (2)*) is income between the starting rate limit and basic rate limit – the basic rate band. The third slice (*subsection (3)*) is income above the basic rate limit – the higher rate band.

48. *Subsection (4)* is a signpost to provisions that apply different rates of tax to certain types of income falling within each band. Income has to be placed in order so that the rates which would otherwise apply can be established. The rules on how this is to be done are in section 16.

### **Section 11: Income charged at the basic rate: other persons**

49. This section charges tax at the basic rate on income of persons other than individuals. It is based on section 1(2) of ICTA.

50. Of the three main rates, only the basic rate applies. But other rates apply to specific sorts of income. In particular, savings income is charged at the savings rate and dividend income at the dividend ordinary rate. And income of discretionary and accumulation settlements is charged at the trust rates. There is a signpost to these exceptions in *subsection (2)*.

### **Section 12: Income charged at the savings rate**

51. This section charges savings income at the savings rate to the extent that it would otherwise fall within the basic rate band. It is based on section 1A(1) of ICTA.

52. There are a number of exceptions that provide that certain savings income is charged differently, usually at the trust rate. These are signposted in *subsection (2)*.

### **Section 13: Income charged at the dividend ordinary and dividend upper rates: individuals**

53. This section applies either the dividend ordinary rate or the dividend upper rate to dividend income of individuals. It is based on sections 1A(1), (1AA), (1A) and (4) and 1B(1) of ICTA.

54. To the extent that the dividend income (other than dividend income charged on the remittance basis) would otherwise fall within the starting rate or basic rate bands, *subsection (1)* provides that the dividend ordinary rate applies instead.

55. To the extent that the dividend income would otherwise fall within the higher rate band, *subsection (2)* provides that the dividend upper rate applies instead.

56. *Subsection (3)* provides that subsections (1) and (2) are subject to any provisions to the contrary.

57. “Dividend income” includes income chargeable under Chapter 5 or 6 of Part 4 of ITTOIA (see the definition in section 19). See *Change 1* in Annex 1.

### **Section 14: Income charged at the dividend ordinary rate: other persons**

58. This section applies the dividend ordinary rate to dividend income of persons other than individuals. It is based on section 1A(1), (1A) and (4) of ICTA.

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59. *Subsection (1)* applies the dividend ordinary rate in place of the basic rate to dividend income (other than dividend income charged on the remittance basis). A number of provisions which override this rule (typically to provide that one of the trust rates applies instead), are signposted by *subsection (2)*.

#### **Section 15: Income charged at the trust rate and the dividend trust rate**

60. This section provides a signpost to Chapters 3 to 6 of Part 9, which are about the circumstances in which income tax is charged at the trust rate and the dividend trust rate. It is new.

#### **Section 16: Savings and dividend income to be treated as highest part of total income**

61. This section provides the ordering rules that determine at what rate a particular type of income would be charged but for the sections imposing the savings rate or the dividend rates. It is based on section 1A(5) of ICTA.

62. *Subsection (2)* says that the rules apply for all other income tax purposes as well, except in the cases mentioned.

63. *Subsections (3) to (5)* contain the ordering rules. In essence, dividend income is the top part of income, savings income the middle part, and other income the lowest part.

64. *Subsection (6)* is a signpost to section 1012 which deals with the relationship between the rules in this section and other rules requiring particular income to be treated as the highest part.

65. *Subsection (7)* ensures that dividend income charged on the remittance basis does not count as dividend income for the purposes of this section.

#### **Section 17: Repayment: tax paid at basic rate instead of starting or savings rate**

66. This section allows a repayment claim outside Self Assessment if a person has suffered tax at the basic rate on income received and the person is only liable at the starting rate or the savings rate on that income. It is based on sections 1(6A) and 1A(6A) of ICTA.

#### **Section 18: Meaning of “savings income”**

67. This section defines “savings income”. It is based on section 1A(1AA), (2), (3) and (4) of ICTA.

68. The definition includes income on which personal representatives are liable under section 466 of ITTOIA (gains from contracts for life insurance etc), removing an anomaly in the source legislation. See *Change 2* in Annex 1.

#### **Section 19: Meaning of “dividend income”**

69. This section defines “dividend income”. It is based on section 1A(1AA), (2), (3) and (8) and section 1B(1) and (3) of ICTA.

#### **Section 20: The starting rate limit and the basic rate limit**

70. This section sets out the starting rate limit and the basic rate limit. It is based on section 1(2) to (3) of ICTA.

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71. The figures used in this Act are those for 2006-07. They will be updated for 2007-08 by means of an indexation order.

### **Section 21: Indexation of the starting rate limit and the basic rate limit**

72. This section provides for indexation of the starting rate and basic rate limits. It is based on section 1(4) to (6) of ICTA.

73. *Subsections (2) and (3)* set out in step form how to compute the limit for a given year by reference to the limit for the previous year and the percentage rise in the retail prices index. The words “unless Parliament otherwise determines” in section 1(4) have been omitted as it is always open to a Finance Act to disapply this provision, so no express provision to this effect is needed.

74. *Subsection (4)* is an administrative provision to reflect the fact that it is usually only known at the time of the Chancellor’s Budget speech whether statutory indexation will apply. This leaves insufficient time before the start of the tax year for employers to update their payroll systems. This rule gives employers until the first pay-day after 17 May to make the necessary changes.

75. *Subsection (5)* obliges the Treasury to specify the indexed amounts in a statutory instrument which must be made in the tax year before the tax year to which they are to apply.

### **Chapter 3: Calculation of income tax liability**

#### ***Overview***

76. This Chapter deals with the calculation of a person’s income tax liability for a tax year.

77. The calculation sets out how the rules about the rates at which income is charged, and provisions about reliefs, allowances, tax reductions etc, are applied to the components of a person’s total income to arrive at the person’s income tax liability.

78. The calculation does not deal with amounts of tax suffered (eg under PAYE or by way of deduction of tax at source) as these are set off against a person’s liability rather than deducted in arriving at it. See section 59B(1) of TMA.

79. Nor does it deal with relief given by discharge or repayment, as here too the relief can operate only once the amount of a person’s liability has been determined. Examples of such reliefs include paragraph 6 of Schedule 14 to ICTA (life insurance relief for non-residents) and section 416 of CAA (mineral extraction allowance - expenditure on restoration within 3 years of ceasing to trade).

### **Section 22: Overview of Chapter**

80. This section provides an overview of the Chapter. It is new.

81. The persons liable to income tax include individuals, trustees, personal representatives, non-UK resident companies, and companies acting in a fiduciary or representative capacity.

82. But where non-UK resident companies carry on a trade in the United Kingdom through a permanent establishment, they are liable to corporation tax instead of income tax on their chargeable profits. See the commentary on section 5.

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### **Section 23: The calculation of income tax liability**

83. This section sets out the steps to be taken in calculating a taxpayer's liability to income tax for a tax year. It is based on many provisions in the source legislation, in particular section 835 of ICTA.

84. *Step 1* brings together all the amounts of income on which a taxpayer is charged to income tax for the tax year. The sum of these amounts is called "total income", and each of the amounts is a "component" of total income.

85. In the source legislation there were some contexts in which "total income" was used in a different sense (eg in section 1 of ICTA, where it meant what is defined in Step 2 as "net income"). But in this Act it is used consistently to denote this first stage result. And the consequential amendments to other legislation in Schedule 1 ensure that it will always be used in this sense elsewhere.

86. *Step 2* deals with those reliefs (other than personal allowances) which are given by deduction from income.

87. Most of the reliefs listed in section 24 may be deducted from any type of income. But some may only be deducted from certain components of total income. See section 25(3).

88. Step 2, combined with the provisions about the reliefs themselves and the rules in section 25 about the way in which deductions are made, ensures that the reliefs are allowed in the proper way to arrive at "net income".

89. It is important that this is done by reference to the components of total income, to pave the way for Step 4.

90. *Step 3* deals with the deduction of the personal allowance and blind person's allowance from the components of net income. This step only affects individuals. The rule that these deductions come last is based on section 835(5) of ICTA.

91. Again, it is important that this is done by reference to the components of total income, to pave the way for Step 4.

92. *Step 4* applies the rates of tax specified in Chapter 2 (and, where the taxpayer is a trustee, the relevant Chapters of Part 9 of this Act) to the amounts of the components remaining after Step 3.

93. *Step 5* adds together the amounts of tax on each component.

94. *Step 6* then deducts any tax reductions. These are listed in section 26. Further rules about how these tax reductions are made are in sections 27 to 29.

95. *Step 7* then adds on certain other amounts of income tax for which a taxpayer may be liable, as listed in section 30.

### **Section 24: Reliefs deductible at Step 2**

96. This section lists all the reliefs that may be deducted from components of total income at Step 2 of the calculation. It is based on many provisions in the source legislation.

97. The section is arranged to highlight those reliefs which apply only to individuals, and to avoid duplication of references to particular reliefs.

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98. This section, and others in the Chapter, contains lists of provisions some of which are in this Act and some which are elsewhere. Such lists are arranged by reference to the order that the provisions appear in this Act and by reference to the date on which other legislation was enacted.

99. The entries in the lists are not each given their own sub-paragraph reference. This will reduce the scope for confusion should any amendments need to be made to the lists in future Finance Acts.

100. One of the reliefs deducted at this step is for annual payments and patent royalties under Chapter 4 of Part 8. See *Change 81* in Annex 1 and the overview commentary on Chapter 4 of Part 8.

101. The opportunity has been taken to clarify the way in which reliefs under sections 446 and 454 of ITTOIA work. See the amendments made to those sections in Schedule 1.

102. The list of reliefs does not include section 811 of ICTA. That section allows a reduction of a component of income for foreign tax suffered on that income where no credit is available. It has been excluded on the basis that the relief reduces the amount of income from the source (and where appropriate can create or augment a trading loss) before it enters into the calculation in section 23.

103. For the same reason, the list does not include relief under section 798C of ICTA which was introduced by FA 2005.

104. For the rules about what (if anything) may be done with any excess relief over the amount of income from which it can be deducted it is necessary to refer to the particular provisions dealing with the relief concerned. But see also the provisions of section 25.

### **Section 25: Reliefs and allowances deductible at Steps 2 and 3: supplementary**

105. This section contains rules about the way deductions are made against components of income. It is based on section 835(3), (4) and (5) of ICTA.

106. The main rule, in *subsection (2)* is that deductions are allowed in the way that results in the greatest reduction of income tax liability.

107. This rule means that where a deduction may be set against more than one component of income or there are two or more deductions available, they are allowed in the way that produces the least income tax liability. The order in which deductions that are allowable against a particular component of income are made under Step 2 cannot affect the liability for the tax year concerned. If there is sufficient income then all deductions are allowed in full. If there is insufficient income then unrelieved income is nil. But the order in which they are made can affect the amount of relief that is available to carry forward or back (in the case of reliefs where that is a possibility).

108. *Subsection (3)* is a signpost to provisions that modify the rule in *subsection (2)*, in particular in the case of reliefs given only against certain types of income.

109. *Subsections (4) and (5)* ensure that a deduction is only given to the extent that there is income to absorb the deduction, taking into account deductions already made.

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110. Some, but not all, of the source provisions contain the rule that income cannot be reduced below nil, but even where not explicitly mentioned, it has always been the accepted practice that a deduction can only be made from income to the extent that there is income to absorb the deduction. The position is now explicit for all income deductions.

111. A similar point arises in connection with deductions that operate as tax reductions. See the commentary on section 29.

### **Section 26: Tax reductions**

112. This section lists the tax reductions that are allowed in terms of tax at Step 6 of the calculation in section 23. It is based on many provisions in the source legislation.

113. The approach adopted to the layout of this section is in line with that adopted in relation to section 24.

114. One of the tax reductions is for relief under section 539 of ITTOIA. See *Change 3* in Annex 1.

### **Section 27: Order of deducting tax reductions: individuals**

115. This section provides rules about the order in which tax reductions are to be given for individuals. It is based on many provisions in the source legislation.

116. In the source legislation, many of the provisions dealing with tax reductions contain rules which specify how that reduction interacts with other tax reductions. These rules, so far as they relate to individuals, are brought together in *subsections (4) to (6)*.

117. But those rules are not comprehensive. As well as bringing the existing rules together into one place, the section introduces a new rule in *subsections (2) and (3)* providing that, subject to the following subsections, the reductions are allowed in the way that gives the greatest reduction in liability for the year. See *Change 4* in Annex 1.

118. Subsections (4) and (5) list those provisions where rules setting out some priority are contained in the source legislation. Subject to the point mentioned in the next paragraph, the provisions are listed in the order in which the source rules require the reliefs to be allowed. If any other reduction (except double taxation relief) is due then it may be allowed at whatever stage (before or after any of the provisions in subsection (5)) gives the maximum reduction.

119. It is clear from section 256 of ICTA that reductions under Chapter 1 of Part 7 of ICTA are given after all other reductions (except double taxation relief), but no order of priority between the two reductions within that Chapter is given. Since the reduction for married couples and civil partners is transferable whereas the reduction under section 273 of ICTA is not, it will always be beneficial if any reduction under section 273 of ICTA comes first. Subsection (5) reflects this. See *Change 4* in Annex 1.

### **Section 28: Order of deducting tax reductions: other persons**

120. This section provides rules about the order in which tax reductions are to be given for persons other than individuals. It is based on sections 790(3) and 796(1) of ICTA and sections 26 and 27(1) of FA 2005.

121. There are fewer tax reductions available than for individuals, so the rules are less complex. *Subsection (2)* corresponds to section 27(2) in providing a new rule that the

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reductions are allowed in the way that gives the greatest reduction in liability. See *Change 4* in Annex 1 and the commentary on section 27.

122. *Subsection (5)* is a special rule concerning the tax reduction given to certain trustees under section 26 of FA 2005.

### **Section 29: Tax reductions: supplementary**

123. This section contains additional rules about the giving of tax reductions. It is based on a number of provisions in the source legislation.

124. *Subsections (2)* and *(3)* ensure that a reduction is only given to the extent that there is tax to absorb the reduction, taking into account reductions already made. Many of the source provisions contain the rule that the tax cannot be reduced below nil (see for example section 256(2) of ICTA). And top-slicing relief under section 535 of ITTOIA cannot give a greater tax reduction than the tax increase resulting from including the gain concerned within total income. The position is now explicit for all tax reductions. See the commentary on section 25.

125. *Subsection (4)* ensures that the rules in this section limiting the amount of a tax reduction by reference to the amount of tax against which it is set will not affect the calculation under section 796 of ICTA of the limit on income tax credit relief for double taxation. It also ensures that those rules will not affect the operation of any other provisions limiting the amount of a tax reduction.

126. *Subsection (5)* ensures that any reference in this Chapter to double taxation relief under section 788 of ICTA brings in relief allowed in accordance with arrangements made under that section.

### **Section 30: Additional tax**

127. This section lists provisions under which amounts of tax are added to the tax liability at Step 7 of the calculation. It is based on a number of provisions in the source legislation.

### **Section 31: Total income: supplementary**

128. This section provides supplementary rules, in particular about the tax year in which income received under deduction of tax or with a tax credit is to be taken into account. It is based on section 835(6) and (7) of ICTA.

### **Section 32: Liability not dealt with in the calculation**

129. This section lists income tax liabilities not dealt with in the calculation. It is new.

130. These liabilities arise in connection with:

- the recovery of excessive relief (eg the withdrawal or reduction of EIS relief or the recovery of excess credit for overseas tax) where the taxpayer's self-assessment for the tax year is final;
- deduction of tax at source (eg Chapters 15 to 17 of Part 15 and the reverse charge provisions), where the liability is not in respect of the person's own liability; and
- stand-alone charges (eg Chapter 1 of Part 13, or in relation to the administration of pension schemes).

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### **Part 3: Personal reliefs**

#### ***Overview***

131. This Part contains rules relating to personal reliefs for individuals. It is based on Chapter 1 of Part 7 of ICTA.

132. The reliefs dealt with in this Part fall into two distinct categories. First, there are two reliefs that operate as a deduction from net income. They are the personal allowance and blind person's allowance. The rules for those reliefs are in Chapter 2.

133. Second, there is one relief which operates by way of a reduction in terms of tax. That is the tax reduction for certain married couples and civil partners. The rules for that relief are in Chapter 3.

134. Chapter 4 contains general provisions, in particular relating to residence and indexation of allowances.

135. The reliefs under Chapters 2 and 3 are available only to individuals meeting the residence etc requirements of section 56, which is based on section 278 of ICTA. Individuals who, under the source legislation, could claim these reliefs only by virtue of meeting the condition in section 278(2)(a) are catered for by corresponding provisions in ICTA, as amended by this Act, rather than by this Part. This is because if the condition concerned (which, in particular, operates by reference to whether the individual is a Commonwealth citizen) were included in this Act it would not have been possible to certify that the Act was compatible with the Human Rights Act 1998.

136. In addition, to limit the extent to which the provisions of this Act depend on reliefs given by virtue of an individual meeting the condition in section 278(2)(a) of ICTA, transfers of blind person's allowance and married couple's allowance will no longer be available unless the two individuals concerned make their claims to relief under the same set of provisions. This rule is subject to a transitional provision providing that it will not apply to those entitled to such allowances immediately before the Act comes into force until the start of the 2009-10 tax year. See Part 4 of Schedule 2 and *Change 7* in Annex 1.

137. The figures used for allowances and income thresholds throughout this Part are those for 2006-07. An indexation order will be made before 6 April 2007 setting the figures for 2007-08 (unless those figures are then changed by FA 2007). Although that order will expressly apply only to ICTA, the continuity of the law provisions in Schedule 1 to this Act will ensure that the figures here are also updated.

### **Chapter 1: Introduction**

#### **Section 33: Overview of Part**

138. This section explains where to find the rules relating to each relief that is dealt with in this Part. It is new.

### **Chapter 2: Personal allowance and blind person's allowance**

#### ***Overview***

139. This Chapter makes provision for the personal allowance and the blind person's allowance. It is based on sections 256(1), 257, 265 and 278 of ICTA.

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140. The residence requirement for each allowance has been built into sections 35 to 39 with no special provision for claims by non-UK residents to be made to the Commissioners for Her Majesty's Revenue and Customs. Claims for allowances are made to officers of Revenue and Customs, and no appeals are reserved to the Special Commissioners. This is achieved by not specifying to whom claims are to be made. See *Change 5* in Annex 1.

#### **Section 34: Allowances under Chapter**

141. This section introduces the Chapter and explains where to find the rules relating to those allowances given by deduction from income. It is new.

#### **Section 35: Personal allowance for those aged under 65**

142. This section sets out the conditions for an individual aged under 65 to be entitled to a personal allowance. It is based on sections 256(1), 257 and 278 of ICTA.

143. Section 256 of ICTA makes it clear that a claim is required. Although in practice this personal allowance is often given automatically for years for which a valid claim would still be possible (a practice which will continue), it is necessary to retain the formal claims procedure in order to provide a mechanism to resolve disputed claims. For claims generally, see *Change 5* in Annex 1 and the overview commentary on this Chapter.

#### **Section 36: Personal allowance for those aged 65 to 74**

144. This section provides a higher level of allowance for individuals aged 65 to 74. It is based on sections 256(1), 257 and 278 of ICTA.

145. *Subsection (2)* is the rule that the allowance is reduced if the individual's adjusted net income exceeds a threshold. But the allowance cannot be reduced below the amount of the personal allowance in section 35.

#### **Section 37: Personal allowance for those aged 75 and over**

146. This section provides a higher level of allowance for individuals aged 75 and over. It is based on sections 256(1), 257 and 278 of ICTA.

147. As in section 36, *subsection (2)* rewrites the rule that provides for the reduction of the allowance if the claimant's income exceeds a threshold. But the allowance cannot be reduced below the amount of the personal allowance in section 35.

#### **Section 38: Blind person's allowance**

148. This section deals with the conditions for blind person's allowance. It is based on sections 256(1), 265 and 278 of ICTA.

149. As with the personal allowances, the residence requirement has been built into *subsection (1)*. In fact, due to the particular conditions of the relief set out in the following subsections, it is very rare for a non-resident to be entitled to the allowance.

150. Section 265(1) of ICTA requires the claimant to be a "registered blind person". This term is defined in section 265(7) in two legs.

151. The first leg refers to registers compiled under section 29 of the National Assistance Act 1948. That Act never applied to Northern Ireland and was repealed in relation to Scotland by the Social Work (Scotland) Act 1968 (section 95(2) and Part 1 of Schedule 9). It follows

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that any registers maintained by local authorities in Scotland or Northern Ireland or by Societies for the Blind on their behalf are not registers under section 29. So *subsection (2)* makes it clear that this condition can only apply to registers kept by local authorities in England and Wales.

152. The second leg of the definition in section 265(7), which applies only to Scotland and Northern Ireland, refers to persons who are blind within the meaning of section 64(1) of the National Assistance Act 1948. This definition, which is that the individual is unable to do any work for which eyesight is essential, is the same as that underpinning entitlement to registration by local authorities in England and Wales, and is set out in *subsection (3)*.

153. *Subsection (4)* legislates ESC A86. This treats a claimant as satisfying the registration condition in the year prior to formal registration where evidence of blindness on which registration is based had been obtained in that prior year. See *Change 6* in Annex 1.

### **Section 39: Transfer of part of blind person's allowance to a spouse or civil partner**

154. This section allows the transfer of any excess allowance due to a blind person to his or her spouse or civil partner if the blind person's income is insufficient to absorb the allowance fully. It is based on sections 256(1), 265 and 278 of ICTA.

155. It is implicit in section 265 of ICTA that a spouse or civil partner receiving all or part of an allowance under this provision must be an individual entitled to claim allowances in their own right. *Subsection (1)* makes this explicit by incorporating the residence requirement for the receiving spouse or civil partner.

156. *Subsection (2)* specifies that it is only the excess allowance that can be transferred, that the transferor must make an election (see section 40), and makes it clearer that in order to be entitled to the allowance the transferee must claim it.

157. *Subsection (3)* provides rules for determining the amount by which the allowance exceeds income for the purposes of this section. It takes the amount of net income as the starting point. The appropriate personal allowance is then deducted.

158. Section 265(3)(c) of ICTA has not been rewritten as it is obsolete.

### **Section 40: Election for transfer of allowance under section 39**

159. This section sets out rules about elections under section 39. It is based on section 265(5) and (6) of ICTA.

160. There is no need to specify that the election must be in the form specified by the Commissioners for Her Majesty's Revenue and Customs since paragraph 2(3) of Schedule 1A to TMA achieves that result.

161. *Subsection (2)* provides that if an individual has made an election for the transfer of his or her excess blind person's allowance in a tax year then this is also treated as an election for the transfer of any excess tax reduction for married couples and civil partners.

### **Section 41: Allowances in year of death**

162. This section addresses the position if an individual dies in the tax year for which an allowance may be due. It is based on section 257(4) of ICTA.

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163. *Subsection (1)* is new, but states what is implicit in the current legislation. The amount of the allowance for any tax year is not reduced on account of death, so that the full amount is due, even if death occurs on 6 April.

164. *Subsections (2) and (3)* provide that the age-related personal allowances are given for a tax year on the basis that an individual will reach 65 or 75 in that year and are not affected if death occurs before the relevant birthday.

### **Chapter 3: Tax reductions for married couples and civil partners**

#### **Overview**

165. This Chapter provides for a tax reduction where a party to a marriage or civil partnership was born before 6 April 1935. It is based on sections 257A, 257AB, 257BA, 257BB and 278 of ICTA, as amended by the Tax and Civil Partnership Regulations 2005 (SI 2005/3229).

166. The residence requirement has been built into sections 45 to 49 with no special provision for claims by non-UK residents to be made to the Commissioners for Her Majesty's Revenue and Customs. Claims to allowances are made to officers of Revenue and Customs, and no appeals are reserved to the Special Commissioners. This is achieved by not specifying to whom claims are to be made. See *Change 5* in Annex 1.

167. A tax reduction is only due if the parties live together. The meaning of living together is in section 1011.

#### **Section 42: Tax reductions under Chapter**

168. This section explains where to find the rules about the relief for married couples and civil partners given as a reduction in terms of tax. It is new.

169. These reliefs are often known as married couple's allowances (the term referring to the amounts by reference to which the tax reductions are calculated).

170. Relief is available only if one spouse or civil partner was born before 6 April 1935.

171. The general rule in section 256(2)(b) of ICTA that prevents the tax reduction exceeding the liability is reflected in section 29.

#### **Section 43: Meaning of "the minimum amount"**

172. This section specifies the minimum amount of the allowance by reference to which relief is given. It is based on sections 257A(5A) and 257AB(5) of ICTA.

173. The tax reduction for married couples and civil partners is a percentage of a specified amount known as the "married couple's allowance" (see sections 45(3) and 46(3)). The allowance depends on the ages of the couple and the level of the claimant's income. But that amount cannot be reduced below a certain level which is given a new label "the minimum amount".

#### **Section 44: Election for new rules to apply**

174. This section defines, and provides rules about, elections for the rules introduced by the Tax and Civil Partnership Regulations 2005 to apply. It is based on section 257AB(8) of ICTA.

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175. The new rules concern marriages taking place and civil partnerships formed on or after 5 December 2005. Existing marriages are not affected. But the husband and wife of an existing marriage may jointly elect for the new rules to apply. The main effect of an election is that the spouse with the higher income, rather than the husband, is the individual entitled to make the primary claim to relief.

#### **Section 45: Marriages before 5 December 2005**

176. This section applies if a marriage took place before 5 December 2005 unless an election for the new rules is in force. It is based on sections 256 and 257A of ICTA.

177. *Subsection (1)* provides that the husband may claim the relief and that if the conditions in *subsection (2)* are met he is entitled to a tax reduction. The amount of the tax reduction is 10% of the amount specified in *subsection (3)*.

178. *Subsection (4)* provides that the allowance is reduced if the husband's adjusted net income exceeds a threshold. The calculation of adjusted net income for this purpose is similar to, but slightly more complicated than, that under section 36(2) because it takes into account the fact that he will have already suffered a reduction in his personal allowance if he is aged 65 or over.

#### **Section 46: Marriages and civil partnerships on or after 5 December 2005**

179. This section applies if a marriage takes place or a civil partnership is formed on or after 5 December 2005, or if a married couple elect for the new rules to apply. It is based on sections 256 and 257AB of ICTA.

180. Where a same-sex couple registered their relationship in an overseas jurisdiction listed in Schedule 20 to the Civil Partnership Act 2004 before 5 December 2005 they are treated under that Act as having formed a civil partnership on 5 December 2005. According, in those circumstances a claim may be made under this section.

181. *Subsection (1)* provides that on a valid claim a tax reduction is due to the individual who makes the claim. As is made clear in *subsection (2)*, that individual is the spouse or civil partner with the higher income.

182. *Subsection (2)* sets out the conditions for the relief under this section. The "higher income" test operates by reference to net income. If, exceptionally, both parties have the same income, then they jointly nominate either party as the claimant.

183. *Subsection (4)* provides that the allowance is reduced if the claimant's adjusted net income exceeds a threshold. The calculation of adjusted net income for this purpose is similar to, but slightly more complicated than, that under section 36(2) because it takes into account the fact that the individual will have already suffered a reduction in the personal allowance if the individual is aged 65 or over.

#### **Section 47: Election by individual to transfer relief under section 45 or 46**

184. This section allows an individual to claim a transfer of part of the relief available to that individual's spouse or civil partner. It is based on section 257BA(1) of ICTA.

185. The tax reduction is claimed by and given to the husband under section 45, or to the party with the higher income under section 46.

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186. The transfer that can be made (from this primary claimant) to the wife or to the lower income party (as appropriate) is of a tax reduction calculated by reference to one half of the “the minimum amount” in section 43.

187. *Subsection (1)* provides that the recipient is entitled to a tax reduction of 10% of one half of the minimum amount provided the primary claimant is entitled to a tax reduction, and the conditions in *subsection (2)* are met.

188. The procedure for making an election is set out in section 50. In addition to the election, which remains in force until withdrawn, the spouse or civil partner must claim the tax reduction for a particular tax year.

189. *Subsections (3) and (4)* ensure that if a spouse or civil partner does receive a tax reduction under this section then the primary claimant’s tax reduction (calculated after any reduction attributable to income exceeding the threshold or due to marriage or entry into civil partnership in the year) is correspondingly reduced.

#### **Section 48: Joint election to transfer relief under section 45 or 46**

190. This section allows spouses or civil partners to make a joint claim for the transfer between them of the part of the relief attributable to the whole of the minimum amount. It is based on section 257BA(2) of ICTA.

#### **Section 49: Election for partial transfer back of relief**

191. This section provides that if a joint election has been made under section 48, then the primary claimant may unilaterally elect to transfer back the tax reduction attributable to one half of the minimum amount. It is based on section 257BA(3) of ICTA.

192. This is in addition to that individual benefiting from any tax reduction attributable to the allowance in excess of the minimum that remained with that individual in the first place. The election remains in force until withdrawn and the procedure is set out in section 50. The individual also has to make a claim for each tax year for which a transfer back is wanted.

#### **Section 50: Procedure for making and withdrawing elections under sections 47 to 49**

193. This section details the procedure for making elections for the transfer of relief to a spouse or civil partner and for the re-transfer of relief back and for the withdrawal of those elections. It is based on section 257BA(4), (5), (7) and (8) of ICTA.

194. *Subsection (2)* concerns the making of an election. The election must be in the form specified by the Commissioners for Her Majesty’s Revenue and Customs, in accordance with paragraph 2(3) of Schedule 1A to TMA.

195. *Subsection (3)* sets out the two circumstances in which an election first takes effect in the year in which it is made rather than in the following year. Where “appropriate notice” is to be given, it must be in writing (see section 989).

#### **Section 51: Transfer of unused relief**

196. This section provides for the transfer to a spouse or civil partner of so much the relief as cannot be used in calculating the primary claimant’s liability to income tax. It is based on section 257BB(1), (2) and (3A) of ICTA.

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197. In looking to see whether the claimant has unused relief, *subsection (1)* provides for a comparison to be made between that individual's tax reduction (including any tax reduction transferred back from the spouse or civil partner) and the individual's "comparable tax liability". The meaning of this new term is given in section 53. The unused part of the total tax reduction under this Chapter is the amount eligible for transfer.

198. In order for this provision to apply the spouse or civil partner must be entitled to relief and the primary claimant must give notice that the transfer is to apply. These rules are contained in *subsection (4)*.

### **Section 52: Transfer back of unused relief**

199. This section is effectively the reverse of section 51. It is based on section 257BB(3) and (3A) of ICTA.

200. It applies if a spouse or civil partner has claimed a tax reduction based on the whole or half of the "minimum amount", but cannot use that relief in full. In such a case, if that spouse or civil partner gives due notice, the excess relief goes back to the primary claimant.

### **Section 53: Transfer of unused relief: general**

201. This section contains general provisions about transfers of unused relief. It is based on sections 256(2) and (3) and 257BB(1), (3) and (5) of ICTA.

202. In particular, the section explains how an individual's "comparable tax liability" is determined in calculating whether there is excess relief eligible for transfer to a spouse or civil partner under section 51 or 52.

203. *Subsection (2)* makes it clear that the comparison is made before deducting any double taxation relief. This ensures that any double taxation relief is given last.

204. Certain tax liabilities are ring-fenced so that they cannot be reduced by reliefs given by tax reductions. If an individual makes gift aid donations, the tax reduction under this Chapter may have to be restricted under the gift aid rules. This means that there is a greater reduction potentially available to transfer to the spouse or civil partner. The same applies in reverse if the spouse or civil partner makes gift aid donations and there is a transfer back to the primary claimant. *Subsection (3)* ensures that these rules work as intended by restricting the amount that may be transferred.

### **Section 54: Tax reductions in the year of marriage or entry into civil partnership**

205. This section provides rules that apply in the year of marriage or entry into civil partnership. It is based on sections 257A(6), 257AB(7) and 257BA(6) of ICTA.

206. *Subsection (2)* provides that in the year of marriage or entry into civil partnership, the allowance by reference to which the tax reduction is calculated is reduced by one twelfth for each complete month in the tax year prior to the marriage or civil partnership.

207. *Subsection (3)* makes it clear that the allowance to be reduced under this section is the allowance after it has been adjusted on account of the primary claimant's income exceeding the threshold.

208. *Subsection (4)* addresses the situation where an individual has been married or in a civil partnership in the tax year and remarries or enters into a new civil partnership.

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209. It may be advantageous for the claim to be made for the later marriage or civil partnership rather than the earlier one even though the later one (but not the earlier one) will usually give rise to an adjustment under subsection (2).

210. The wording here makes it clear that the individual can choose to claim for the later marriage or civil partnership but that, if the claim is made for the marriage or civil partnership which existed at the start of the tax year, the individual will not suffer the adjustment under this section.

211. *Subsection (5)* ensures that if tax reductions based on the minimum amount are being transferred between spouses or civil partners, the minimum amount is also reduced by one twelfth for each complete month in the tax year prior to the marriage or civil partnership.

#### **Section 55: Sections 45 to 53: supplementary**

212. This section contains miscellaneous rules based on several source provisions.

213. *Subsection (1)* provides that an individual is entitled to only one tax reduction under sections 45 to 48 in a tax year. It is based on sections 257A(6), 257AB(6) and 257BA(9) of ICTA.

214. *Subsection (2)* corresponds to the rule in section 41(3) in relation to allowances under Chapter 2 that the higher level of relief under this Chapter is given for the tax year in which an individual will reach 75 and is not affected if death occurs before the 75th birthday. It is based on sections 257A(4) and 257AB(3) of ICTA.

215. *Subsection (3)* is new, but reflects the current law. It addresses the position where an individual dies and corresponds to the rule in section 41(1). It is a clear statement that the amount of the relief is not reduced on account of death, so that the full amount is due, even if death occurs on 6 April.

#### **Chapter 4: General**

##### ***Overview***

216. This Chapter contains the residence requirement for personal reliefs, provides for the indexation of allowances and income thresholds and makes provision about the determination of an individual's income in connection with the age-related allowances.

#### **Section 56: Residence etc of claimants**

217. This section provides details of residence conditions which have to be satisfied for personal reliefs to be available. It is based on section 278 of ICTA.

218. *Subsection (1)* provides that the section applies in relation to personal allowances, blind person's allowance and tax reductions for married couples and civil partners. Section 460 provides corresponding rules for certain other reliefs given in Chapter 6 of Part 8.

219. *Subsection (2)* provides that the requirements of this section are met if the individual is UK resident or meets one of the alternative tests in subsection (3).

220. Residence is a concept that applies to a tax year so that an individual is either resident in or not resident in the United Kingdom for a complete tax year. But ESC A11 allows tax years to be split, and will continue to do so. Personal reliefs are given in full for any tax year

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in which a qualifying individual is resident in the United Kingdom whether or not the tax year is split under ESC A11.

221. *Subsection (3)* is based on section 278(2) of ICTA. If the individual is not UK resident then one of conditions (a) to (f) must be satisfied. The drafting makes it explicit that a test only has to be met at some time in the tax year. In rewriting section 278(2)(e) of ICTA it has been assumed that the word “employed” is implicit before the word “service”.

222. Individuals who, under the source legislation, were able to claim the reliefs only by virtue of meeting the condition in section 278(2)(a) are catered for by provisions remaining in ICTA, as amended by this Act. See the overview commentary on this Part.

### **Section 57: Indexation of allowances**

223. This section provides for the annual indexation of allowances. It is based on sections 257C and 265(1A) of ICTA.

224. *Subsection (1)* lists all the amounts within Chapters 2 and 3 of this Part that are subject to indexation.

225. *Subsections (2) to (4)* set out how the increases due to indexation are to be calculated. The words “unless Parliament otherwise determines” in section 257C(1) have been omitted as it is always open to a Finance Act to disapply this provision, so no express provision to this effect is needed.

226. *Subsection (5)* is an administrative provision to reflect the fact that it is usually only known at the time of the Chancellor’s Budget speech whether statutory indexation will apply. This leaves insufficient time before the start of the tax year for employers to update their payroll systems. This rule gives employers until the first pay-day after 17 May to make the necessary changes.

227. *Subsection (6)* obliges the Treasury to specify the indexed amounts in a statutory instrument which must be made in the tax year before the tax year to which they are to apply.

### **Section 58: Meaning of “adjusted net income”**

228. This section brings together the rules from several source provisions about calculating income for the purposes of the age-related personal allowances. It is based on section 835(5) of ICTA, section 25(9A) of FA 1990 and section 192(5) of FA 2004.

229. The starting point is the measure of an individual’s net income as set out in Step 2 in section 23. An individual’s net income is determined before allowances under Chapter 2 of this Part are deducted. Section 835(5) of ICTA makes it clear that such allowances are not deducted in determining the income threshold for the purpose of sections 257(5) and 257A(5) of ICTA. Due to an oversight in the amendments made by the Tax and Civil Partnership Regulations 2005 (SI 2005/3229), the rule was not applied to the calculation of the income threshold in section 257AB(4) of ICTA. That oversight is corrected here. See *Change 8* in Annex 1.

230. *Subsection (1)* makes a number of adjustments to the amount of net income.

231. Before FA 2000, covenanted donations to charities were charges on income. But section 41 of FA 2000 amended that rule so that charitable donations are no longer charges

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on income. In order that the measure of income used in the calculation of age-related personal allowances was not affected by this change, section 25(9A) of FA 1990 was inserted to ensure that charitable donations continued to reduce income for this purpose. *Step 2* gives effect to this rule.

232. Under the gift aid rules the donor gives an amount (the net amount) which is grossed up at the basic rate of tax to provide a “grossed up amount”. *Step 2*, together with *subsection (2)*, make it clear that, as has always been understood, it is the gross amount that is to be deducted.

233. *Step 3* together with *subsection (3)* provide for a deduction to be made from income for the gross amount of certain pension contributions paid under deduction of tax. This rule is based on section 192(5) of FA 2004.

234. *Step 4* ensures that any relief given under section 457 or 458 that has been deducted in arriving at net income is added back. That reflects section 835(5) of ICTA in relation to the income threshold in the age-related personal allowances and in married couple’s allowance for marriages taking place before 5 December 2005. This provision applies the rule also to the calculation of the income threshold for marriages and civil partnerships entered into to on or after that date. See *Change 8* in Annex 1.

#### **Part 4: Loss relief**

##### ***Overview***

235. This Part contains rules relating to various reliefs for losses that are deducted in calculating net income (see *Step 2* of section 23). It is based on sections 117 to 118ZO and Chapter 1 of Part 10 (sections 379A to 392) of ICTA.

236. The reliefs are set out in separate Chapters following (so far as relevant) the order in which the types of income concerned are set out in ITTOIA.

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

##### **Section 59: Overview of Part**

237. This section provides an overview of the Part. It is new.

238. *Subsection (2)* provides that the Part is to be read with Chapter 3 of Part 2. In particular that Chapter provides rules about the order in which different reliefs are deducted in calculating net income.

239. *Subsection (3)* provides a signpost to rules about the calculation of the amount of losses, for which relief may be available under this Part.

#### **Chapter 2: Trade losses**

##### ***Overview***

240. This Chapter provides relief for trading losses.

##### **Section 60: Overview of Chapter**

241. This section provides an overview of the Chapter. It is new.

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242. *Subsection (1)* lists the various reliefs available for trade losses and certain restrictions on the reliefs.

243. *Subsection (2)* provides a signpost to Schedule 1B of TMA. Schedule 1B gives rules for the mechanics where there is a claim that relief for losses of one tax year be given against income of an earlier tax year.

244. *Subsection (3)* provides a signpost to provisions which treat an individual as starting or permanently ceasing to carry on a trade, profession or vocation in certain circumstances. It is based on section 384(4) of ICTA.

245. *Subsection (4)* introduces a label (“sideways relief”) for the two reliefs that allow trading losses for a tax year to be set against other income arising in the same tax year or an earlier tax year.

#### **Section 61: Non-partners: losses of a tax year**

246. This section provides that references to losses made in a tax year means losses made in the basis period for the tax year. It is based on sections 382(3) and 385(1) of ICTA.

#### **Section 62: Partners: losses of a tax year etc**

247. This section sets out certain rules that apply if the losses are made by a person who is a partner and provides signposts to the relevant provisions in ITTOIA. It is based on sections 110(1A), 118ZE(5) and (6), 382(3), 385(1) and 389(4) of ICTA.

#### **Section 63: Prohibition against double counting**

248. This section ensures relief is only given once for a particular loss or part of a loss. It is based on sections 380(1), 381(3), 385(7), 388(2), 504A(5) of ICTA and section 72(2) of FA 1991.

249. This section does not reproduce the rule in section 382(4) of ICTA that an amount of a loss of a trade, which would otherwise be included in calculations for two successive years, is not to be included in the calculation for the second of those years. That rule is covered by section 206 of ITTOIA, to which section 61(5) provides a signpost.

#### **Section 64: Deduction of losses from general income**

250. This section provides for trade loss relief against general income. It is based on section 380(1) of ICTA.

251. “Trade loss relief against general income” is a descriptive label for the relief covered by this section; the words “general income” are not used in Chapter 3 of Part 2 (calculation of income tax liability).

252. The section makes explicit what is only implicit in section 380(1) of ICTA:

- in *subsection (2)*, that a claim may be made for both the tax year in which the allowable loss is incurred and the previous tax year;
- in *subsection (3)*, what is required in practice to establish how the claim is to apply to each year;
- in *subsection (4)*, that, in the case of a claim in respect of one year only, the claim must specify which year; and

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- *in subsection (6)*, that a claim specifying one year does not prevent a further claim (in respect of an unused part of the loss) which specifies the other.

### **Section 65: How relief works**

253. This section specifies how deductions for the loss are to be made. It is based on section 380(1) and (2) of ICTA.

254. *Subsection (1)* makes explicit what is only implicit in section 380(1) of ICTA, that:

- the whole amount of the loss must be deducted in calculating the claimant's net income for the specified tax year;
- if a claim is made in respect of two tax years, then only so much, if any, of the amount of the loss which it has not been possible to deduct from the claimant's income for the specified year can be deducted in calculating the claimant's net income for the other year.

255. This section does not deal with the parts of section 380(1)(a) and (b) of ICTA that limit the amount of the deduction for any tax year to the whole of the claimant's income for the year, where the income is less than the amount of the loss. That limit is in section 25(4) and (5). Section 25 contains rules about how the reliefs listed in section 24, which include trade loss relief, are to be deducted at Step 2 of section 23 in order to calculate the claimant's net income.

256. *Subsections (2) and (3)* provide that if claims are made in respect of trade losses incurred in successive tax years and both claims specify that relief is to be given against income of the same tax year, then the claim in respect of the loss in the earlier year takes priority.

257. *Subsection (4)* makes it explicit that this rule also operates in relation to the interaction between claims for trade loss relief and claims for employment loss relief.

### **Section 66: Restriction on relief unless trade is commercial**

258. This section denies trade loss relief in relation to trades which are not commercial. It is based on section 384 of ICTA.

259. *Subsections (2) and (5)* provide that whether the trade is commercial is determined by reference to the basis period for the tax year, rather than by reference to the tax year as in the source legislation. See *Change 9* in Annex 1.

260. *Subsection (4)* provides for the case where the trade is carried on as part of a larger undertaking. In such a case the larger undertaking (that is the undertaking as a whole) may be carried on with a view to the realisation of profits even if the smaller trade is not.

261. In *subsection (6)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See section 1018 and *Change 152* in Annex 1.

### **Section 67: Restriction on relief in case of farming or market gardening**

262. This section restricts, in certain cases, the use of losses arising from a trade of farming or market gardening. It is based on section 397(1), (3) to (5) and (8) of ICTA.

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263. *Subsection (2)* sets out the circumstances in which loss relief is restricted. Broadly, this is once losses have arisen for six successive tax years. A signpost to section 70 is included since that section sets out the way in which losses are determined in previous tax years.

#### **Section 68: Reasonable expectation of profit**

264. This section sets out the “reasonable expectation of profit” test which, if met, prevents relief being restricted under section 67. It is based on section 397(3) and (5) of ICTA.

#### **Section 69: Whether trade is the same trade**

265. This section sets out a number of assumptions to make in determining whether section 67 restricts relief for losses. It is based on section 397(8) and (10) of ICTA.

#### **Section 70: Determining losses in previous tax years**

266. This section provides rules for deciding whether a trade of farming or market gardening made losses in earlier tax years. It is based on section 397(7) and (10) of ICTA.

267. *Subsection (2)* provides that, for earlier tax years, losses are calculated for actual tax years (6 April to following 5 April) rather than (as is normally the case) for the basis period ending in the tax year.

268. The difference in approach (which prevents any manipulation of periods of account directed at side-stepping the restriction) arises from the fact that losses used to be calculated for actual tax years, but following the move to a current year basis of assessment (in FA 1994) the calculation of losses for the main loss relief provisions was changed to mirror the calculation of profits.

269. *Subsection (4)* adapts rules in section 203 of ITTOIA to deal with cases where profits or losses have not actually been calculated by reference to tax years. In such cases, the calculation of profits or losses for tax years is an arithmetical exercise, involving apportioning (on a time basis) the profits or losses of periods falling partly within the tax year, and combining these with the profits or losses of any periods falling completely within the tax year.

#### **Section 71: Treating trade losses as CGT losses**

270. This section is a signpost to a capital gains tax relief. It is new.

271. Capital gains tax relief may be available for a tax year in which there is insufficient income to absorb a claim for trade loss relief against general income. Details of that relief are set out in new sections 261B and 261C of TCGA, inserted by Schedule 1 to this Act.

#### **Section 72: Relief for individuals for losses in first 4 years of trade**

272. This section provides relief for losses made in the first four tax years in which an individual carries on a trade. It is based on sections 380(1) and 381(1), (2) and (7) of ICTA.

273. An individual can make a claim for such losses to be deducted in calculating net income for the three tax years which precede the tax year in which the loss is made.

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### **Section 73: How relief works**

274. This section sets out the order in which losses, for which a claim is made under section 72, are deducted from income of the three preceding tax years. It is based on section 381(2) of ICTA.

275. The deduction for the loss is made first from income of the earliest of the three tax years referred to in subsection (2) of section 72, with any remaining loss deducted from income of the next tax year and then from income of the third of those tax years. Any remaining loss is available for a different loss relief claim.

### **Section 74: Restrictions on relief unless trade is commercial etc**

276. This section denies early trade loss relief in relation to trades which are not commercial. It is based on section 381(4), (5) and (7) of ICTA.

277. *Subsection (2)* provides that whether the trade is commercial is determined by reference to the basis period for the tax year, rather than by reference to the tax year as in the source legislation. There is a similar provision in section 66. See *Change 9* in Annex 1.

278. *Subsection (3)* provides for the case where the trade is carried on as part of a larger undertaking. In such a case the larger undertaking (that is the undertaking as a whole) may be carried on with a view to the realisation of profits even if the smaller trade is not.

### **Section 75: Trade leasing allowances given to individuals**

279. This section denies sideways relief in relation to losses derived from trade leasing allowances if the individual carrying on the trade does not meet the time commitment test. It is based on section 384(6) and (7) of ICTA.

280. *Subsection (2)* defines a “trade leasing allowance”.

281. The time commitment test requires that conditions A and B are met.

282. *Subsection (5)* sets out condition A. Its reference to “a continuous period of at least 6 months beginning or ending in the basis period for the tax year in which the loss was made” covers cases of a commencement or a cessation of the trade. In such cases the basis period may be shorter than six months.

283. *Subsection (6)* sets out condition B. Its reference to “a continuous period of at least 6 months beginning or ending in the loss-making basis period” also covers cases of a commencement or a cessation of the trade. In such cases the basis period may be shorter than six months.

284. The section removes an inconsistency in the source legislation between:

- the period during which substantially the whole of the individual’s time must be devoted to carrying on the trade;
- the period during which the individual must carry on the trade; and
- the basis period in respect of which the loss is calculated.

285. The inconsistency arose because of the change from the preceding year basis of assessment to the current year basis of assessment, made by FA 2004. This change resulted in losses being calculated by reference to basis periods ending in a tax year while the time

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commitment test continued to relate to the tax year itself. This section provides that the time commitment test also relates to the basis period in which the loss is made. See *Change 10* in Annex 1.

#### **Section 76: First-year allowances: introduction**

286. This section denies sideways relief for any part of the loss that derives from a first-year allowance in the circumstances set out in either section 77 or section 78. It is based on section 384A(1) of ICTA.

#### **Section 77: First-year allowances: partnerships with companies**

287. This section sets out the first circumstance in which section 76 may deny sideways relief for part of a loss. It is based on section 384A(2) and (3) of ICTA.

#### **Section 78: First-year allowances: arrangements to reduce tax liabilities**

288. This section sets out the second circumstance in which section 76 may deny sideways relief for part of a loss. It is based on section 384A(4) and (5) of ICTA.

#### **Section 79: Capital allowances restrictions: supplementary**

289. This section supplements sections 76 to 78. It is based on sections 384(8) and (11) and 384A(6) and (8) of ICTA.

#### **Section 80: Ring fence income**

290. This section provides that sideways relief in respect of a trading loss cannot be given against income arising from oil extraction activities or oil rights, unless the loss also arises from such activities or rights. It is based on sections 492(2) and 502(1) of ICTA.

#### **Section 81: Dealings in commodity futures**

291. This section denies sideways relief for a loss made by a person in a trade of dealing in commodity futures, where that person carries on the trade in partnership with a company and arrangements have been made to reduce a tax liability by means of sideways relief. It is based on section 399(2), (3) and (5) of ICTA.

#### **Section 82: Exploitation of films**

292. This section provides signposts to sections in Chapter 3 of Part 4 that provide for a restriction on loss relief if an individual carries on a trade as a partner in certain types of partnership, and to a section in Chapter 5 of Part 13 (avoidance involving trading losses). It is new.

#### **Section 83: Carry forward against subsequent trade profits**

293. This section provides carry-forward relief for trade losses. It is based on section 385(1) of ICTA and section 72(8) of FA 1991.

294. A person who makes a trading loss in a tax year may claim to carry it forward, to the extent that relief has not been given for it under any other provision.

295. The carry-forward trade loss can only be deducted from profits of the trade in which the loss arose. And a carry-forward trade loss must be deducted from the trading profits of a future tax year before those profits can be reduced by way of any other loss relief.

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#### **Section 84: How relief works**

296. This section sets out the way in which deductions for the carry-forward trade loss are to be made. It is based on section 385(1) of ICTA.

#### **Section 85: Use of trade-related interest and dividends if trade profits insufficient**

297. This section provides that certain interest and dividends are treated as trade profits if the profits are otherwise insufficient to use some or all of a carry-forward trade loss. It is based on section 385(4) of ICTA.

298. Interest and dividends are normally taxed separately from trade profits so, in the absence of this provision, a carry-forward trade loss could not be set against such income. But it is only interest and dividends that would otherwise be treated as receipts of the trade that can attract this treatment.

299. The source legislation refers to interest or dividends on investments arising in that year – meaning interest or dividends arising in the year from investments. But as interest and dividends can only arise from investments, the word “investments” has been dropped, just as it was when earlier legislation was consolidated in ICTA for the purposes of terminal loss relief. See the commentary on section 92.

#### **Section 86: Trade transferred to a company**

300. This section provides for certain cases in which an individual’s carry-forward trade losses may be used against income that the individual derives from a company to which the trade has been transferred and in which that individual was allotted shares. It is based on section 386(1) and (3) of ICTA.

301. Section 386(2) of ICTA has not been rewritten. See *Change 11* in Annex 1.

#### **Section 87: Ring fence trades**

302. This section provides that a loss in a tax year derived from oil-related activities can be deducted from the profits of a trade in a future tax year so far as the profits are derived from activities which would be treated as part of the same trade as the oil-related activities but for the ring-fencing rules. It is based on section 492(4) of ICTA.

#### **Section 88: Carry forward of certain interest as loss**

303. This section provides for cases where interest paid by an individual in a tax year, and eligible for relief under certain provisions, may be treated as a loss qualifying for carry-forward trade loss relief. It is based on section 390 of ICTA.

304. The interest must be incurred wholly and exclusively for the purpose of a trade, profession or vocation carried on wholly or partly in the United Kingdom and there must be insufficient income for relief to be given under Chapter 1 of Part 8.

#### **Section 89: Carry back of losses on a permanent cessation of a trade**

305. This section provides for terminal trade loss relief. It is based on section 388(1) of ICTA.

306. A claim for terminal trade loss relief may be made by a person who permanently ceases to carry on a trade if the person makes a loss in the trade in the final tax year or in the

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previous tax year. But only that part of a loss from the previous tax year that falls within a period starting 12 months before the cessation is available for this purpose.

307. If a claim is made the full amount of the terminal losses, or as much of them as possible, must be used to reduce the trading profits of the final tax year and the three previous tax years.

308. *Subsection (3)* omits the concept, in section 388(1) of ICTA, of the trading profits having been “charged” to income tax. See *Change 12* in Annex 1.

309. Section 388(5) of ICTA, which is concerned with the interaction between terminal loss relief and charges on income, is not rewritten. This is linked to the approach adopted by this Act to the rules in ICTA about charges on income. The Act gives relief for the payments concerned as a deduction in computing net income, and repeals section 387 of ICTA and section 51 of ITTOIA. See *Change 81* in Annex 1.

#### **Section 90: Losses that are “terminal losses”**

310. This section sets out how terminal losses are to be calculated. It is based on section 388(6) of ICTA.

311. The relievable loss is calculated by adding (a) any loss in the final tax year to (b) any loss in the part of the previous tax year falling within 12 months of the date of cessation. Each of these losses is called a terminal loss. If a profit arises in either of the periods, it is ignored.

312. *Subsections (2) to (4)* provide that profits or losses for each of these terminal loss periods are calculated by allocating profits or losses of periods of account to them. *Subsection (5)* makes it explicit how any deduction allowed for overlap profit arising under section 205 of ITTOIA is taken into account. *Subsection (6)* makes explicit provision in relation to partnerships. See *Change 12* in Annex 1.

#### **Section 91: How relief works**

313. This section sets out the way in which terminal trade loss relief is given. It is based on section 388(3) of ICTA.

#### **Section 92: Use of trade-related interest and dividends if trade profits insufficient**

314. This section provides that certain interest and dividends are treated as trade profits if the profits are otherwise insufficient to use some or all of a terminal trade loss. It is based on section 388(4) of ICTA.

315. Interest and dividends are normally taxed separately from trade profits so, in the absence of this provision, a terminal trade loss could not be set against such income. But it is only interest and dividends that would otherwise be treated as receipts of the trade that can attract this treatment.

316. The provisions on which the source legislation is based referred to interest or dividends on investments arising in that year, meaning interest or dividends arising in the year from investments. But as interest and dividends can only arise from investments, the word “investments” was dropped when earlier legislation was consolidated in ICTA.

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### **Section 93: Mineral extraction trade and carry back of balancing allowances**

317. This section provides that a terminal trade loss relief claim takes precedence over a claim for balancing allowances in circumstances in which both are claimed on the cessation of a mineral extraction trade. It is based on section 389(2) of ICTA.

### **Section 94: Carry back of certain interest as loss**

318. This section provides that where an individual has paid interest in a tax year which is eligible for relief, but is unable to utilise the deduction in full, the amount remaining may be treated for the purposes of terminal trade loss relief as a trade loss made at the date of payment, provided the interest is incurred wholly and exclusively for the purposes of a trade carried on wholly or partly in the United Kingdom. It is based on section 390 of ICTA.

### **Section 95: Foreign trades etc: reliefs only against foreign income**

319. This section provides that losses arising from trades carried on wholly outside the United Kingdom can only be used to reduce profits from certain categories of foreign income, depending on the type of relief being claimed. It is based on section 391 of ICTA.

320. *Subsection (2)(c)* makes it explicit that losses arising from trades carried on wholly outside the United Kingdom are not available for use for capital gains tax purposes. See *Change 13* in Annex 1.

### **Section 96: Post-cessation trade relief**

321. This section provides relief for certain payments made, or certain losses on debts made, after a trade has ceased (and for which relief would not otherwise be available). It is based on section 109A(1) and section 110(1A) and (1B) of ICTA.

322. A claim for post-cessation trade relief is possible if a person ceases carrying on a trade and within seven years makes a qualifying payment (see section 97) or a qualifying event occurs in relation to a debt of the trade owed to the person (see section 98).

### **Section 97: Meaning of “qualifying payment”**

323. This section sets out the meaning of qualifying payment. It is based on section 109A(2) of ICTA.

### **Section 98: Meaning of “qualifying event” etc**

324. This section sets out the meaning of a qualifying event occurring in relation to a debt owed to the person concerned and the amount that may be relievable in relation to such an event. It is based on section 109A(4) and (4A) of ICTA.

325. The source legislation treated the release of a debt or the occasion of a debt proving to be bad as if it were a payment which qualified as post-cessation expenditure. These sections are structured so that such deeming is not needed.

326. *Subsection (2)(c)* refers to a debt being released as part of a statutory insolvency arrangement. This term is defined by reference to section 259 of ITTOIA. The source legislation used the term “relevant scheme or arrangement”. See *Change 14* in Annex 1.

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### **Section 99: Reduction of relief for unpaid trade expenses**

327. This section reduces post-cessation trade relief by reference to expenses claimed as a deduction in computing trading profits, but which were unpaid at the time that the trade ceased. It is based on section 109A(5) of ICTA.

328. The section provides that post-cessation trade relief is reduced by the amount of the expenses that are still unpaid at the end of the tax year in question, but that the reduction shall not include any amount taken into account as a reduction in a previous tax year. And it adds that any such expenses paid subsequently are to be treated as a qualifying payment.

### **Section 100: Prohibition against double counting**

329. This section prevents a person from claiming post-cessation trade relief for an amount for which relief is given or available under other provisions of the Income Tax Acts. It is based on section 109A(6) of ICTA.

### **Section 101: Treating excess post-cessation trade relief as CGT loss**

330. This section is a signpost to a capital gains tax relief that may be available where there is insufficient income to absorb an amount claimed by way of post-cessation trade relief. It is new.

## **Chapter 3: Restrictions on trade loss relief for certain partners**

### ***Overview***

331. This Chapter sets out restrictions on trade loss relief that apply in certain cases where an individual carries on a trade as a member of a partnership. The restrictions do not apply to persons other than individuals, or in relation to professions.

332. The main restrictions are on deducting trading losses from income (other than income from the trade) or capital gains. Broadly, the amount of such deductions must not exceed the amount that the individual stands to lose commercially.

333. In various places, source legislation expresses the amount that a partner stands to lose commercially by reference to the partner's contribution to the trade that a partnership carries on (the "contribution to the trade"). But, in such cases, the amount that a partner stands to lose commercially is more likely to be reflected in the partner's contribution to the partnership that carries on the trade.

334. So this Chapter, and Chapter 5 of Part 13 (avoidance involving trading losses), makes a change by expressing the amount that a partner stands to lose commercially in terms of the partner's contribution to the partnership (the "contribution to the firm"). The change to contribution to the firm requires that the possibility of there being partnerships with more than one trade is addressed by the change. And for consistency with other partnerships, the possibility of a limited liability partnership carrying on more than one trade is also addressed. This change affects many sections in this Chapter and it also makes a number of other clarifications as to what is included in a partner's contribution. See *Change 16* in Annex 1.

### **Section 102: Overview of Chapter**

335. This section introduces the Chapter. It is new.

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336. *Subsection (1)* is a signpost to the main restrictions, which apply in certain cases where the individual is a limited partner, a member of a limited liability partnership or a non-active partner.

337. *Subsection (2)* is a signpost to a further restriction applying where the trade consists of or includes the exploitation of films.

338. *Subsections (3) and (4)* provide signposts to sections in Chapter 5 of Part 13 (avoidance involving trading losses).

### **Section 103: Meaning of “sideways relief”, “capital gains relief” and “firm”**

339. This section defines these terms. It is new.

340. The definition of “capital gains relief” refers to section 261B of TCGA, which is inserted by Schedule 1 to this Act.

### **Section 104: Restriction on reliefs for limited partners**

341. This section restricts the use of a trade loss made in a tax year by an individual carrying on the trade as a limited partner. It is based on section 117(1) and (2) of ICTA.

342. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual’s contribution to the firm.

343. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit. See *Change 13* in Annex 1.

344. The individual’s contribution to the firm is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

345. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.

### **Section 105: Meaning of “contribution to the firm”**

346. This section sets out details of what is included in determining the contribution to the firm. It is based on section 117(3) and (5) of ICTA.

347. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.

348. The individual’s contribution of capital to the firm is reduced by any amounts drawn out or received back. *Subsection (5)* provides an exception. The exception is for an amount drawn out or received back which is treated as income chargeable to income tax. This exception is similar to the one in section 111(5), based on section 118ZG(5) of ICTA. See *Change 17* in Annex 1.

### **Section 106: Meaning of “limited partner”**

349. This section defines “limited partner”. It is based on section 117(2) of ICTA.

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350. A limited partner of a limited partnership registered under the Limited Partnerships Act 1907 is someone who is not entitled to take part in the management of the firm's business and is not liable for the debts or obligations of the firm beyond a certain limit. And a limited partner of any other firm is someone who is similarly not entitled to take part in management and not liable for debts or obligations in accordance with the rules applying to the firm in question.

351. *Subsection (4)* is introduced as part of drafting in terms of an individual's "contribution to the firm" in place of "contribution to the trade". See *Change 16* in Annex 1.

### **Section 107: Restriction on reliefs for members of LLPs**

352. This section restricts the use of a trade loss made in a tax year by an individual carrying on a trade as a member of a limited liability partnership (LLP). It is based on sections 117(1) and (2) and 118ZB(1) and (2) of ICTA.

353. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual's "contribution to the LLP".

354. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit. See *Change 13* in Annex 1.

355. The individual's contribution to the LLP is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

356. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

### **Section 108: Meaning of "contribution to the LLP"**

357. This section sets out details of what is included in determining the contribution to the LLP. It is based on sections 118ZB(1) and 118ZC of ICTA.

358. An LLP formed under the Limited Liability Partnerships Act 2000 is an entity with separate legal personality. That Act defines what is meant by contribution to the limited liability partnership.

359. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

360. The individual's contribution of capital to the LLP is reduced by any amounts drawn out or received back. *Subsection (6)* provides an exception. The exception is for an amount drawn out or received back which is treated as income chargeable to income tax. This exception is similar to the one in section 111(5), based on section 118ZG(5) of ICTA. See *Change 17* in Annex 1.

### **Section 109: Unrelieved losses brought forward**

361. This section specifies how the amount of any loss, which could not be relieved because of section 107, may be brought forward for use in a later tax year in which the

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individual continues to carry on the trade as a member of an LLP. It is based on sections 118ZD and 118ZM(8) of ICTA.

362. The section treats the unrelieved loss as a trading loss of the later tax year, unless it is an excluded loss (see *subsection (3)*).

363. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit in section 107, to which this section refers. See *Change 13* in Annex 1.

#### **Section 110: Restriction on reliefs for non-active partners in early tax years**

364. This section restricts the use of trade losses made by an individual carrying on a trade as “a non-active partner” in an “early tax year”. It is based on sections 118ZE and 118ZF of ICTA.

365. A non-active partner is an individual who does not devote a significant amount of time to the trade and is not a limited partner. See section 112.

366. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual’s “contribution to the firm”.

367. The restriction applies only to losses made in the first tax year in which the individual carries on the trade or in any of the next three tax years. See section 112(6).

368. The interaction between section 72 of FA 1991 and section 118ZE of ICTA is made explicit. See *Change 13* in Annex 1.

369. The individual’s contribution to the firm is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

370. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.

371. *Subsection (8)* disapplies the rules in the case of losses from a trade of underwriting at Lloyd’s. Lloyd’s underwriters are subject to a specific tax regime which reflects the nature of the business and the partners’ liabilities for the underwriting losses.

#### **Section 111: Meaning of “contribution to the firm”**

372. This section sets out details of what is included in determining the individual’s contribution to the firm. It is based on section 118ZG of ICTA.

373. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.

374. The definition differs slightly from the definition of “contribution to the firm” for limited partners. The definition for a non-active partner includes a reference to any additional amount contributed on a winding-up, whereas the definition for a limited partner includes no such reference, as a limited partner is under no obligation to contribute any amounts beyond the amount originally agreed as the required contribution.

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### **Section 112: Meaning of “non-active partner” and “early tax year” etc**

375. This section sets out details of who is carrying on a trade as a non-active partner in an early tax year. It is based on sections 118ZE, 118ZH and 118ZM of ICTA.

376. The definition excludes limited partners. So only a general partner (that is, a partner other than a limited partner) or a member of an LLP may be a non-active partner.

377. In broad terms, a non-active partner is an individual who does not devote a significant amount of time to the trade and is, therefore, unlikely to be anything more than a financial investor.

378. *Subsection (2)* provides that a significant amount of time is taken as being a minimum of ten hours per week, on average taken across the period.

379. *Subsections (3) and (4)* define the “relevant period” for the purposes of subsection (2) as the whole of the basis period for the tax year, or a continuous period of at least six months either beginning with the date of commencement or ending with the date of cessation. For example, if an individual commences a trade on 1 April 2007, the basis period for 2006-07 is 1 April 2007 to 5 April 2007. And the relevant period ends on 30 September 2007 for the purposes of this section in relation to the tax year 2006-07. So the individual must meet the “significant amount of time” test for six months rather than just for five days.

380. *Subsection (5)* provides that where relief is given but the activity rules prove not to be satisfied, relief is withdrawn by making an assessment under this section.

### **Section 113: Unrelieved losses brought forward**

381. This section specifies how the amount of any loss, which could not be relieved because of section 110, may be brought forward for use in a later tax year in which the individual continues to carry on the trade as a partner (or contributes to the firm on its winding up). It is based on sections 118ZI and 118ZM of ICTA.

382. The section treats the unrelieved loss as a trading loss of the later tax year unless it is an excluded loss (see *subsection (4)*).

383. The interaction between section 72 of FA 1991 and section 118ZE of ICTA is made explicit in section 110, to which this section refers. See *Change 13* in Annex 1.

384. The section reflects the contribution to the firm being measured at the end of the basis period for a tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

### **Section 114: Exclusion of amounts in calculating contribution to the firm or LLP**

385. This section enables regulations, which can apply on a retrospective basis, to exclude certain amounts from the calculation of the contribution to the firm or LLP. It is based on section 118ZN of ICTA.

386. Regulations made under this section are subject to the affirmative resolution procedure.

387. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.

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388. Some regulations have been made under section 118ZN of ICTA, with effect from 22 July 2005. See the Partnerships (Restrictions on Contributions to a Trade) Regulations 2005 (SI 2005/2017). See also the commentary on Part 5 of Schedule 2 about consequential amendments made to these regulations by this Act.

389. In *subsection (4)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See section 1018 and *Change 152* in Annex 1.

### **Section 115: Restrictions on reliefs for firms exploiting films**

390. This section extends the restriction on the use of sideways relief and capital gains relief to (effectively) non-active partners carrying on a trade that exploits films, where there is a relevant agreement that guarantees the individual an amount of income. It is based on sections 118ZL and 118ZM of ICTA.

391. The interaction between section 72 of FA 1991 and section 118ZL of ICTA is made explicit. See *Change 13* in Annex 1.

### **Section 116: Exclusion from restrictions under section 115: certain film expenditure**

392. This section specifies that the restriction under the previous section does not apply to the extent any loss qualifying for relief derives from unrestricted film expenditure. It is based on sections 118ZL and 118ZM of ICTA.

## **Chapter 4: Losses from property businesses**

### ***Overview***

393. This Chapter provides relief for losses from property businesses.

### **Section 117: Overview of Chapter**

394. This section provides an overview of the Chapter. It is new.

395. *Subsection (1)* lists the types of relief available for property losses and refers to the various sections where the details of the reliefs and associated miscellaneous provisions can be found.

396. *Subsection (2)* highlights the fact that a UK property business, so far as it consists of the commercial letting of furnished holiday accommodation, is treated as a trade for loss relief purposes.

### **Section 118: Carry forward against subsequent property business profits**

397. This section provides relief for property losses against property business income of later years. It is based on sections 379A and 379B of ICTA.

398. Section 272 of ITTOIA specifies that the same rules apply in calculating profits and losses of a property business as apply for calculating profits and losses of a trade. So rewriting section 379A(7) of ICTA is unnecessary. See the reference to section 272 of ITTOIA in section 59.

### **Section 119: How relief works**

399. This section explains how the deductions are made. It is based on sections 379A(1) and 379B of ICTA.

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### **Section 120: Deduction of property losses from general income**

400. This section provides relief for property losses against general income, if the loss has a capital allowances or relevant agricultural connection. It is based on sections 379A and 379B of ICTA.

### **Section 121: How relief works**

401. This section explains how the deductions are made. It is based on sections 379A and 379 B of ICTA.

### **Section 122: Meaning of “the applicable amount of the loss”**

402. This section defines “the applicable amount of the loss”, with the effect that a claim by a person for property loss relief against general income is restricted to the lesser of the loss itself and the amount arising from the relevant connection. It is based on sections 379A(4) and 379B of ICTA.

### **Section 123: Meaning of “the loss has a capital allowances connection” and “the business has a relevant agricultural connection”**

403. This section defines the meaning of “the loss has a capital allowances connection” and “the business has a relevant agricultural connection”. It is based on section 379A and 379B.

### **Section 124: Supplementary**

404. This section provides the time limit for making a claim under section 120 and supplementary matters if a claim is made. It is based on sections 379A(3) and 379B of ICTA.

### **Section 125: Post-cessation property relief**

405. This section provides relief for payments of certain expenses etc after a property business has ceased (and for which relief would not otherwise be available). It is based on section 109A and section 110 of ICTA.

406. A claim for post-cessation property relief is possible if a person ceases carrying on a UK property business and within seven years makes a qualifying payment (see section 97) or a qualifying event occurs in relation to a debt of the business (see section 98).

### **Section 126: Treating excess post-cessation property relief as CGT loss**

407. This section is a signpost to a capital gains tax relief that may be available where there is insufficient income to absorb an amount claimed by way of post-cessation property relief. It is new.

### **Section 127: UK furnished holiday lettings business treated as trade**

408. This section provides, subject to modifications, the same range of reliefs for a loss from a UK furnished holiday lettings business as is available for a trade loss. It is based on section 504A of ICTA.

409. *Subsection (4)* applies Chapter 2 (trade losses) with the omission of the section restricting the availability of trade leasing allowances, as an individual letting furnished holiday accommodation cannot lease out equipment as part of that business.

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410. *Subsections (5) and (6)* deny early trade loss relief to an individual in respect of a tax year if any of the accommodation was first let by the individual as furnished accommodation more than three years before the start of the tax year.

## **Chapter 5: Losses in an employment or office**

### ***Overview***

411. This Chapter provides relief for losses in an employment or office.

### **Section 128: Employment loss relief against general income**

412. This section provides relief for a person's losses in an employment or office. It is based on section 380(1) of ICTA.

413. The reference to "office" is new, but reflects the long-standing HMRC practice of allowing the holder of an office to set off losses against general income. See *Change 18* in Annex 1.

414. Section 384A of ICTA restricts relief under section 380 of ICTA in relation to avoidance schemes entered into by individuals carrying on a leasing trade, or another qualifying activity, and involving first-year allowances. See section 76.

415. As section 380 of ICTA provides relief for losses in an employment (as well as in a trade) the restriction in section 384A of ICTA is, in principle, applicable to an employment loss.

416. In view of the remote possibility of section 384A of ICTA ever applying to employment losses, this section is not subject to a restriction equivalent to that in section 76. See *Change 19* in Annex 1.

### **Section 129: How relief works**

417. This section explains how deductions are made. It is based on section 380(1) and (2) of ICTA.

418. *Subsections (2) and (3)* provide that, if claims are made in respect of employment losses incurred in successive tax years and both claims specify that the relief is to be given against income of the same tax year, the claim in respect of the loss in the earlier year takes priority.

419. *Subsection (4)* makes it explicit that this rule also operates in relation to the interaction between claims for employment losses and those for trade losses.

### **Section 130: Treating loss in employment or office as CGT loss**

420. This section is a signpost to a capital gains tax relief that may be available where there is insufficient income to absorb an amount claimed by way of employment loss relief. It is new.

## **Chapter 6: Losses on disposal of shares**

### ***Overview***

421. This Chapter is based on sections 305A and 574 of ICTA and, to the extent that they supplement section 574 of that Act, sections 575 and 576 of that Act. So far as sections 575

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and 576 of ICTA supplement section 573 of that Act (share loss relief for companies), they continue in force, together with new sections 576A to 576L of ICTA (see Schedule 1 to this Act and the commentary on those new sections of ICTA).

422. Section 574 of ICTA provides for relief against income tax for allowable losses for capital gains tax purposes incurred on the disposal of ordinary shares in qualifying trading companies for which an individual has subscribed.

423. Section 305A of ICTA provides that section 574 of that Act also applies, with minor modifications, on the disposal by an individual of shares to which enterprise investment scheme income tax relief is attributable under Chapter 3 of Part 7 of ICTA. The provisions of section 305A of ICTA are included as an integral part of this Chapter and a signpost to this Chapter is included in section 161 in Part 5 (Enterprise investment scheme).

424. Section 125A of TCGA introduced by Schedule 1 to this Act is based on section 576(2) and (3) of ICTA, which have effect only for the purposes of capital gains tax or corporation tax on chargeable gains, and on sections 573(4) and 574(1) of ICTA which have effect only for the purposes of corporation tax on chargeable gains and capital gains tax respectively. See the commentary on section 125A of TCGA in Schedule 1.

425. This Chapter contains 21 sections structured as follows:

- three setting out the basic conditions for share loss relief, the entitlement of the individual to make a claim and how the relief works;
- thirteen applying only to shares to which EIS relief is not attributable and setting out requirements to be satisfied if relief is to be available on the disposal of such shares;
- three applying generally and dealing with limits on relief and the identification of shares disposed of; and
- two containing miscellaneous and supplementary provisions.

### **Section 131: Share loss relief**

426. This section deals with eligibility for share loss relief and the requirements relating to the kinds of disposal and to the type of shares disposed of. It is based on sections 305A(1), 574(1) and 575(1) and (3) of ICTA.

427. *Subsection (1)(b)* provides that the disposal must be of “qualifying shares”. *Subsection (2)* provides that shares are qualifying shares if either EIS relief is attributable to them or they are shares in a qualifying trading company for which the individual has subscribed. EIS relief is defined in section 151(1) and includes not only relief under Part 5 of this Act attributable to shares issued on or after 6 April 2007 (see section 201) but also relief under Chapter 3 of Part 7 of ICTA attributable to shares issued after 31 December 1993 and before 6 April 2007 (see section 289B of that Act).

428. *Subsection (3)(a)* is based on section 575(1)(a) of ICTA which specifies as one of the kinds of disposal:

a disposal by way of a bargain made at arm’s length for full consideration.

*Subsection (3)(a)* omits the words “for full consideration” on the basis that they add nothing. See *Change 20* in Annex 1.

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### **Section 132: Entitlement to claim**

429. This section deals with the making of a claim for share loss relief. It is based on section 574(1) of ICTA.

430. This section makes explicit what is only implicit in section 574(1) of ICTA:

- in *subsection (1)*, that a claim may be made for both the tax year in which the allowable loss is incurred and the previous tax year;
- in *subsection (2)*, what is required in practice to establish how the claim is to apply to each year; and
- in *subsection (3)*, that, in the case of a claim in respect of one year only, the claim must specify which year.

### **Section 133: How relief works**

431. This section explains how deductions for the loss are to be made. It is based on section 574(1) and (2) of ICTA.

432. *Subsection (1)* states explicitly what is implicit in section 574(1) of ICTA, that:

- the whole amount of the loss must be deducted in calculating the claimant's net income for the specified tax year; and
- if a claim is made in respect of two tax years, then only so much, if any, of the amount of the loss which it has not been possible to deduct from the claimant's income for the specified year can be deducted in calculating the claimant's net income for the other year.

433. This section does not include the words in section 574(1)(a) and (b) of ICTA which limit the amount of the deduction for any tax year to the whole of the claimant's income for the year, where the income is less than the amount of the loss. That limit is included in section 25(5) and (6). Section 25 explains how the reliefs listed in section 24, which include share loss relief, are to be deducted at Step 2 of section 23 in order to calculate the claimant's net income.

434. *Subsection (5)* is new. It makes explicit that the balance of any allowable loss for which share loss relief is not obtained continues to be capable of being claimed as a deduction under TCGA.

### **Section 134: Qualifying trading companies**

435. This section is the first of 13 sections which apply only to shares to which EIS relief is not attributable. It is based on section 576(4) of ICTA. It defines what is a qualifying trading company. Shares, other than shares to which EIS relief is attributable, must form part of the ordinary share capital of a qualifying trading company if they are to be qualifying shares (see section 131(2)(b) and the definition of "shares" in section 151(1) and (3) to (6)).

436. Section 576(4) of ICTA defines a "qualifying trading company" in terms of its being an "eligible trading company" and having been such for a specified continuous period. Section 576(4A) of ICTA defines an "eligible trading company" by applying the requirements of section 293 and other provisions of Chapter 3 of Part 7 of ICTA (Enterprise investment scheme) with modifications.

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437. This section avoids the double layer of definition in section 576(4) of ICTA and omits the concept of an “eligible trading company”.

438. *Subsection (2)*, therefore, directly introduces the four requirements of section 293 of ICTA (as modified and applied by section 576(4A) and (4B) of that Act) which must be met on a continuing basis (see also *subsection (3)*).

439. Subsections (2)(b) and (3)(b) omit the words “that is not an eligible trading company” which qualify “trading company” in section 576(4)(a)(ii) and (b)(ii) of ICTA on which those paragraphs are based. Those words are otiose.

440. *Subsection (4)* directly introduces the two requirements of section 293 of ICTA (as modified and applied by section 576(4A) and (4B) of that Act) which are to be met only when the shares in respect of which share loss relief is claimed are issued.

441. This direct application of these two requirements resolves the apparent inconsistency between sections 293 and 576(4) of ICTA. Section 293 of ICTA requires them to be met only at the time of issue of the shares. But section 576(4) of that Act requires the company to be an eligible trading company at a subsequent time and during a continuous period. Section 576(4) of ICTA thus appears to require the company to meet these requirements also at that subsequent time and during that period.

### **Section 135: Subscriptions for shares**

442. This section sets out the requirements relating to the subscription for shares in a qualifying trading company. It is based on section 574(3) of ICTA and includes a new provision relating to “corresponding bonus shares”.

443. *Subsection (2)* provides that shares are subscribed for by the individual if they have been issued to the individual in consideration of money or money’s worth. See also *subsection (4)*.

444. *Subsection (3)* is based on section 574(3)(b) of ICTA, which provides that:

an individual shall be treated as having subscribed for shares if his spouse or civil partner did so and transferred them to him by a transaction *inter vivos*.

445. Subsection (3)(a) is extended to cover not only the case where A is the actual subscriber but also cases where A is treated as having subscribed under the provisions relating to the issue of “corresponding bonus shares” (see *subsection (4)*) or under an earlier application of this subsection. See *Change 21* in Annex 1.

446. Subsection (3)(c), read with the definitions of “civil partner” and “spouse” in section 151(1), makes explicit that the relevant time at which A and B must be spouses or civil partners living together is the time of the transfer. See *Change 22* in Annex 1.

447. Subsection (4) is new and treats “corresponding bonus shares” issued in respect of shares which have been subscribed for as themselves having been subscribed for. See *Change 23* in Annex 1.

### **Section 136: Disposals of new shares**

448. This section applies to the disposal of qualifying shares (other than shares to which EIS relief is attributable) which are identified by virtue of section 127 of TCGA with shares

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previously held by the individual. The section denies or restricts share loss relief unless certain conditions are met. It is based on section 575(2) of ICTA.

449. The cross-reference to section 145(3) at the end of *subsection (2)* makes clear that this section does not apply to an exchange of shares to which section 145(1) applies. See the commentary on section 145 and *Change 24* in Annex 1.

### **Section 137: The trading requirement**

450. This section is the first of ten new sections relating to the requirements for a company to be a qualifying trading company. These sections replace the provisions of section 576(4A) and (4B) of ICTA which apply section 293 and certain associated provisions of Chapter 3 of Part 7 of that Act, with modifications and omissions.

451. All these sections correspond to sections in Part 5 of this Act (Enterprise investment scheme). So far as possible cross-references to sections of Part 5 have been minimised. Cross-references have, however, been retained where the material referred to is lengthy, for example the definition of “excluded activities” in sections 192 to 199.

452. This section corresponds to section 181 with modifications. Section 181 is based on section 293(2) and (3A) to (3F) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period, which is the effect of the modification of section 293(2) of ICTA made by section 576(4A)(d) of that Act.

453. *Subsection (2)* corresponds to section 181(3) and *subsection (6)* corresponds to section 181(7). For the reason for the introduction of subsections (3) and (7) of section 181, see *Change 42* in Annex 1 and the commentary on section 181.

454. *Subsection (5)* corresponds to section 181(6), including the change made in section 181(6)(d) by *Change 41* in Annex 1.

455. In the definition of “incidental purposes” in *subsection (7)* the words “capable of”, which appear in the definition in section 293(2) of ICTA on which it is based, have been omitted. This mirrors the definition of “incidental purposes” in section 181(8), which is also based on the definition in section 293(2) of ICTA. See the commentary on section 181.

456. The definition of “non-qualifying activities” in *subsection (7)* includes the change affecting the definition of that term for the purposes of section 181(8) made by *Change 43* in Annex 1.

### **Section 138: Ceasing to meet trading requirement because of administration or receivership**

457. This section corresponds to section 182 with two changes. Section 182 is based on section 293(4A) to (6) and (8A) of ICTA.

458. The first change modifies section 182(3) by substituting for the reference to “the end of period B” a reference to “the time that is relevant for the purposes of section 134(2)”. This is the substitution required by section 576(4A)(d) of ICTA to section 293(5) of that Act, on which section 182(3) is based.

459. The second change modifies section 182(4) by omitting the reference to dissolution and adding the condition that the company continues, during the winding up, to be a trading

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company. These are the modifications required by section 576(4A)(b) of ICTA to section 293(6) of that Act, on which section 182(4) is based.

### **Section 139: The control and independence requirement**

460. This section corresponds to section 185 with modifications. Section 185 is based on section 293(8) and (8A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period, which is the effect of the modification of section 293(8) of ICTA made by section 576(4A)(d) of that Act.

461. *Subsections (1) to (3)* correspond to section 185, with the omission in subsections (1)(a) and (2)(a) of the words “at any time in period B” and the substitution in subsection (3) of a reference to section 145(3) for the reference to section 247(4). *Change 44* in Annex 1 relating to section 185(1)(a) is replicated in this subsection.

462. The term “control” is used in both subsection (1)(a) and subsection (2)(a)(ii). There is a definition of “control” in *subsection (4)*, which refers to section 416(2) to (6) of ICTA, but this applies only to the use of that term in subsection (1)(a). This reflects section 257(3), which applies the definition of “control” in section 416(2) to (6) of ICTA in section 185(1)(a) but not in section 185(2)(a)(ii). By virtue of section 1021(2), the term “control” in sections 139(2)(a)(ii) and 185(2)(a)(ii) has the meaning given by section 995.

### **Section 140: The qualifying subsidiaries requirement**

463. This section corresponds to section 187 with modifications. Section 187 is based on sections 293(3A) and 308(1) and (5A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period. This, together with the omission of the words “at any time in period B”, gives effect to the modification of sections 293(3A) and 308(1) of ICTA made by section 576(4A)(d) of that Act.

### **Section 141: The property managing subsidiaries requirement**

464. This section corresponds to section 188 with modifications. Section 188 is based on section 293(6ZA) to (6ZC) and (8A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period. This, together with the omission of the words “at any time in period B”, gives effect to the modification of section 293(6ZA) of ICTA made by section 576(4A)(d) of that Act.

### **Section 142: The gross assets requirement**

465. This section corresponds to section 186 with modifications. Section 186 is based on section 293(6A) to (6C) of ICTA. This requirement has to be met only at the times specified in *subsections (1) and (2)* (see section 134(4)(a)).

466. Section 576(4A)(c) of ICTA requires that for the words “the eligible shares” in section 293(6A) of that Act there be substituted the words “the shares in respect of which the share loss relief is claimed under section ... 574”. This substitution has been reflected in subsections (1)(a) and (2)(a). Section 150 applies for the purposes of those paragraphs to determine the time of issue of the shares in certain circumstances.

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### **Section 143: The unquoted status requirement**

467. This section corresponds to section 184 with modifications. Section 184 is based on sections 293(1A), (1B) and (8A) and 312(1), (1B), (1C) and (1E) of ICTA. This requirement has to be met only at the time specified in *subsection (1)* (see section 134(4)(b)).

468. Subsection (1) corresponds to section 184(1) with the substitution for “the beginning of period B” of “the time at which the shares in respect of which the share loss relief is claimed are issued”. This is the substitution required by section 576(4A)(ab) of ICTA to section 293(1A) of that Act, on which section 184(1) is based. Section 150 applies for the purposes of this subsection to determine the time of issue of the shares in certain circumstances.

469. In subsection (1)(c)(i) a reference to section 145 is substituted for the reference in section 184(1)(c)(i) to section 247.

### **Section 144: Power to amend requirements by Treasury order**

470. This section is included to enable sections 137 to 143 to be amended by Treasury order whenever the corresponding sections in Part 5 are amended by such an order under the power in section 200. It is based on sections 298(4) and 576(4A) of ICTA.

471. This preserves the position under the source legislation if an amendment were made under the power in section 298(4) of ICTA. In the case of an amendment of a provision which is applied by section 576(4A) of ICTA, the amendment would also have effect for the purposes of section 574 of that Act.

### **Section 145: Relief after an exchange of shares for shares in another company**

472. This section corresponds to section 247 with modifications. Section 247 is based on section 304A(1), (2), (6), (7) and (8) of ICTA.

473. Section 576(4A)(e) of ICTA requires that for the words “eligible shares” in section 304A(1)(e)(i) of that Act there are substituted the words “shares in respect of which relief is claimed under section ... 574”. Those words are not entirely apposite, as the relief will be claimed, if at all, in respect of the new shares not the old shares.

474. Section 304A(1)(e)(i) of ICTA is needed in the context of EIS relief (see section 247(1)(e)(i)). But that provision is unnecessary in the context of share loss relief. Section 576(4A)(a) and (4B)(d) require the omission of section 304A(1)(e)(ii) of that Act. Accordingly, section 247(1)(e) has not been replicated in this section.

475. The provision in *subsection (1)(e)* has been based on paragraph 8(1)(f) of Schedule 5B to TCGA (Enterprise investment scheme: re-investment) rather than section 304A(1)(f) and (8) of ICTA. Accordingly, section 247(2), which is based on section 304A(8) of ICTA, has not been replicated in this section. See *Change 25* in Annex 1.

476. *Subsection (3)* corresponds to section 247(4) with two modifications.

477. Subsection (3)(a) is new and resolves the apparent conflict between section 136 and this section. See *Change 24* in Annex 1.

478. In subsection (3)(b) reference to section 139(1) has been substituted for the reference in section 247(4) to section 185.

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### **Section 146: Substitution of new shares for old shares**

479. This section corresponds to section 249 with modifications. Section 249 is based on section 304A(3) and (4) of ICTA.

480. Section 249 makes separate provision for circumstances where the shares are held by the individual who subscribed for them and for circumstances where the shares have been transferred to the individual by the individual's spouse or civil partner.

481. The structure of section 249 is dictated by the differing forms of subsections (2)(d) and (4)(d) which are based on section 304A(3)(d) and (4)(d) of ICTA. The difference between those provisions is necessary for the purposes of EIS relief. But section 576(4B)(d) of ICTA requires that section 304A(3)(d) and (4)(d) of that Act are omitted in the application of section 304A for the purposes of share loss relief.

482. Section 135 provides that references in this Chapter to an individual having subscribed for shares include, in relation to shares to which EIS relief is not attributable, references to the individual being treated as having subscribed for shares for which the individual's spouse or civil partner subscribed. The structure of section 146 is, therefore, simpler than that of section 249.

483. *Subsection (1)* corresponds to section 249(1) and (3), with the omission, as required by section 574(4B)(d) of ICTA, of the words "to which EIS relief becomes attributable under section 247" and with two further changes.

484. The first of these changes is that the words "and issued to" in section 249(1) have not been reproduced having regard to the meaning given to "subscribed for" by section 135(2).

485. The second of these changes is that the words "or by a nominee for an individual" have been added. These words reflect so much of section 250(1) as relates to the holding or disposal of shares by a nominee for an individual. In this way, the requirements of section 135 relating to the subscription for the shares by the individual are preserved, while recognising that the individual may have subsequently transferred the shares into the name of a nominee for the individual.

486. *Subsection (2)(a)* and *(b)* correspond to section 249(2)(a) and (b) and (4)(a) and (b), with the substitution of "this Chapter" for "this Part". As required by section 576(4B)(d) of ICTA, section 249(2)(c) and (d) and (4)(c) and (d) are not reproduced in this subsection. Section 150 applies for the purposes of subsection (2)(b) to determine the time of issue of the shares in certain circumstances.

487. *Subsection (2)(c)* is new. It expressly sets out the effect of sections 145 and 146. This is that, in determining whether the shares in the new company are, on their disposal, qualifying shares, any requirements of this Chapter for the new company to be a qualifying trading company which were met by the old company before the exchange are to be treated as met by the new company.

### **Section 147: Limits on share loss relief**

488. This section deals with the calculation of the amount of share loss relief. It is based on section 576(1) of ICTA. It is the first of a group of three sections which apply generally for the purposes of this Chapter.

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489. Section 576(1) of ICTA provides that, if a person disposes of shares for which the person has subscribed and which form part of a holding, the share loss relief in relation to those shares is not to exceed the sums which would have been allowable as deductions in computing the allowable loss for capital gains tax purposes if the shares had not formed part of the holding.

490. To cater for the abolition of pooling in relation to shares issued on or after 6 April 1998 and the changes in section 148 described in *Change 29* in Annex 1, section 147 refines the circumstances in which the provision applies. See *Change 26* in Annex 1.

491. *Subsection (8)* explains what is meant by shares “that are not capable of being qualifying shares” for the purposes not only of this section but also of section 148. *Change 27* in Annex 1 contains a detailed explanation of why a mixed holding is defined for the purposes of section 148 in terms of a holding which includes such shares.

492. *Subsection (9)* extends this meaning for the purposes only of *subsection (5)* to cover reorganisations involving the issue of shares of a different class.

#### **Section 148: Disposal of shares forming part of mixed holding**

493. This section deals with the identification of shares disposed of where those shares form part of a “mixed holding”. It is based on section 576(1) to (1B) and (5) of ICTA, with a number of changes.

494. Section 576(1) of ICTA defines a mixed holding as one which comprises shares for which a person has subscribed and shares which the person has acquired otherwise than by subscription.

495. *Subsection (1)* provides that this section applies to a holding in which some only of the shares are shares “that are not capable of being qualifying shares” (as defined in section 147(8)). See *Change 27* in Annex 1 which contains a detailed explanation of why a mixed holding has been defined in terms of a holding which includes such shares.

496. *Subsection (2)* provides that the section applies for the purpose of answering the questions:

- whether the shares disposed of are qualifying shares; and
- which of any qualifying shares acquired at different times are disposed of.

497. This is a change from section 576(1) of ICTA, which is not expressed to apply for the purpose of determining which of any qualifying shares are disposed of. See *Change 28* in Annex 1.

498. *Subsection (3)* introduces the rules for determining the answers to the questions in subsection (2).

499. Section 576(1) of ICTA, on which subsection (3)(a) is based, identifies the shares disposed of on a last in first out (LIFO) basis. Section 576(1) of ICTA and its predecessor, section 37 of FA 1980, were enacted at a time when shares were pooled and treated as a single asset for capital gains tax purposes. Accordingly, it was and remains necessary to have a rule identifying the order in which shares in the pool are disposed of, in order to ensure that share loss relief is obtained only on the disposal of qualifying shares.

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500. FA 1998 made changes to the identification rules in TCGA, as a result of which shares acquired on or after 6 April 1998 are not pooled but, on a disposal, are in most cases identified on a LIFO basis.

501. Taking account of those changes, subsection (3)(a) applies the FA 1998 rules (see *subsection (4)*) or, in the case of shares acquired on different dates before 6 April 1998, a specific LIFO rule (see *subsection (5)*). See *Change 29* in Annex 1.

502. Subsection (3)(b) is based on section 576(1A) of ICTA and applies the rules in *subsection (6)*, based on section 576(1B) of that Act, if the mixed holding includes any of:

- shares issued before 1 January 1994 to which business expansion scheme relief is attributable;
- shares to which EIS income tax relief is attributable; and
- shares to which EIS deferral relief is attributable.

503. *Subsection (7)* is new and puts on a statutory basis the practice under which questions which cannot be determined by the specific provisions of this section are to be determined on a just and reasonable basis. This subsection will principally be required in cases where some but not all of the shares of the same class acquired, or treated as having been acquired, on the same day are shares that are not capable of being qualifying shares. See *Change 29* in Annex 1.

#### **Section 149: Section 148: supplementary**

504. This section supplements section 148. It is new.

505. *Subsection (1)* corrects the absence of an amendment to section 299 of ICTA as applied by section 576(1B) of that Act consequential upon the enactment of section 105A of TCGA by FA 2002. It applies if an individual has a mixed holding which includes shares to which business expansion scheme relief, EIS income tax relief or EIS deferral relief is attributable.

506. Subsection (1) ensures that, if the individual makes an election for the alternative identification rule under section 105A of TCGA to apply for the purposes of capital gains tax on the disposal of shares in the holding where “approved scheme shares” are acquired on the same day as other shares of the same class, the alternative rule will also apply for the purposes of share loss relief. See *Change 30* in Annex 1.

507. *Subsection (2)* determines the time of acquisition for the purposes of section 148 of shares issued in a reorganisation within the meaning of section 126 of TCGA to which section 127 of that Act applies. See *Change 31* in Annex 1.

508. *Subsection (3)* clarifies that shares held or disposed of by a nominee or bare trustee for an individual are part of the individual’s holding for the purposes of section 148. See *Change 32* in Annex 1.

#### **Section 150: Deemed time of issue for certain shares**

509. This section contains provisions which determine the time of issue of shares for the purposes of the provisions listed in *subsection (1)*. It is based on section 574(3) of ICTA.

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510. *Subsection (2)* mirrors section 135(3) and applies in cases where the shares have been transferred to an individual by that individual's spouse or civil partner. See *Change 33* in Annex 1.

511. *Subsection (3)* mirrors section 135(4) and applies to corresponding bonus shares. See *Change 34* in Annex 1.

### **Section 151: Interpretation of Chapter**

512. This section explains the meaning of expressions used in this Chapter. It is based on section 576(5) of ICTA.

513. *Subsection (1)* includes the definition of "corresponding bonus shares". *Subsection (2)* amplifies that definition. See *Change 23* in Annex 1.

514. The introduction of sections 137 to 146 makes it necessary to ensure that the word "shares" has the same meaning in those sections as it does in the sections of Part 5 to which they correspond with modifications. Accordingly, *subsections (3) to (6)* provide that the application of the definition of "shares" in subsection (1) is subject to the exceptions mentioned in section 576(5) of ICTA, those required for the purposes of sections 137 to 146 of this Act and those required for the purposes of section 147 as a result of the changes described in *Change 26* in Annex 1.

515. *Subsection (8)* is new and clarifies that the date of disposal is the time when the disposal is made or treated as made for the purposes of the capital gains tax legislation. See *Change 35* in Annex 1.

### **Chapter 7: Losses from miscellaneous transactions**

#### ***Overview***

516. This Chapter gives relief for losses from miscellaneous transactions.

#### **Section 152: Losses from miscellaneous transactions**

517. This section provides relief for losses from certain transactions (known as Case VI losses before the enactment of ITTOIA). It is based on section 392 of ICTA.

518. The provisions relating to Case VI income are in Chapter 8 of Part 5 of ITTOIA. That Act amended section 392 of ICTA (which operates by reference to section 836B of ICTA, also inserted by Schedule 1 to ITTOIA). Section 836B of ICTA is rewritten as section 1016 of this Act.

519. A person can make a claim to deduct a loss incurred in a relevant transaction in computing the person's net income of the tax year or of a subsequent tax year, but only from the person's miscellaneous income from relevant transactions. Transactions are relevant if any profits from them would be liable to income tax under a provision listed in section 1016.

#### **Section 153: How relief works**

520. This section explains how the deductions are made. It is based on section 392(2) and (5) of ICTA.

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## **Section 154: Transactions in deposit rights**

521. This section explains the application of the loss relief against miscellaneous income rules as they apply to transactions in deposit rights. It is based on section 398 of ICTA.

## **Section 155: Time limit for claiming relief**

522. This section sets out the time limits for making claims for loss relief against miscellaneous income. It is based on section 392(6) and (7) of ICTA.

## **Part 5: Enterprise investment scheme**

### ***Overview***

523. This Part provides income tax reductions to individuals who subscribe for shares in smaller unquoted trading (and some other) companies with which they are not connected.

524. A tax reduction is available where an individual provides additional full risk equity finance by subscribing money for shares and holds those shares, in most cases, for at least three years and the other conditions of the scheme are met.

525. The structure of the Part is as follows:

- The tax reduction and an overview (Chapter 1);
- Conditions relating to the investor (Chapter 2);
- Conditions relating to money raised and other matters (Chapter 3);
- Conditions relating to the issuing company (Chapter 4);
- Claiming the tax reduction and attributing the reduction to shares (Chapter 5);
- Withdrawing tax reductions that prove to be excessive (Chapter 6);
- Method of withdrawing tax reduction and related matters (Chapter 7); and
- Supplementary provisions (Chapter 8).

526. As set out in section 156(3), this Part has effect only in relation to shares issued on or after 6 April 2007 in accordance with section 1034(3). This is subject to provisions in Schedule 2, in particular the general provisions concerning the continuity of the law in Part 1 and the transitional provisions in Part 7 of that Schedule.

527. For example, the effect of Part 1 of Schedule 2 on section 218 (value received when there is more than one issue of shares) is that the section is read, in relation to shares issued before 6 April 2007, as a reference to the corresponding provision in the source legislation.

528. As a result of the commencement basis applying to Part 5, the minor changes in the law made by this Act will not affect shares issued before 6 April 2007, subject to one exception. This exception is the consequential amendment to section 312(2A) of ICTA, explained in the explanatory note on this section in Schedule 1.

529. Section 1034(3) also provides that consequential amendments and repeals associated with Part 5 have effect only in relation to shares issued on or after 6 April 2007. So enterprise investment scheme (EIS) shares and BES shares (BES is the common name for the business expansion scheme) issued before that date are unaffected.

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530. Sections 292, 294, 295, 296 and 395 of ICTA have not been rewritten since these provisions are spent.

## **Chapter 1: Introduction**

### ***Overview***

531. This Chapter sets out the conditions for an individual to be entitled to a tax reduction and quantifies the amount of the entitlement. It also gives an overview of the Part, labels certain concepts and provides signposts to other material related to EIS.

### **Section 156: Meaning of “EIS relief” and commencement**

532. This section says the relief is a tax reduction and provides labels for the scheme and the relief. It is based on section 312(1) of ICTA.

533. *Subsection (3)* sets out the commencement basis for Part 5 in accordance with section 1034(3). See the notes in the general overview to this Part.

### **Section 157: Eligibility for EIS relief**

534. This section states the conditions to be satisfied for the relief to be available and indicates where further detail can be found on certain conditions. It is based on sections 289(1), 290(1) and 291(1) of ICTA.

### **Section 158: Form and amount of EIS relief**

535. This section quantifies the amount of the income tax reduction to which an individual is entitled if the individual claims EIS relief for a tax year. It is based on sections 289A(1) to (4) and 290(2) of ICTA.

536. *Subsection (1)* provides that an individual may, if that individual wishes, claim EIS relief in respect of some, but not all, of the shares in relation to which the individual is eligible for relief. See *Change 36* in Annex 1. There are consequential changes in later sections to deal with cases where an individual claims EIS relief in relation to some, but not all, of the shares in relation to which the individual is eligible for relief. The commentary on those later sections refers back to the commentary on this section.

537. *Subsection (1)* is expressed in terms of the individual’s entitlement to a tax reduction. Sections 27 and 29 (within the calculation of income tax liability Chapter in Part 2) contain provisions about how effect is given to the entitlement to a reduction and how the actual reduction is quantified.

538. *Subsection (2)(a)* adds the words “and claims”, before “EIS relief”, to make explicit a requirement that is implied when sections 289A(1) and 289A(2)(a) of ICTA are considered together.

539. *Subsection (2)(b)* provides that there is an upper limit on the amount of an individual’s entitlement to EIS relief rather than an upper limit on the subscriptions in respect of which the relief may be claimed. See *Change 37* in Annex 1.

### **Section 159: Periods A, B and C**

540. This section labels and defines periods (relating to an issue of shares) that are referred to in other sections in this Part. It is based on section 312(1) and (1A) of ICTA.

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## **Section 160: Overview of other Chapters of Part**

541. This section indicates the content of Chapters that are not mentioned in section 157. It is new.

## **Section 161: Other tax reliefs relating to EIS**

542. This section signposts other reliefs and material that may be relevant to EIS. It is new.

## **Chapter 2: The investor**

### ***Overview***

543. This Chapter sets out the conditions which the investor must meet in order to be a “qualifying investor” in relation to the issue of shares in question.

## **Section 162: Overview of Chapter**

544. This section states the three conditions that must be met by an investor in order to be a qualifying investor and indicates where further detail can be found about them. It is new.

## **Section 163: The no connection with the issuing company requirement**

545. This section provides that the investor must not be connected with the issuing company during the period indicated. It is based on section 291(1) of ICTA.

546. There is a reference to connection before the issuing company is incorporated. This covers for example a former employee of a company which becomes a subsidiary or partner of the issuing company within the prescribed period, see section 167(1)(a).

## **Section 164: The no linked loans requirement**

547. This section denies relief in the cases set out (loans connected with the subscription for the relevant shares). It is based on section 299A of ICTA.

548. The effect of the cross-reference in section 299A(2) of ICTA to section 307(6)(ca) of ICTA is achieved by making reference in section 239(1) of this Act (date from which interest is chargeable) to the meaning of “the making of the loan” in this section.

549. Section 1008(1) notes that “assignment” is the term used in Scotland for “assignment”. Both terms are used in section 299A(2)(b) of ICTA.

## **Section 165: The no tax avoidance requirement**

550. This section stops the investor being a qualifying investor if the subscription was not for commercial reasons or if a main purpose was tax avoidance. It is based on section 289(6) of ICTA. There is a complementary requirement in respect of the issue of the shares in Chapter 3 of this Part.

551. Section 289(6) of ICTA has introductory wording about the investor “not being eligible for relief”. There is no need for similar introductory words in this section, because section 162 already provides that the investor is not a qualifying investor if the no tax avoidance requirement is not met, and is therefore not eligible for EIS relief (section 157(1)(b)).

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552. To be consistent with related legislation, for example paragraph 14 of Schedule 15 to FA 2000 (corporate venturing scheme), this section refers to “commercial reasons” rather than “commercial purposes”.

### **Section 166: Connection with issuing company**

553. This section defines, for the purposes of this Chapter, the meaning of an individual being connected with the issuing company and provides signposts to the sections that provide further detail of the way in which such connection can occur. It is based on section 291(2) of ICTA.

554. This section clarifies the application of the definition of connected in section 291(2) of ICTA. See *Change 38* in Annex 1.

### **Section 167: Employees, directors and partners**

555. This section defines how an individual can be connected with the issuing company as a result of a person being “an employee, director or partner”. It is based on section 291(2), (3) and (4) of ICTA.

556. *Subsection (3)* is based on section 291(4) of ICTA. It provides that an individual who is both a director and an employee of the issuing company is covered by *subsection (1)(c)* rather than *subsection (1)(a)* and so can benefit from the let-outs in sections 168 and 169. In such a case, references in sections 167 to 169 to an individual in his or her capacity as a director also includes the individual in his or her capacity as an employee. So, for example, in these cases any remuneration received as an employee is taken into account in section 169(2).

### **Section 168: Directors excluded from connection**

557. This section provides that an individual will, in specific circumstances, not be connected with the issuing company. It is based on sections 291(5) and 291A(1), (2), (3) and (6) of ICTA.

558. This section allows, in limited cases, the investor to be eligible for EIS relief in relation to a share issue even if the investor (or an associate) is a director of the issuing company. Such limited cases *broadly* include those where:

- the sole reason for connection would have been the relationship as director; but
- in relation to the period over which connection is tested;
  - there are no payments to the individual (or to certain other persons), and no entitlement to such payments, from the issuing company (or from certain other persons), or
  - any such payments fall to be disregarded by virtue of *subsection (2)*.

559. *Subsection (4)(a)(i)* narrows the definition of “related person”. See *Change 39* in Annex 1.

560. The meaning of “connected” in *subsection (4)(a)(ii)* is found in section 993. This differs from the other references to “connected” in this Chapter, which take their meaning from section 166.

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561. The words “at any time in period A” in *subsection (5)* are needed to convey the full meaning of the expression “51% subsidiary” in section 291A(6) of ICTA. For the source legislation, this expression has a specific definition in section 312(1) of ICTA, but this is not reproduced in the rewritten EIS sections. Instead a “51% subsidiary” in this Part takes its meaning from section 838 of ICTA - see section 989.

#### **Section 169: Directors qualifying for relief despite connection**

562. This section provides an exception to the rule that a person is not a qualifying investor if that person is connected with the issuing company. It is based on section 291(5) and section 291A(4) and (5) of ICTA.

563. This exception might apply to certain, otherwise unconnected, business angel investors whose only connection with the issuing company will be as directors. (A business angel is the term used for investors who also make their business expertise available to a company by becoming a director.)

564. In *subsection (3)(a)* the reference to “connected” takes its meaning from section 166, see *Change 38* in Annex 1.

565. In section 291A(5) of ICTA there is a reference to the word “trade” including “any business, profession or vocation”. As an incorporated company cannot carry on a vocation there is now in *subsection (3)(b)* a reference to “the trade, business or profession” carried on by the company or its subsidiary.

#### **Section 170: Persons interested in capital etc of company**

566. This section sets out cases in which an individual is treated as connected with the issuing company because of certain interests in that company or a subsidiary of that company. It is based on section 291(5) and section 291B of ICTA other than section 291B(5).

567. In *subsection (1)(a)*, based on section 291B(1)(a) of ICTA, there is a reference to ordinary share capital without the word “issued”. This is because the definition of ordinary share capital in section 989 defines ordinary share capital in terms of issued share capital.

568. In *subsections (1)(a), (2)(a) and (10)*, it has been made clear that the subsidiary referred to is the subsidiary of the issuing company.

569. *Subsection (6)* refers to “the issuing company”. This replaces a reference to “a company” in section 291B(4) of ICTA, on which subsection (6) is based. The clarification is consistent with the context of section 291B of ICTA generally and with the reference in section 291B(5) of ICTA to “another company ... assuming it to be an issuing company” in particular.

#### **Section 171: Persons subscribing for shares under certain arrangements**

570. This section provides a further instance where an individual is treated as connected with the issuing company. It is based on section 291B(5) of ICTA.

571. The references to “connected” take their meaning from section 166, see *Change 38* in Annex 1.

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### **Chapter 3: General requirements**

#### ***Overview***

572. This Chapter sets out conditions for the general requirements that need to be met in relation to the relevant shares.

#### **Section 172: Overview of Chapter**

573. This section lists the various conditions that are contained in this Chapter and where further detail can be found. It is new.

#### **Section 173: The shares requirement**

574. This section sets out the conditions that the relevant shares must satisfy. It is based on section 289(1), (7), (8) and (8A) of ICTA.

575. The shares (apart from bonus shares) have to be fully paid up in cash at the time they are issued. Bonus shares are defined in section 257.

576. *Subsection (2)* provides in effect that the shares must also be full-risk ordinary shares throughout period B. The label “eligible shares” which appears in section 289(7) of ICTA is no longer used. Instead of references to “eligible shares”, there are now references elsewhere in this Part to shares which meet the requirements of this subsection.

577. There are several instances in ICTA where the reference to *eligible* shares adds nothing to the meaning. The word *eligible* has been omitted in the Part where this is the case, and if identification of the shares in question is needed, an alternative such as “the relevant shares” has been used.

578. Similarly the term “new ordinary shares” has not been reproduced. As EIS relief depends on subscribing for shares that are issued to the investor, it is not necessary to describe the shares as “new”. This approach mirrors that in paragraph 35 of Schedule 15 to FA 2000 (corporate venturing scheme).

#### **Section 174: The purpose of the issue requirement**

579. This section sets out the condition concerning the purpose for which the share issue raises money. It is based on section 289(1) of ICTA.

#### **Section 175: The use of the money raised requirement**

580. This section sets out the requirements for the employment of the money raised by the issue of relevant shares. It is based on section 289(1), (3) and (3A) of ICTA.

581. *Subsection (1)* contains a reference to bonus shares which are defined in section 257(1). Such shares do not need to meet the tests of this section. This enables for example section 201(4) (attribution of EIS relief to shares) to work. As a result, under section 201(4)(b) this Part applies as if the “original issue” of shares included “corresponding bonus shares”.

582. Section 257(5) explains when shares are treated as being of the same class.

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### **Section 176: The minimum period requirement**

583. This section requires that the companies mentioned in *subsection (2)* must carry on the qualifying business activity for a certain period of time. It is based on section 289A(6) to (8A) of ICTA.

584. *Subsection (1)* makes the requirements of this section a condition of eligibility for EIS relief instead of, as in section 289A(6) of ICTA, a condition for claiming the relief. See *Change 40* in Annex 1.

585. *Subsections (2)* and *(3)* refer to “at or after the time of the issue” to make more obvious the fact that the period in question may end after the share issue has occurred.

### **Section 177: The no pre-arranged exits requirement**

586. This section denies relief if certain arrangements exist in connection with the issue of shares. It is based on section 299B of ICTA.

587. The words in brackets in *subsection (1)(c)* “in terms of value” are not in section 299B(1)(c), although they do appear in paragraph 37(1) of Schedule 15 to FA 2000 (corporate venturing scheme). Introducing the words here is intended to clarify what is meant by “a substantial amount” in this context.

### **Section 178: The no tax avoidance requirement**

588. This section requires that there be commercial reasons for the issue of the relevant shares and that a main purpose is not tax avoidance. It is based on section 289(6) of ICTA.

589. There is a complementary requirement in respect of the subscription for the shares in Chapter 2.

590. To be consistent with related legislation, for example, in paragraph 14 of Schedule 15 to FA 2000 (corporate venturing scheme), this section refers to “commercial reasons” rather than “commercial purposes”.

### **Section 179: Meaning of “qualifying business activity”**

591. This section says what “qualifying business activity” means. It is based on section 289(2), (3A) and (8) of ICTA.

592. For EIS relief to be available, the share issue must raise money for the purpose of a qualifying business activity. (See section 174.)

593. In *subsection (1)* a qualifying business activity is explained by reference to activity A and activity B. The requirement is that these activities are carried out by the company or a qualifying 90% subsidiary.

594. The phrase “or preparing to carry on and then carrying on” in *subsection (2)(b)* is intended to be clearer than the phrase “preparing to carry on, or carrying on,” in section 289(2)(a)(ii) of ICTA. Each is concerned with money being raised *both* for the preparations for a trade *and* the subsequent carrying on of that trade.

595. *Subsections (4)* and *(5)* extend the cases in which R&D activities can be treated as a qualifying business activity. See *Change 41* in Annex 1.

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596. *Subsection (7)* enables certain requirements to be met in relation to a company that is not a qualifying 90% subsidiary at the time the shares are issued. See *Change 42* in Annex 1.

## **Chapter 4: The issuing company**

### **Overview**

597. This Chapter sets out the conditions to be met if the issuing company is to be a qualifying company in relation to the relevant shares.

### **Section 180: Overview of Chapter**

598. This section summarises the conditions to be met and indicates where further detail can be found. It is based on sections 289(1)(ba) and 293(1) of ICTA but there is no equivalent provision in ICTA that draws these conditions together.

599. Where there are shared provisions, the order matches Chapter 4 of Part 6, “qualifying holdings” in the venture capital trust scheme (VCT), as far as possible.

### **Section 181: The trading requirement**

600. This section sets out the trading requirement which the issuing company must meet throughout period B. It is based on section 293(2), (3A) to (3F) and (8A) of ICTA.

601. The nature of the requirement is set out in *subsection (2)*. The requirement can be met in one or other of two ways. Either the issuing company must exist essentially for the purpose of carrying on one or more *qualifying* trades during period B, or it can be a parent company of a group that carries on qualifying activities. It can alternate between these two conditions providing that at all times within period B it meets one or other of them.

602. The meaning of “qualifying trade” is explained in section 189. “Parent company”, “group” and “group company” are defined in section 257(1). Only part of section 293(3A) of ICTA appears in this section: it is in *subsection (4)*. The requirements in section 293(3A)(a) and (b) of ICTA are covered respectively by the definition of “parent company” in section 257(1) and by section 187.

603. *Subsections (3)* and *(7)* provide that certain requirements can be met in relation to a company that is not part of the group at the time the shares are issued. See *Change 42* in Annex 1.

604. The provision for property used for R&D in *subsection (6)(d)* has been extended. See *Change 41* in Annex 1.

605. The words “capable of” have been omitted in *subsection (8)*, rewriting the definitions of “incidental purposes” and of “mainly trading subsidiary” in sections 293(2)(a) and 293(3F)(a) of ICTA. The intention is to make the definitions simpler to interpret. In practice the test will not change.

606. The label “non-qualifying activities” in *subsection (2)(b)* is defined in *subsection (8)*. Paragraph (a) of that definition refers to excluded activities. These are listed in section 192. Section 194 provides a let-out for certain leasing of ships from being treated as a non-qualifying activity.

607. The way that *subsection (8)* interprets non-qualifying activities means that no distinction is made between the let-out in section 194(4), derived from section 297(6)(a) to

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(d) of ICTA, and the let-out in section 194(7), derived from the final words of section 297(6) of that Act. This contrasts with section 293(3C)(b) of ICTA. See *Change 43* in Annex 1.

### **Section 182: Ceasing to meet trading requirement because of administration or receivership**

608. This section provides an exception to section 181 in the cases specified. It is based on section 293(4A) to (6) and (8A) of ICTA.

609. The cases specified relate to administration or receivership carried out for commercial reasons and which do not have tax avoidance as a main purpose.

610. The meanings of “in administration” and “in receivership” are provided by section 252.

### **Section 183: The issuing company to carry on the qualifying business activity requirement**

611. This section requires that, subject to the rules in the section, during period B it is only the issuing company or a qualifying 90% subsidiary of the issuing company that carries on the qualifying business activity for which money was raised by the share issue. It is based on section 289(1A) to (1E) and (8) and section 312(1) of ICTA.

612. Section 289(1)(ba) of ICTA, stating that the requirements of section 289(1A) of that Act must be met, is not reproduced explicitly. Instead it is implicit in section 180(b), as part of the list of the requirements in relation to the issuing company.

### **Section 184: The unquoted status requirement**

613. This section requires that when the relevant shares are issued:

- the issuing company is unquoted; and
- no arrangements as are mentioned in the section are in existence.

It is based on sections 293(1A), (1B) and (8A) and 312(1), (1B), (1C) and (1E) of ICTA.

614. The words in brackets in section 293(1) of ICTA “whether it is resident in the United Kingdom or elsewhere” have not been rewritten. The words do not add anything to the tests in section 179 (meaning of “qualifying business activity”).

615. The definition of unquoted company in section 312 of ICTA is set out in this section, rather than in Chapter 8, since this is the only mention of unquoted status in the EIS provisions.

616. Section 312(1D) of ICTA is not rewritten in this Part. It concerns orders made by the Commissioners for Her Majesty’s Revenue and Customs and is covered by section 1014 which is based on section 828 of ICTA.

617. FA 2001 removed the requirement that the issuing company remain unquoted throughout the relevant period. Following that change, section 312(1E) of ICTA has little or no practical significance, but in exceptional circumstances this provision could still apply in relation to the “arrangements” in section 293(1B) of ICTA, (rewritten in *subsection (1)(b)* and *(c)*). Section 312(1E) has therefore been rewritten in *subsection (6)*.

618. “Arrangements” are defined in section 257(1).

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### **Section 185: The control and independence requirement**

619. This section is based on section 293(8) and (8A) of ICTA. It *broadly* requires that throughout period B:

- any company that the issuing company (on its own or together with connected persons) controls is a qualifying subsidiary of the issuing company
- the issuing company is not a 51% subsidiary of or controlled by another company (on its own or together with connected persons); and
- there are no arrangements which could lead the issuing company to fail either of these tests.

620. Section 293(3) of ICTA has not been rewritten. The definition of “a qualifying subsidiary of another company” is contained in section 191.

621. In *subsection (1)(a)* the words “of the issuing company” have been added after “a qualifying subsidiary”. See *Change 44* in Annex 1.

622. “Control” in *subsection (2)(a)* is defined in section 995. The meaning of “control” in subsection (1)(a) is different and is given by section 257(3).

### **Section 186: The gross assets requirement**

623. This section sets out the limits that apply to the value of a company’s gross assets before and after a share issue. It is based on section 293(6A) to (6C) of ICTA.

624. The requirement differentiates between a “single company” and a “parent company”. Both these terms are defined in section 257(1).

625. Section 293(6D) of ICTA has not been rewritten as a separate provision. The term the “company’s group” and the reference to “in relation to any time” are not needed given the definitions in section 257(1) and the way in which this section as a whole is drafted.

626. *Subsection (3)(b)* sets out more clearly what is meant in relation to a group of companies by the words “aggregate value at that time of the gross assets” in section 293(6B)(b) of ICTA. Similar wording is used in paragraph 12(3) of Schedule 5 to ITEPA (enterprise management incentives).

### **Section 187: The qualifying subsidiaries requirement**

627. This section requires that during period B any subsidiary of the issuing company must be a qualifying subsidiary. It is based on sections 293(3A) and 308(1) and (5A) of ICTA.

### **Section 188: The property managing subsidiaries requirement**

628. This section requires that any property managing subsidiary of the issuing company must also be its qualifying 90% subsidiary. It is based on section 293(6ZA) to (6ZC) and (8A) of ICTA.

629. In section 293(6ZC) of ICTA “land” and “property deriving its value from land” take the meaning in section 776 of ICTA. *Subsection (3)*, applying for the purposes of *subsection (2)* of the rewritten section, provides the definition of “property deriving its value from land”. “Land” itself is not defined in this Act and instead relies on the definition in Schedule 1 to the Interpretation Act 1978. See the commentary on section 772.

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### **Section 189: Meaning of “qualifying trade”**

630. This section gives the meaning of “qualifying trade”. It is based on sections 297(2) and (8) and 298(3) and (5) of ICTA.

631. The wording of *subsection (1)(b)* is more compact than section 297(2) of ICTA. The comparable wording is that the trade must not “consist of one or more of the following activities if that activity amounts, or those activities when taken together amount, to a substantial part of the trade”.

632. Excluded activities referred to in this subsection are set out in section 192.

633. *Subsection (2)* excepts references to a trade in certain sections in this Chapter from the extended meaning of “trade” in section 989, based on the definition in section 832(1) of ICTA.

### **Section 190: Meaning of “qualifying 90% subsidiary”**

634. This section gives the meaning of “qualifying 90% subsidiary”. It is based on section 289(9) to (13) of ICTA.

### **Section 191: Meaning of “qualifying subsidiary”**

635. This section defines “qualifying subsidiary”. It is based on section 308(2) to (4) and (5B) of ICTA.

636. The term “51% subsidiary” in *subsection (2)(a)*, which is based on section 308(2)(ca) of ICTA, takes its meaning from the definition in section 989. The definition provides a signpost to section 838 of ICTA. Section 308(5B) of ICTA, which applies section 838(2) to (10) to section 308(2)(ca), has not been rewritten as it is unnecessary.

### **Section 192: Meaning of “excluded activities”**

637. This section gives the meaning of “excluded activities”. It is based on section 297(2) of ICTA.

638. The meaning of excluded activities is needed to determine whether a trade is a qualifying trade and the extent to which the business of a group includes non-qualifying activities.

639. *Subsection (2)* indicates where further detail can be found on certain of the activities listed in *subsection (1)*.

### **Section 193: Excluded activities: wholesale and retail distribution**

640. This section supplements section 192(1)(b). It is based on section 297(3) of ICTA.

641. *Subsection (2)* makes it clear that there are two sets of determinants, one set establishing what is a trade of wholesale and retail distribution and the other what is an ordinary trade of wholesale and retail distribution.

642. The words “or exposed” before “for sale” have been added in *subsection (4)*. This is intended to reflect the normal description of a trade of retail distribution in United Kingdom statute law.

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643. *Subsection (5)(b)* refers to “the trader” rather than “the company” which is referred to in section 297(3)(c)(ii) of ICTA. See *Change 45* in Annex 1.

**Section 194: Excluded activities: leasing of ships**

644. This section supplements section 192(1)(d). It is based on sections 297(6) and (7) and 298(5) of ICTA.

645. *Subsection (2)* takes paragraph 18(2) of Schedule 5 to ITEPA (enterprise management incentives) as its model. This additional material, which is not in the source legislation, makes it clear that the requirements of *subsection (4)* do not have to be met in relation to offshore installations and pleasure craft.

646. *Change 43* applies for the purposes of *subsection (7)*. See the commentary on section 181.

**Section 195: Excluded activities: receipt of royalties and licence fees**

647. This section supplements section 192(1)(e). It is based on section 297(4) to (5C) of ICTA.

**Section 196: Excluded activities: property development**

648. This section supplements section 192(1)(g). It is based on section 298(5), (5B) and (5C) of ICTA.

**Section 197: Excluded activities: hotels and comparable establishments**

649. This section supplements section 192(1)(j). It is based on sections 297(3A) and 298(5A) of ICTA.

**Section 198: Excluded activities: nursing homes and residential care homes**

650. This section supplements section 192(1)(k). It is based on sections 297(3A) and 298(5) of ICTA.

**Section 199: Excluded activities: provision of services or facilities for another business**

651. This section treats the provision of services or facilities as excluded activities if:

- the services or facilities are provided to businesses which themselves consist largely of excluded activities; and
- the specified control requirements exist.

It is based on sections 297(2) and 298(1) to (3) of ICTA.

652. The section is written in terms of a business. As a consequence, the way in which the definition of a trade in section 298(3) of ICTA, governing sections 297 and 298, is applied within those sections has been simplified. See *Change 46* in Annex 1.

**Section 200: Power to amend by Treasury order**

653. This section allows the Treasury to make orders amending the provisions mentioned in the section. It is based on section 298(4) of ICTA.

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## **Chapter 5: Attribution of and claims for EIS relief**

### ***Overview***

654. This Chapter deals with attributing EIS relief to shares, claiming the relief and associated matters.

### **Section 201: Attribution of EIS relief to shares**

655. This section attributes EIS relief for a tax year:

- first, to the issues of shares on which relief is claimed; and
- second, to shares included in those issues.

It is based on section 289B(1) to (3A) and (5) and (6) of ICTA.

656. These attributions are needed because the investor may have subscribed to more than one share issue of a single company, or to share issues of more than one company, during the tax year. Each such share issue to the investor may have different periods associated with it for the purpose of recovery or withdrawal of relief. And the question of whether relief is attributable to shares disposed of is also relevant to relief for losses on shares and for capital gains tax purposes.

657. *Subsections (2) to (4)* cater for cases where an individual claims EIS relief in respect of all of the shares in relation to which the individual is eligible for relief. They also cater for cases where an individual claims EIS relief in respect of some, but not all, of the shares in relation to which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

### **Section 202: Time for making claims for EIS relief**

658. This section sets out the intervals during which claims for EIS relief can be made for a tax year. It is based on sections 289B(5) and 306(1) of ICTA.

### **Section 203: Entitlement to claim**

659. This section requires the investor to hold a certificate (compliance certificate) from the issuing company before claiming EIS relief. It is based on section 306(2), (7), and (8) of ICTA.

660. *Subsection (2)* omits the words “and admitted” which are in section 306(7) of ICTA. Those words are not needed as there is no separate PAYE admittance procedure.

### **Section 204: Compliance certificates**

661. This section says what compliance certificates are and deals with matters associated with their issue to investors (including the pre-condition that the issuing company gives a compliance statement to HMRC). It is based on section 306(2), (3) and (4) of ICTA.

662. The compliance certificate is commonly known as an EIS 3, the form provided by HMRC for the issuing company to issue to its investors.

663. The reference to requirements for EIS relief being “for the time being met” in *subsection (1)(b)* is new. There is an explanation in *Change 57* in Annex 1.

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664. *Subsection (5)* requires an officer of Revenue and Customs to notify the officer's decision on a request by the issuing company for permission to issue a compliance certificate. See *Change 47* in Annex 1.

### **Section 205: Compliance statements**

665. This section says what compliance statements are and deals with associated matters (including the period during which they can be given). It is based on section 306(3), (3A), (5) and (11) of ICTA.

666. The compliance statement is commonly known as an EIS 1, the form provided by HMRC for completion by the issuing company.

667. The reference to requirements for EIS relief being "for the time being met" in *subsection (1)(a)* is new. There is an explanation in *Change 57* in Annex 1.

### **Section 206: Appeal against refusal to authorise compliance certificate**

668. This section allows an issuing company to appeal, to an independent body, if the officer of Revenue and Customs refuses to authorise the issue of compliance certificates by the company. It is based on section 306(10) of ICTA.

### **Section 207: Penalties for fraudulent certificate or statement etc**

669. This section provides for penalties in the circumstances set out. It is based on section 306(6) of ICTA.

## **Chapter 6: Withdrawal or reduction of EIS relief**

### ***Overview***

670. This Chapter deals with cases in which EIS relief, otherwise available to the investor in relation to a share issue, is reduced or withdrawn.

### **Section 208: Overview of Chapter**

671. This section provides a signpost to the various ways in which EIS relief may be withdrawn or reduced. It is new.

### **Section 209: Disposal of shares**

672. This section withdraws or reduces EIS relief if the investor disposes of relevant shares before the end of period A relating to those shares. It is based on sections 299(1), (2) and (8) and 304(1) of ICTA.

673. EIS relief is only reduced to the extent that the relief is attributable to the shares which are the subject of the disposal.

674. *Subsection (4)* provides an exception in the case of certain disposals between spouses or civil partners.

675. Section 299(3) of ICTA is not rewritten. It is not needed because other provisions identify the shares that are disposed of and calculate the appropriate proportion of the relief attributable to those shares.

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### **Section 210: Cases where maximum EIS relief not obtained**

676. This section deals with the case where EIS relief on a subscription for shares was effectively obtained for a tax year at a rate that is below the savings rate of tax for the tax year concerned. It is based on sections 289B(5) and 299(4) of ICTA.

677. *Subsection (1)* effectively reduces the rate at which section 209(3)(a) recovers EIS relief on the proceeds from a disposal of the shares concerned. The rate of recovery is reduced, from the savings rate of tax for the year in which the shares were issued, to the rate at which EIS relief was effectively obtained.

678. The subsection also caters for cases where an individual claims EIS relief in respect of some, but not all, of the shares in relation to which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

679. *Subsection (2)* deals with the complication that arises where the investor has obtained relief on some of the shares as if they were issued in the previous tax year. Subsection (1) is then applied as if there were two separate issues. That is necessary because the investor may have obtained EIS relief at different effective rates in the two years concerned (and one or both of these effective rates could be less than the savings rate for the tax year concerned).

680. *Subsections (3) and (4)* are new and correspond to provisions in paragraph 46(5) and (6) of Schedule 15 to FA 2000 (corporate venturing scheme - disposal of shares). See *Change 48* in Annex 1.

### **Section 211: Call options**

681. This section treats the grant of a call option by the investor as if it were a disposal of shares for the purpose of section 209 (disposal of shares). It is based on section 299(8) of ICTA.

### **Section 212: Put options**

682. This section deals with put options granted to the investor during period A relating to the relevant shares concerned. It is based on section 299(5), (5A) and (8) of ICTA.

683. The grant of the put option to the investor leads to the withdrawal of any EIS relief attributable to the shares to which the put option relates.

### **Section 213: Value received by the investor**

684. This section sets out what happens if the investor receives value from the issuing company at any time during period C relating to an issue of shares. It is based on sections 300(1) to (1B), 301(4A), 301A(5) and 312(1) of ICTA.

685. Any EIS relief attributable to the issue of shares is either withdrawn or reduced. The amount of value received by the investor is taken into account in determining whether there is a withdrawal or reduction of relief (and the size of any reduction).

686. Subsection (3) makes explicit the order in which to apply sections 218 to 220.

### **Section 214: Value received: receipts of insignificant value**

687. This section prevents section 213 applying to insignificant amounts of value received by the investor. But such amounts are not ignored if, taken together with certain other

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receipts of value by the investor, the total amount received is not insignificant. It is based on section 300(1) and (1BC) and section 312(1) of ICTA.

**Section 215: Meaning of “receipts of insignificant value”**

688. This section gives the meaning of “receipts of insignificant value” for the purpose of section 214. It is based on section 301A(1) to (4) and section 312(1) of ICTA.

**Section 216: When value is received**

689. This section sets out the time at which, and circumstances in which, the investor is treated as receiving value from the issuing company. It is based on sections 300(1D) to (3), (5) and (6) and 301(3), (4) and (5) of ICTA.

690. *Subsection (3)* refers, for clarity, to “the issuing company” where the source legislation refers to “a company”.

**Section 217: The amount of value received**

691. This section contains a table which sets out the amount of value received by the investor in cases where section 216 treats value as received by the investor. It is based on section 300(4) and (5) of ICTA.

**Section 218: Value received where there is more than one issue of shares**

692. This section deals with cases where the investor receives value but there is more than one issue of shares from which section 213 reduces or withdraws EIS relief. It is based on section 300(1BA) and (1BB) and section 312(1) of ICTA.

693. *Subsection (2)* apportions the value received between the different share issues before the calculation in section 213(2) takes place. Without such a provision the value received might be counted two, or more, times for reducing or withdrawing EIS relief.

694. By referring to the amount on which the investor obtains relief the subsection also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

**Section 219: Value received where part of share issue treated as made in previous tax year**

695. This section deals with a complication that can arise where section 213(2) applies to an issue of shares. The complication occurs where the investor has obtained relief on part of that share issue as if that part of the share issue had taken place in the previous tax year. It is based on sections 289B(5), 299(4) and 300(1B) of ICTA.

696. If that complication occurs, *subsection (2)* sets out the steps by which to arrive at the amount referred to in section 213(2)(a). Setting out these steps is a change because the source legislation is not explicit on this aspect. See *Change 49* in Annex 1.

697. By referring to the amount on which the investor obtains relief Step 1 also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

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698. Step 2 includes a deeming of two separate issues of shares and apportionment of the value received between those two deemed issues. That is necessary because there may be a different savings rate of tax in each of the tax years.

699. Step 2 also requires the application of section 220, where appropriate, to deal with cases where the investor has not obtained EIS relief at the savings rate for one or both of the two years concerned in Step 2.

#### **Section 220: Cases where maximum EIS relief not obtained**

700. This section deals with the case where EIS relief on a subscription for shares was obtained for a tax year at a rate which is less than the savings rate of tax for that tax year. It is based on sections 299(4) and 300(1B) of ICTA.

701. *Subsection (1)* effectively lowers the rate at which section 213(2) recovers EIS relief on value received by the investor. The rate of recovery is reduced to the rate at which EIS relief was effectively obtained. The subsection also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

702. *Subsections (2) and (3)* are new and correspond to provisions in paragraph 52(2) and (3) of Schedule 15 to FA 2000 (corporate venturing scheme - cases where maximum relief not obtained). See *Change 48* in Annex 1.

#### **Section 221: Receipts of value by and from connected persons etc**

703. This section extends the meaning of terms used in some of the preceding sections. It is based on sections 300(1C) and 301(6) and (6A) of ICTA.

704. Without this extension the rules in preceding sections about reduction or withdrawal of EIS relief might be avoided in various ways.

#### **Section 222: Receipt of replacement value**

705. This section prevents section 213 reducing or withdrawing EIS relief in certain cases. It is based on sections 300A(1) to (6) and (11), 301(5) and 312(1) of ICTA.

706. This section applies to certain cases where the person who received value effectively repays all of it to the person who gave that value.

#### **Section 223: Section 222: supplementary**

707. This section supplements section 222. It is based on section 300A(1), (2) and (7) to (11) and section 312(1) of ICTA.

708. *Subsections (1) and (2)* contain limitations on the application of section 222.

709. There is a new reference in *subsection (2)(c)* to “the day” on which the amount of relief is determined. This is in line with the interpretation that the provision disqualifies restitution if it happens on the 61<sup>st</sup> day after *the day* of the determination.

710. *Subsections (3) and (4)* set out, for one particular case, the consequences of section 222 applying. Subsection (4) combines part of the provision in section 300A(10) of ICTA with material from paragraph 13C(4) of Schedule 5B to TCGA. A consequential amendment

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to that paragraph completes the picture (see the commentary in Part 2 of Schedule 1 to this Act on paragraph 13C of Schedule 5B to TCGA).

#### **Section 224: Repayments etc of share capital to other persons**

711. This section reduces or withdraws EIS relief in certain cases where, broadly, the issuing company (group) repays some of its share capital within period C relating to the issue of shares in question. It is based on sections 303(1) to (1C), (9A) and (9B), 303AA(2), 303A(2) and 312(1) of ICTA.

712. *Subsection (2)* sets out the calculation of the withdrawal or reduction in the simplest case where the repayment affects only a single issue of shares and only a single subscriber to that issue.

713. *Subsection (3)* provides a signpost to other sections that, depending on the particular combination of circumstances present, may modify (or remove the need for) the calculation in subsection (2). Subsection (3) makes explicit the order in which to apply sections 226 to 229.

714. *Subsections (4) and (5)* prevent this section applying in two cases. First, where the repayment causes a withdrawal or reduction of EIS relief (under other sections) or of relief under Schedule 15 to FA 2000 (the corporate venturing scheme) or precipitates a qualifying chargeable event for the purposes of Schedule 5B to TCGA (enterprise investment scheme: reinvestment). Second, where there would be a withdrawal etc in these cases if the repayment were not treated as insignificant.

715. The references in subsections (4)(b) and (c) to “that person’s shares in the issuing company” are more explicit than in the source legislation and are consistent with section 303(IB)(a) of ICTA.

716. *Subsection (6)* is new and corresponds to paragraph 58(1) of Schedule 15 to FA 2000 (corporate venturing scheme - supplementary to value received). See *Change 50* in Annex 1.

#### **Section 225: Insignificant repayments ignored for purposes of section 224**

717. This section provides an exception to section 224 in certain cases where the repayment is insignificant. It is based on section 303AA(1) to (5) and section 312(1) of ICTA.

#### **Section 226: Amount of repayments etc where there is more than one issue of shares**

718. This section apportions the repayment for cases where that repayment results in relief being reduced or withdrawn, under section 224(2), in relation to two or more issues of shares. It is based on section 303(2) and (2A) of ICTA.

719. By referring to the relief which the individuals obtain *subsection (2)* caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

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### **Section 227: Single issue affecting more than one individual**

720. This section apportions the repayment for cases where, in relation to a single issue of shares affected by that repayment, there is more than one individual that has shares to which EIS relief is attributable. It is based on section 303(1C) and (1D) of ICTA.

721. By referring to the relief which the individual obtains, *subsection (2)* caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

### **Section 228: Single issue treated as made partly in previous tax year**

722. This section deals with a complication that can arise where section 224(2) applies to an issue of shares. The investor may obtain relief as if part of that share issue had taken place in the previous tax year; a different savings rate may apply in the previous tax year. It is based on sections 289B(5), 299(4) and 303(1C) of ICTA.

723. Setting out steps, involving apportionment of the repayment, in *subsection (2)* is a change because the source legislation is not explicit on how to deal with such a complication. See *Change 49* in Annex 1.

724. By referring to the amount on which the individual obtains relief the subsection also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

### **Section 229: Maximum relief not obtained for share issue**

725. This section deals with the case where EIS relief on a subscription for shares was obtained for a tax year at a rate that is less than the savings rate for that tax year. It is based on sections 299(4) and 303(1C) of ICTA.

726. *Subsection (1)* caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

727. *Subsection (2)* lowers the rate at which section 224(2) recovers EIS relief on the repayment. The rate of recovery is reduced to the rate at which EIS relief was effectively obtained.

728. *Subsections (3)* and *(4)* are new and correspond to provisions in paragraph 56(7) and (8) of Schedule 15 to FA 2000 (corporate venturing scheme - value received by other persons). See *Change 48* in Annex 1.

### **Section 230: Repayment of authorised minimum within 12 months**

729. This section provides an exception to section 224 for certain repayments. It is based on section 303(9) of ICTA.

730. *Subsection (1)(b)* widens the exception in the source legislation and corresponds to paragraph 58(5)(b) of Schedule 15 to FA 2000 (corporate venturing scheme - repayment of authorised minimum within 12 months). See *Change 51* in Annex 1.

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### **Section 231: Restriction on withdrawal of relief under section 224**

731. This section provides for section 224 to apply as if the repayment were a reduced, or zero, amount in cases where the repayment has led to a reduction of relief under Schedule 15 to FA 2000 (corporate venturing scheme). It is based on section 303A(1), (3) to (7) and (9) of ICTA.

### **Section 232: Acquisition of a trade or trading assets**

732. This section withdraws relief from an individual in the circumstances set out in the section. It is based on section 302(1), (2) and (4) to (5) of ICTA.

733. The definition of “subsidiary” in section 302(5) of ICTA is not needed in sections 232 and 233 because they refer to “any qualifying subsidiary” and apply to period A.

734. *Subsection (7)* differs from the source legislation by not referring to a vocation. That is on the footing that an incorporated company cannot carry on a vocation.

### **Section 233: Acquisition of share capital**

735. This section withdraws relief from an individual in the circumstances set out in the section. It is based on section 302(3), (4A), (4B) and (5) of ICTA.

### **Section 234: Relief subsequently found not to have been due**

736. This section withdraws EIS relief in cases where the conditions for EIS relief, having been satisfied at the time it was obtained, cease to be satisfied. It is based on section 307(1) and (1A) of ICTA.

## **Chapter 7: Withdrawal or reduction of EIS relief: procedure**

### ***Overview***

737. This Chapter deals with the withdrawal or reduction of EIS relief after it has been obtained along with related matters such as information requirements, interest and penalties.

### **Section 235: Assessments for the withdrawal or reduction of EIS relief**

738. This section provides that an assessment must be made to withdraw or reduce EIS relief after it has been obtained. It is based on section 307(1) and (8A) of ICTA.

### **Section 236: Appeals against section 234(3)(b) notices**

739. This section allows the issuing company to appeal to an independent tribunal in cases where the issuing company disagrees with a notice under section 234(3)(b). It is based on section 307(1B) and (1C) of ICTA.

### **Section 237: Time limits for assessments**

740. This section sets out the time limits for making an assessment or giving a notice under section 234(3)(b). It is based on section 307(2), (5) and (8A) of ICTA.

### **Section 238: Cases where assessment not to be made**

741. This section provides for two cases in which EIS relief will not be withdrawn or reduced. It is based on section 307(3), (4) and (8A) of ICTA.

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742. *Subsections (2) and (3)* cover the case of events occurring after the individual has disposed of all the shares, on which reduction of relief is still possible, by way of bargains at arm's length. An assessment cannot be made in relation to such events unless the individual is connected with the issuing company.

743. Subsection (2) limits, compared to the source legislation, the shares that need consideration in deciding whether an assessment cannot be made. See *Change 52* in Annex 1.

#### **Section 239: Date from which interest is chargeable**

744. This section gives the date from which interest runs if EIS relief is withdrawn or reduced by an assessment. It is based on sections 299A(2) and 307(6) and (8A) of ICTA.

745. *Subsection (1)* contains a table setting out the dates that apply. Those dates depend on the provision on which the assessment is based.

746. The table does not include anything derived from section 307(6)(a) and (aa) and (7) of ICTA. Nor is there any material derived from 306(9) of ICTA. Those provisions do not fit with Self Assessment. See *Change 53* in Annex 1.

747. Section 307(8) of ICTA is redundant as it refers to spent legislation and has not been rewritten.

#### **Section 240: Information to be provided by the investor**

748. This section requires an investor to provide information to an officer of Revenue and Customs if certain events occur after the investor has obtained EIS relief. It is based on section 310(1), (2A) and (9A) of ICTA.

#### **Section 241: Information to be provided by the issuing company etc**

749. This section requires the issuing company, or certain other persons, to provide information to an officer of Revenue and Customs if certain events occur which could withdraw or reduce EIS relief. It is based on section 310(2), (2A) and (9A) of ICTA.

750. *Subsection (1)* differs from section 310 of ICTA as it links the provision of a compliance statement to the requirement to give notice of certain events and it refers to events having an effect "if EIS relief had been obtained". This follows the approach in paragraph 65(1) of Schedule 15 to FA 2000 (corporate venturing scheme). See *Change 54* in Annex 1.

751. *Subsection (4)* also follows the corporate venturing scheme approach and differs from section 310 of ICTA. It allows the issuing company to provide notice of one particular event within 60 days of coming to know of that event. See *Change 54* in Annex 1.

752. Section 310(3) of ICTA is redundant as it refers to spent legislation and has not been rewritten.

#### **Section 242: Power to require information where section 240 or 241 applies or could have applied**

753. This section allows an officer to require information in certain cases. It is based on section 310(4) of ICTA.

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### **Section 243: Power to require information in other cases**

754. This section provides additional circumstances in which an officer can require information for the purposes of this Part. It is based on section 310(5) to (8) of ICTA.

### **Section 244: Obligations of secrecy**

755. This section allows an officer of Revenue and Customs to give certain information to the issuing company. It is based on section 310(9) of ICTA.

## **Chapter 8: Supplementary and general**

### **Overview**

756. This Chapter deals with some special cases and definitions.

### **Section 245: Transfers between spouses or civil partners**

757. This section provides for step in shoes treatment where shares are transferred between spouses or civil partners in specified circumstances. It is based on section 304(2) and (3) of ICTA.

758. *Subsection (2)(b) and (d) and subsection (3)* contain material, not in the source legislation, making clearer how the step in shoes treatment operates. See *Change 55* in Annex 1.

### **Section 246: Identification of shares on a disposal**

759. This section gives rules identifying which shares are disposed of. It is based on sections 299 (6) to (6D) and 304(4) of ICTA.

### **Section 247: Continuity of EIS relief where issuing company is acquired by new company**

760. This section allows, in limited circumstances, the issuing company to become a wholly-owned subsidiary of another company without jeopardising EIS relief attributable to shares in the issuing company. It is based on section 304A(1), (2) and (6) to (8) of ICTA.

761. When this section applies, the exchange of shares and the issuing company becoming a subsidiary do not cause a reduction or withdrawal of EIS relief.

762. There is effectively step in shoes treatment given to the shares in the new company (which the shareholder receives in exchange for shares in the issuing company). The following two sections deal with that “step in shoes” treatment.

### **Section 248: Carry over of obligations etc where EIS relief attributed to new shares**

763. This section gives the new company the rights and obligations, in relation to EIS relief, of the issuing company that has been acquired. It is based on section 304A(5) of ICTA.

### **Section 249: Substitution of new shares for old shares**

764. This section treats the shareholder in the new company broadly as if actions etc taken in relation to the issuing company had been taken in relation to the new company. It is based on section 304A(3) and (4) of ICTA.

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### **Section 250: Nominees and bare trustees**

765. This section deals with the actions of nominees or bare trustees. It is based on section 311(1) to (2A), (4) and (5) of ICTA.

766. *Subsection (2)* adopts a different approach from that in section 311 of ICTA. Section 311 begins with the words “where eligible shares are held on a bare trust” and section 289(7) of ICTA defines “eligible shares” in terms of “new” shares. *Subsection (2)* begins with the words “if shares have been issued to a bare trust” and thereby makes it clear that these “new” shares are *issued* to bare trustees.

767. Elsewhere in this Part the concept of eligible shares being “new” has been dropped as redundant in the context of a subscription for shares. *Subsection (3)* reproduces the other conditions of “eligible” shares by applying section 173(2).

### **Section 251: Approved investment fund as nominee**

768. This section removes the minimum subscription requirement for shares in a company and allows the investment to be treated as made earlier than was in fact the case where investment is made through an approved investment fund. It is based on section 311(2A) to (6) of ICTA.

769. The use in *subsection (1)* of “at a time when” makes it clear that the conditions in paragraphs (a) to (c) all have to be met but not in any prescribed order.

770. The certificate issued to the investor in an approved fund by the manager (see *subsection (5)*) is commonly known as an EIS 5, the form provided for this purpose by HMRC.

### **Section 252: Meaning of a company being “in administration” or “in receivership”**

771. This section gives the meaning of a company being in administration (or receivership). It is based on section 312(2A) of ICTA.

772. The reference to Northern Ireland legislation in *subsection (2)(a)* takes into account amendments to the Insolvency (Northern Ireland) Order 1989 by the Insolvency (Northern Ireland) Order 2005. The reference in *subsection (2)(b)* to the law of a country or territory outside the United Kingdom accords with the insolvency law in force in Great Britain and in Northern Ireland. See *Change 56* in Appendix 1.

### **Section 253: Meaning of “associate”**

773. This section gives the meaning of “associate” in relation to a person. It is based on sections 312(1) and 417(3) and (4) of ICTA.

### **Section 254: Meaning of “disposal of shares”**

774. This section extends references to a disposal of shares and treats some matters as if they were disposals of shares. It is based on section 312(3) of ICTA.

775. Section 136 of TCGA may treat the investor, in the case of certain reorganisations, as having exchanged “old shares” even though the investor continues to hold the same “old shares” as were held before the reorganisation (together with some “new shares”). This section treats that reorganisation as a disposal of the “old shares”.

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### **Section 255: Meaning of “issue of shares”**

776. This section gives a meaning to (a) an issue of shares and (b) an issue of shares to an individual. It is based on sections 289B(4) and 312(4A) of ICTA.

777. Section 289B(4) of ICTA, on which *subsection (1)(b)* is based, is subject to the rule in section 289B(5).

778. Section 289B(5) of ICTA has been rewritten in section 201(6) for the purposes of that section and in other sections where that rule is relevant. So *subsection (2)* makes *subsection (1)(b)* subject to section 201(6) and also to the other sections where that rule is applied.

779. The exception for section 289A(6) and (7) of ICTA was inserted into section 289B(4) of ICTA by FA 2004 to ensure that the wording of those subsections did not invoke the interpretation in section 289B(4) and instead was linked clearly to the interpretation in section 312(4A) of ICTA. To achieve the same end the formulation in section 176(1) is directly linked to the interpretation in section 255(1)(a), (based on section 312(4A) of ICTA).

### **Section 256: Meaning of “the termination date”**

780. This section gives the meaning of “the termination date”. It is based on section 312(1) and (1ZA) of ICTA.

### **Section 257: Minor definitions etc**

781. This section contains more definitions. It is based on sections 289(9), 291B(10), 293(3A), (6D) and (8AA), 297(5A), 308(2) and 312(1), (2), (4), (4B), (5) and (6) of ICTA.

782. The definitions of “group”, “group company”, “parent company” and “single company” are new.

783. These new labels rely on the way “qualifying subsidiary” is defined in this Part. The definitions of “subsidiary” and “51% subsidiary” in section 312(1) of ICTA have not been reproduced. Instead “qualifying subsidiary” is explained in section 191 and “51% subsidiary” in section 989.

784. The definition of “51% subsidiary” in section 312(1) of ICTA adds a condition that the definition applies for a particular period (period A in the sections). The aim has been to reproduce the same effect of this definition without carrying over the same level of complication. (See the commentary on section 168(5).)

785. In some cases the definition of a term included in the Act-wide index of defined expressions in Schedule 4 is distinguished from the particular use of the term in this Part.

786. For example, the definition of “control” in *subsection (3)* sets out the references to control which are explained by section 416(2) to (6) of ICTA. The entry in Schedule 4, which refers to the meaning in section 995 has a signpost to the exceptions in this subsection.

787. The two references to the “reduction” of relief in *subsection (7)(b)* are new: section 312(6) of ICTA refers only to the withdrawal of relief.

788. The word “withdrawal” in EIS is used both for the occasions for a clawback of relief (in particular in the provisions in Chapter 6) and for the procedure for withdrawing relief which is set out in Chapter 7.

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789. Although the word “withdrawal” can cover both a full and a partial withdrawal of relief, this is made explicit in sections 307 and 310 of ICTA by section 307(8A) and section 310(9A). These subsections note that “references in this section to the withdrawal of relief include its reduction”. This has been handled in this Part by spelling out, wherever relevant, that the rules encompass both the reduction and withdrawal of relief.

790. Making reference to the reduction as well as the withdrawal of relief in subsection (7) ensures that there is consistency with the language used for the occasion of a clawback and with sections 307 and 310 of ICTA, which are concerned with the procedure for withdrawing relief.

791. *Subsection (8)* is new. Paragraph 102(7)(a) of Schedule 15 to FA 2000 (corporate venturing scheme) contains a similar provision.

792. The subsection interprets the reference to requirements being met “for the time being” in section 204(1) (compliance certificates) and section 205(1) (compliance statements), derived from section 306 of ICTA. At the time the compliance certificate is issued by the issuing company it cannot be known if all the EIS requirements will be met in the relevant period.

793. The interpretation addresses this by treating conditions that must be met over a period of time as met at times before that period has ended (provided the condition then remains capable of being met). See *Change 57* in Annex 1.

## **Part 6: Venture capital trusts**

### ***Overview***

794. This Part provides income tax reductions to individuals who subscribe money for full risk shares in certain quoted companies that, in turn, mainly provide additional equity and loan finance to smaller unquoted trading (or certain other) companies with which the quoted company is not connected.

795. The structure of the Part is as follows:

- An overview and a definition of venture capital trust (“VCT”) (Chapter 1);
- The tax reduction and related matters (Chapter 2);
- Conditions for approving a company for the purposes of this Part and related matters (Chapter 3);
- The meaning of “qualifying holding” (Chapter 4);
- Powers to make regulations relating to VCT winding up or mergers (Chapter 5); and
- Supplementary provisions (Chapter 6).

796. In contrast to the enterprise investment scheme (EIS), section 1034(1) (commencement) applies to the VCT scheme: see the overview to Part 5. The minor changes made to the law in this Part are the subject of transitional provisions in Part 8 of Schedule 2.

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## **Chapter 1: Introduction**

### ***Overview***

797. This Chapter gives an overview of the Part, labels certain concepts and gives signposts to material contained elsewhere.

### **Section 258: Overview of Part**

798. This section says that the relief dealt with by this Part (“VCT relief”) is a tax reduction and it provides a navigational aid regarding the content of later Chapters. It is based on section 332A of ICTA.

### **Section 259: Venture capital trusts and VCT approvals**

799. This section defines “venture capital trust”, “VCT” and “VCT approval”. It is based on section 842AA(1) of ICTA and paragraphs 7(4) and 17 of Schedule 33 to FA 2002.

### **Section 260: Other tax reliefs relating to VCTs**

800. This section provides signposts to other tax reliefs relating to VCTs. It is new.

## **Chapter 2: VCT relief**

### ***Overview***

801. This Chapter:

- identifies who is eligible for VCT relief and on what amounts;
- identifies the claims to VCT relief that may be made;
- quantifies the entitlement to the tax reduction;
- deals with cases in which VCT relief is not available or will be reduced or withdrawn;  
and
- deals with other matters (information and powers to make regulations).

### **Section 261: Eligibility for relief**

802. This section identifies cases in which, and amounts in respect of which, an individual is eligible for VCT relief for a tax year. It is based on paragraph 1(1), (2), (4), (9) and (10) of Schedule 15B to ICTA.

### **Section 262: Entitlement to claim relief**

803. This section provides for an individual to claim VCT relief for a tax year. It is based on paragraph 1(1) and (3) of Schedule 15B to ICTA.

804. *Subsection (2)* explicitly provides that a claim by the individual does not have to extend to all the shares by reference to which such eligibility exists for the tax year. This is implied by paragraph 1(3) of Schedule 15B to ICTA which simply sets a limit on a claim for relief.

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**Section 263: Form and amount of relief**

805. This section specifies that a claim for VCT relief gives entitlement to a tax reduction and quantifies the amount of that entitlement. It is based on paragraph 1(5) of Schedule 15B to ICTA.

806. *Subsection (1)* is expressed in terms of the individual's entitlement to a tax reduction. Sections 27 and 29 contain provisions about how effect is given to the entitlement to a reduction and how the actual reduction is quantified.

**Section 264: No entitlement to relief if there is a linked loan**

807. This section removes an individual's entitlement to VCT relief by reference to shares if certain loans are made, as described in this section, to the individual or an associate of the individual. It is based on paragraph 2 of Schedule 15B to ICTA.

**Section 265: No entitlement to relief which would have been lost if it had already been obtained**

808. This section removes entitlement to VCT relief by reference to shares if, before the relief is obtained, circumstances have arisen that would cause the relief to be withdrawn or reduced. It is based on paragraph 1(8) of Schedule 15B to ICTA.

809. This and other sections follow the terminology used by other venture capital schemes and refer to relief being "obtained" where paragraph 1(8) refers, and other paragraphs in Schedule 15B to ICTA refer, to relief being "given".

**Section 266: Loss of relief if shares disposed of within 5 years**

810. This section reduces or withdraws any VCT relief obtained by reference to shares that are disposed of within five years of their issue. It is based on paragraph 3(1) to (4) and (8) of Schedule 15B to ICTA.

**Section 267: Transfers of shares between spouses or civil partners**

811. This section prevents loss of VCT relief occurring where the shares in question are disposed of between spouses or civil partners who are living together at the time of disposal. It also provides for step-in-shoes treatment, for VCT relief purposes, in respect of shares transferred between those spouses or civil partners. It is based on paragraph 3(5) to (7) of Schedule 15B to ICTA.

**Section 268: Loss of relief if VCT approval withdrawn**

812. This section treats certain shares in a company as disposed of, for VCT relief purposes, at the time VCT approval is withdrawn from a company. It is based on paragraph 3(9) of Schedule 15B to ICTA.

813. *Subsection (1)* does not apply where section 281(3) treats VCT approval as never having been given to a company. In those cases there never was any entitlement to VCT relief in respect of the company's shares and any relief that was obtained is withdrawn under section 269.

814. *Subsection (2)* has provisions about the timing (immediately before loss of VCT approval) and nature (not arm's length) of any disposal of shares that is treated as taking place. These provisions ensure that any VCT relief recapture (where the shares were issued

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less than five years before loss of approval) covers all the VCT relief obtained in respect of the shares concerned.

### **Section 269: Loss of relief which is subsequently found not to have been due**

815. This section withdraws any VCT relief that has been obtained but which should not have been obtained. It is based on paragraph 4(1) of Schedule 15B to ICTA.

### **Section 270: Assessment on withdrawal or reduction of relief**

816. This section provides that withdrawal or reduction of VCT relief, under the preceding sections, is by way of assessment for the tax year for which the relief was obtained. It is based on paragraph 4 of Schedule 15B to ICTA.

### **Section 271: Provision of information**

817. This section, in connection with VCT relief, provides for cases where information must be given to an officer of Revenue and Customs and cases where the officer may require information. It is based on paragraphs 1(11) and 5 of Schedule 15B to ICTA.

818. *Subsection (4)* requires a VCT to give notice to an individual if section 261(4) (issue of own shares) prevents the individual from being eligible for relief. Section 261(4) contains a signpost to this requirement.

### **Section 272: Regulations as to procedure etc**

819. This section allows the Treasury to make regulations about certain aspects of VCT relief and other reliefs related to VCTs. It is based on section 73(1) and (2) of FA 1995.

820. This power has been used in relation to the Venture Capital Trust Regulations 1995 (SI 1995/1979).

### **Section 273: Interpretation of Chapter**

821. This section provides definitions of certain terms used in the Chapter. It is based on paragraph 6(1) and (3) of Schedule 15B to ICTA.

822. The section removes a possible doubt as to the effectiveness of the amendment made by section 73(1)(b) of FA 1998 to the definition of “eligible shares” in paragraph 6(1) of Schedule 15B to ICTA. See *Change 58* in Annex 1. Part 8 of Schedule 2 to this Act contains a provision to preserve this possible doubt as to the meaning of eligible shares for shares issued before 6 April 2007.

## **Chapter 3: VCT approvals**

### ***Overview***

823. This Chapter:

- lists the conditions relevant to VCT approval;
- sets out alternative bases on which VCT approval may be given and the time from which VCT approval has effect;
- deals with the withdrawal of VCT approval and the time from which withdrawal has effect; and

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- deals with related matters (including powers to make regulations for certain matters).

#### **Section 274: Requirements for the giving of approval**

824. This section sets out the conditions which must be met before the Commissioners for Her Majesty's Revenue and Customs are able to approve a company as a VCT. It is based on section 842AA(2) and (3) of ICTA.

825. *Subsection (1)* specifies the accounting periods in relation to which the conditions have to be met.

826. *Subsection (2)* gives labels to each of the conditions in section 842AA(2) of ICTA, changes the order in which they appear and uses a tabular layout as an aid to navigation.

827. References in the conditions to qualifying holdings and eligible shares are explained in section 285(1) and (2).

828. *Subsection (3)* provides a signpost to the provisions that contain material supplementing some of the conditions listed in the table.

#### **Section 275: Alternative requirements for the giving of approval**

829. This section allows the Commissioners to approve a company as a VCT if they are satisfied that conditions, which are not met in relation to the company's most recent accounting period, will be met in certain other accounting periods. It is based on section 842AA(4) of ICTA.

830. Most approvals are in practice given under this provision.

#### **Section 276: Conditions relating to income**

831. This section supplements the nature of income condition and the income retention condition. It is based on section 842(1AB) and (2A) to (2C), section 842AA(11) of ICTA and paragraph 40 of Schedule 26 to FA 2002.

832. Section 842AA(11)(za) and (b) of ICTA relies on the user adapting material that applies to similar conditions in section 842 (investment trusts). This section eliminates the need to refer to section 842 of ICTA. In addition *subsections (1) and (2)* rewrite paragraph 40 of Schedule 26 to FA 2002 which deals with derivative contracts in relation to VCTs.

#### **Section 277: The 15% holding limit condition**

833. This section effectively restricts the times at which the 15% holding limit condition is applied in relation to investments in a company and provides supplementary material relating to that condition. It is based on section 842(1A), (2), (3) and (4) and section 842AA(11) of ICTA.

834. Section 842AA(11)(a) and (c) of ICTA applies certain provisions in section 842 (investment trusts) to section 842AA(2)(d). This section eliminates the need to refer to section 842 of ICTA.

835. *Subsection (1)* is based on section 842(3)(b) of ICTA, which provides that if an addition is made to a holding, the holding is treated as acquired at that time. Subsection (1) is also based on section 842(2)(b). The effect is that the 15% holding condition only applies on the occasion or occasions when the holding is acquired or when it is added to.

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836. The underlying approach is that the 15% holding limit condition is applied in relation to a company only at times when shares or securities are acquired in that company. This prevents the condition being breached solely as a result of fluctuations in the value of investments.

**Section 278: Conditions relating to value of investments: general**

837. This section provides rules about the values of holdings of investments of particular descriptions. Those rules are used in applying the 15% holding limit condition, the 70% qualifying holdings condition and the 30% eligible shares condition. It is based on section 842(3) and (4) and section 842AA(5) and (11) of ICTA.

838. The underlying approach is that there is a valuation (or revaluation) of investments of any particular description only when investments of that description are acquired. In that way the three conditions will not cease to be satisfied solely because of later fluctuations in the value of investments.

839. The section makes it clear that the rules about the valuation of a holding in this section apply equally to the 15% holding limit condition, the 70% qualifying holdings condition and the 30% eligible shares condition. See *Change 59* in Annex 1.

**Section 279: Conditions relating to value of investments: qualifying holdings**

840. This section provides what is to be taken as the value of shares or securities acquired on certain exchanges or conversions if those shares or securities are treated as meeting some of the conditions in Chapter 4 (qualifying holdings). It also provides power to make regulations about the value of shares or securities in certain cases. It is based on section 842AA(5AA) to (5AE) of ICTA.

841. An exchange has to meet the requirements of section 326 (restructuring arrangements) and a conversion has to meet the requirements of section 329 (conversion of convertible shares and securities).

842. The power to treat conditions in Chapter 4 as met under section 330 (power to facilitate company reorganisations etc involving exchange of shares) is extended to encompass the valuation of shares and securities involved in reorganisations.

**Section 280: Conditions relating to qualifying holdings and eligible shares**

843. This section provides a period of grace during which the proceeds from most further issues of ordinary shares by a VCT are disregarded in determining whether the VCT meets the 70% qualifying holdings condition and the 30% eligible shares condition. It is based on section 842AA(5A) and (5B) of ICTA and paragraph 11(1), (2) and (4) of Schedule 33 to FA 2002.

844. The underlying rationale is to give the VCT a reasonable amount of time to invest the proceeds of the further share issue in qualifying holdings before taking those proceeds into account for the 70% qualifying holdings condition and the 30% eligible shares condition. Without any period of grace those conditions might deter VCTs from issuing further share capital to raise funds for investment in qualifying holdings.

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845. The section also contains powers to make regulations varying the treatment that would otherwise apply under this section. These powers have been used in making the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004 (SI 2004/2199).

#### **Section 281: Withdrawal of VCT approval of a company**

846. This section sets out cases in which a company's approval as a VCT may be withdrawn and the time from which the withdrawal has effect, and contains supplementary material concerning the time limits for assessing tax consequent on the withdrawal. It is based on section 842AA(6) to (10) of ICTA.

#### **Section 282: Withdrawal of VCT approval in cases for which provision made under section 280(3)**

847. This section gives the Treasury power to make regulations that provide, in certain cases, for withdrawal of VCT approval to have effect before notice of withdrawal is given. It is based on paragraph 12 of Schedule 33 to FA 2002.

848. The cases are limited to those where, but for regulations under section 280(3), section 280(2) (disregard of money raised by further share issue) would have prevented withdrawal of approval.

#### **Section 283: Time as from which VCT approval has effect**

849. This section explains when a VCT approval takes effect. It is based on section 842AA(1) of ICTA.

850. Paragraph (a) of section 842AA(1) of ICTA, which refers to an approval given in 1995-96, has not been rewritten.

851. Section 842AA(1) and (4)(b) of ICTA, and regulation 4(2)(b) of SI 1995/1979, make it clear that the date from which approval has effect is not necessarily the date on which approval is given. *Subsection (3)* notes that an approval can be forward-dated as well as back-dated.

#### **Section 284: Power to make regulations as to procedure**

852. This section gives the Treasury powers to make regulations regarding VCT approvals, the obligations of VCTs in relation to certain matters and the persons liable to account for tax consequent on withdrawal of VCT approval. It is based on section 73(2) of FA 1995.

853. This power has been used in relation to the Venture Capital Trust Regulations 1995 (SI 1995/1979).

#### **Section 285: Interpretation of Chapter**

854. This section provides various definitions for this Chapter. It is based on section 842AA(11A) to (14) of ICTA.

855. *Subsections (4) to (6)*, based on section 842AA(11A) to (11C) of ICTA, provide an interpretation of references to a company's investments. Paragraph 8 of Schedule 14 to FA 2006 does not extend this interpretation explicitly to the definitions in section 842(3) of ICTA. Subsection (4) of this section applies the interpretation to Chapter 3 as a whole. See *Change 59* in Annex 1.

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## **Chapter 4: Qualifying holdings**

### ***Overview***

856. One of the conditions relating to VCT approval is that the investing company holds at least 70% of its investments in qualifying holdings (the 70% qualifying holdings condition in section 274). This Chapter sets out the requirements that need to be met for an investment to be a qualifying holding.

### **Section 286: Qualifying holdings: introduction**

857. This section describes the ground-rules for what is a qualifying holding. It is based on paragraph 1 of Schedule 28B to ICTA.

858. *Subsection (1)* introduces certain labels. The company invested in is described as “the relevant company”, the shares or securities are “the relevant holding” and in this Chapter the company that makes the investments is described as “the investing company”.

859. Where there are shared provisions, the order matches that in Part 5 Chapter 4 (EIS: the issuing company) as far as possible.

860. *Subsections (4) and (5)* provide that in this Chapter, if only part of the money raised by a relevant holding meets the requirements of section 287, section 293 and section 294, the holding is treated as two separate holdings.

### **Section 287: The maximum qualifying investment requirement**

861. This section requires that the relevant holding does not represent an investment that exceeds “the maximum qualifying investment”. It is based on paragraph 7 of Schedule 28B to ICTA.

862. The maximum qualifying investment is £1m, see *subsection (2)*.

863. *Subsection (3)(a)* makes it explicit that if the maximum qualifying investment is exceeded, the £1m can be included as a qualifying holding and the shares or securities which represent the excess over the maximum qualifying investment are not regarded as part of the relevant holding.

864. *Subsection (3)(b)* ensures that there can be no double counting of an amount that represented such an excess. See *Change 60* in Annex 1.

865. *Subsections (4) and (5)* provide a rule for attributing shares or securities subsequently disposed of to the part of an investment that is in excess of the maximum qualifying investment.

866. *Subsections (6) and (7)* set out the consequences if the trade which meets the requirements of section 291(1) is carried on by the relevant company in a partnership or joint venture. The £1m is divided by the number of the members of the partnership or the parties to the joint venture. In subsection (6)(b) the words “as such” after “the joint venture” in paragraph 7(4)(b) of Schedule 28B to ICTA have not been reproduced, as they do not add anything.

867. In *subsection (8)*, which sets out what the relevant period is, it is made clear that the period ends with the issue of the relevant holding.

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### **Section 288: The no guaranteed loan requirement**

868. This section requires that the relevant holding does not include any securities that are backed up by a “guaranteed loan” and explains what is meant by this term. It is based on paragraph 10A of Schedule 28B to ICTA.

### **Section 289: The proportion of eligible shares requirement**

869. This section requires a certain proportion of an investment in a relevant company to be in eligible shares. It is based on paragraph 10B of Schedule 28B to ICTA.

870. *Subsections (2) and (3)* set out rules about the value of shares in or securities of a company. The underlying approach is to value shares and securities at their value when acquired so that the requirement will not cease to be satisfied purely because of later fluctuations in the value of those investments.

871. *Subsection (4)* ensures that the value of the investment cannot be less than its initial cost price.

### **Section 290: The trading requirement**

872. This section requires that the relevant company exists essentially for the purpose of carrying on qualifying trades or is a parent company of a group that carries on qualifying activities. It is based on paragraph 3(2) and (6) to (11) of Schedule 28B to ICTA.

873. A parent company, a group and a group company are defined in section 332.

874. Paragraph 3(6)(c) of Schedule 28B to ICTA is rewritten in *subsection (1)(b)* and *subsection (3)*. The requirements in paragraph 3(6)(b) and (c) are covered respectively by the definition of “parent company” in section 332 and by section 298.

875. *Subsections (2) and (6)* provide that certain requirements can be met in relation to a company that is not part of the group at the time the shares are issued. See *Change 61* in Annex 1. The provision for property used for R&D in *subsection (5)(d)* has been extended. See *Change 41* in Annex 1.

876. The words “capable of” have been omitted in *subsection (7)*, rewriting the definitions of “incidental purposes” and of “mainly trading subsidiary” in paragraph 3(2)(a) and (11) of Schedule 28B to ICTA. The intention is to make the definitions simpler to interpret: in practice the test will not change.

877. The label “non-qualifying activities” in *subsection (1)(b)* is defined in *subsection (7)*. Paragraph (a) in *subsection (7)* refers to excluded activities. These are listed in section 303. Section 305 provides a let-out for certain leasing of ships from being treated as a non-qualifying activity.

878. The way that *subsection (7)* interprets non-qualifying activities means that no distinction is made between the let-out in section 305(4), derived from paragraph 4(7)(a) to (d) of Schedule 28B to ICTA, and the let-out in section 305(7), derived from the final words of paragraph 4(7). This contrasts with paragraph 3(8)(b) of Schedule 28B to ICTA. See *Change 43* in Annex 1.

879. There is no reference to R&D in the definition of non-qualifying activities in *subsection (7)(b)*, in contrast to the definition in section 181(8)(b) in Part 5 (Enterprise

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investment scheme). This is because in VCT the carrying on of R&D is treated as the carrying on of a trade in section 300(2).

### **Section 291: The carrying on of a qualifying activity requirement**

880. This section requires that the relevant company carries on, or certain of its subsidiaries carry on, a qualifying activity at all times from the issue of the relevant holding to the time in question. It is based on paragraph 3(3) to (5B) of Schedule 28B to ICTA.

881. *Subsection (1)* introduces the term “qualifying activity” to cover the activities in paragraph 3(3)(a) and (b) of Schedule 28B to ICTA and these activities are set out in *subsections (2) and (3)*. This should make it easier for persons, who are not relying on subsection (3) to meet any of the requirements in this Chapter, to disregard the material in subsections (3) to (6).

882. *Subsection (8)* is new. The change enables the requirement in subsection (3) to be met in relation to a company that is not a qualifying 90% subsidiary at the time the shares are issued. See *Change 61* in Annex 1.

### **Section 292: Ceasing to meet requirements because of administration or receivership**

883. This section provides a disregard from sections 290(1) and 291(1) where a company is in administration or receivership and there is no tax avoidance purpose. It is based on paragraph 11A(1) and (3) of Schedule 28B to ICTA.

884. The meanings of “in administration” and “in receivership” are provided by section 331.

### **Section 293: The use of the money raised requirement**

885. This section sets out the times when, and extent and purpose for which, the money raised by the issue of the relevant holding must be intended to be employed or actually employed. It is based on paragraph 6(1) to (2AA) and (3) of Schedule 28B to ICTA.

### **Section 294: The relevant company to carry on the relevant qualifying activity requirement**

886. This section contains requirements as to the persons who may carry on the relevant qualifying activity by reference to which the conditions in the preceding section have been met. It is based on paragraph 6(2AB) to (2AG) of Schedule 28B to ICTA.

887. *Subsection (1)* links the relevant qualifying activity that it refers to with the use of the money raised from the issue of shares in question. See *Change 62* in Annex 1.

### **Section 295: The unquoted status requirement**

888. This section requires the relevant company to be unquoted and defines an unquoted company. It is based on paragraph 2 of Schedule 28B to ICTA.

889. The words in brackets in paragraph 2(1), “whether or not it is resident in the United Kingdom” are not rewritten. The words do not add anything to the tests in section 291.

890. Paragraph 2(5) of Schedule 28B to ICTA which concerns orders made by the Board is not rewritten in this section. It is instead covered by section 1014 which is based on section 828 of ICTA.

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### **Section 296: The control and independence requirement**

891. This section requires that:

- any company that the relevant company controls (on its own or together with connected persons) is a qualifying subsidiary of the relevant company;
- the relevant company is not controlled by another company (on its own or together with connected persons); and
- there are no arrangements which could lead the relevant company to fail either of these tests.

It is based on paragraph 9 of Schedule 28B to ICTA.

### **Section 297: The gross assets requirement**

892. This section sets out the limits that apply to the value of a relevant company's gross assets before and after a share issue. It is based on paragraph 8 of Schedule 28B to ICTA.

893. The requirement differentiates between a "single company" and a "parent company". Both these terms are defined in section 332.

894. *Subsection (3)* sets out more clearly what is meant in relation to a group of companies by the "aggregate value at that time of the gross assets" in paragraph 8(2)(b) of Schedule 28B to ICTA. A similar wording is used in paragraph 12(3) of Schedule 5 to ITEPA (enterprise management incentives).

### **Section 298: The qualifying subsidiaries requirement**

895. This section requires that any subsidiary of the relevant company must be a qualifying subsidiary. It is based on paragraphs 3(6) and 10(1) of Schedule 28B to ICTA.

### **Section 299: The property managing subsidiaries requirement**

896. This section requires that any property managing subsidiary of the relevant company must also be its qualifying 90% subsidiary. It is based on paragraph 10ZA of Schedule 28B to ICTA.

897. In paragraph 10ZA(3) "land" and "property deriving its value from land" take the meaning in section 776 of ICTA. *Subsection (3)*, applying for the purposes of *subsection (2)* of the rewritten section, provides the definition of "property deriving its value from land". "Land" itself is not defined in this Act and instead relies on the definition in Schedule 1 to the Interpretation Act 1978. See the commentary on section 772.

### **Section 300: Meaning of "qualifying trade"**

898. This section explains the term "qualifying trade". It is based on paragraph 4(1), (2) and (9) and on paragraph 5(4) of Schedule 28B to ICTA.

899. In *subsection (1)(b)* there is a reference to excluded activities. Excluded activities are set out in section 303.

900. *Subsection (2)* provides that the carrying on of any R&D activities is treated as the carrying on of a qualifying trade in certain circumstances. Paragraph (b) of *subsection (2)*

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now extends the cases in paragraph (a) in which this treatment occurs. See *Change 41* in Annex 1.

901. *Subsection (3)* provides that preparing to carry out R&D does not count as preparing to carry on a qualifying trade. See *Change 63* in Annex 1.

### **Section 301: Meaning of “qualifying 90% subsidiary”**

902. This section gives the meaning of “qualifying 90% subsidiary”. It is based on paragraph 5A of Schedule 28B to ICTA.

903. The label “qualifying 90% subsidiary” copies EIS section 190 and replaces “the relevant qualifying subsidiary”.

### **Section 302: Meaning of “qualifying subsidiary”**

904. This section says what “qualifying subsidiary” means. It is based on paragraph 10 of Schedule 28B to ICTA.

905. The term “51% subsidiary” in this paragraph and elsewhere takes its meaning from the definition in section 989. This provides a signpost to section 838 of ICTA.

### **Section 303: Meaning of “excluded activities”**

906. This section gives the meaning of “excluded activities”. It is based on paragraph 4(2) of Schedule 28B to ICTA.

907. The meaning of excluded activities is needed to determine whether a trade is a qualifying trade and the extent to which the business of a group includes non-qualifying activities.

908. *Subsection (2)* indicates where further detail can be found on certain of the activities listed in *subsection (1)*.

### **Section 304: Excluded activities: wholesale and retail distribution**

909. This section supplements section 303(1)(b). It is based on paragraph 4(3) and (4) of Schedule 28B to ICTA.

910. *Subsection (2)* makes it clear that there are two sets of determinants, one set establishing what is a trade of wholesale and retail distribution and the other what is an ordinary trade of wholesale and retail distribution.

911. The words “or exposed” before “for sale” have been added in *subsection (4)*. This is intended to reflect the normal description of a trade of retail distribution in United Kingdom statute law.

912. *Subsection (5)(b)* refers to “the trader” rather than “the company” which is referred to in paragraph 4(3)(c)(ii) of Schedule 28B to ICTA. See *Change 45* in Annex 1.

### **Section 305: Excluded activities: leasing of ships**

913. This section supplements section 303(1)(d). It is based on paragraph 4(7) and (8) and paragraph 5(1) of Schedule 28B to ICTA.

914. *Subsection (2)* uses as its model paragraph 18(2) of Schedule 5 to ITEPA (enterprise management incentives). This additional material, which is not in the source legislation,

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makes it clear that the requirements of *subsection (4)* do not have to be met in relation to offshore installations and pleasure craft.

915. *Change 43* in Annex 1 applies for the purposes of *subsection (7)*. See the commentary on section 290(7).

**Section 306: Excluded activities: receipt of royalties and licence fees**

916. This section supplements section 303(1)(e). It is based on paragraph 4(5) to (6D) of Schedule 28B to ICTA.

**Section 307: Excluded activities: property development**

917. This section supplements section 303(1)(g). It is based on paragraph 5(1), (5) and (7) of Schedule 28B to ICTA.

**Section 308: Excluded activities: hotels and comparable establishments**

918. This section supplements section 303(1)(j). It is based on paragraph 4(3A) and paragraph 5(6) of Schedule 28B to ICTA.

**Section 309: Excluded activities: nursing homes and residential care homes**

919. This section supplements section 303(1)(k). It is based on paragraph 4(3A) and paragraph 5(1) of Schedule 28B to ICTA.

**Section 310: Excluded activities: provision of services or facilities for another business**

920. This section treats the provision of services or facilities as excluded activities if:

- the services or facilities are provided to businesses which themselves consist largely of excluded activities; and
- the specified control requirements exist.

It is based on paragraph 4(2) and paragraph 5(2) to (4) of Schedule 28B to ICTA.

921. The section is written in terms of a business. The way the definition of a trade in paragraph 5(4), governing paragraph 4 and 5 of Schedule 28B, is applied within those paragraphs has been simplified. See *Change 64* in Annex 1.

**Section 311: Power to amend Chapter**

922. This section allows the Treasury to make orders amending the provisions mentioned in the section. It is based on paragraph 12 of Schedule 28B to ICTA.

**Section 312: Winding up of the relevant company**

923. This section provides that if the requirements of this Chapter would be met but for the winding up of the relevant company, they are treated as met. The winding up must be commercial and not entered into for tax avoidance purposes. It is based on paragraph 11 of Schedule 28B to ICTA.

924. This supplements the provisions on winding up in section 294(4) and (5) in relation to the relevant company or any other company (in this case this extends to a dissolution too) and in section 302(3) in relation to a qualifying subsidiary or any other company.

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### **Section 313: Interpretation of Chapter**

925. This section provides an interpretation for certain terms used in this Chapter. It is based on paragraphs 1(1), 5(4) and 13 of Schedule 28B to ICTA.

926. *Subsection (3)* excepts references to a trade in certain sections in this Chapter from the extended meaning of “trade” in section 989, based on the definition in section 832(1) of ICTA. See the commentary on section 310 and *Change 64* in Annex 1.

### **Chapter 5: Powers: winding up and mergers of VCTs**

#### ***Overview***

927. This Chapter gives the Treasury power to make regulations for cases where a VCT is liquidated or two or more VCTs merge. Any such regulations will mainly ensure that reliefs available to shareholders in a VCT are “protected” in the cases that they cover.

928. These powers have been used in making the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004 (SI 2004/2199).

#### **Section 314: Power to treat VCT-in-liquidation as VCT**

929. This section allows regulations to treat a VCT-in-liquidation as if it remained a VCT and withdrawal of its VCT approval as taking place at a time different to when withdrawal actually takes place. It is based on paragraph 2 of Schedule 33 to FA 2002.

#### **Section 315: Power to treat conditions for VCT approval as met with respect to VCT-in-liquidation**

930. This section allows regulations to treat a VCT-in-liquidation as if it met conditions in section 274(2). It is based on paragraph 3 of Schedule 33 to FA 2002.

#### **Section 316: Power to make provision about distributions by VCT-in-liquidation**

931. This section allows regulations to apply, disapply or modify the way in which tax enactments affect distributions by a VCT-in-liquidation. It is based on paragraph 4 of Schedule 33 to FA 2002.

#### **Section 317: Power to facilitate disposal to VCT by VCT-in-liquidation**

932. This section allows regulations to be made that have the effect of treating certain holdings acquired by a VCT, from a VCT-in-liquidation, as if those holdings were qualifying holdings of the acquiring VCT. It is based on paragraph 5 of Schedule 33 to FA 2002.

#### **Section 318: Power in respect of periods before and after winding up**

933. This section extends the powers in the preceding sections to periods before and after a company becomes a VCT-in-liquidation. It is based on paragraph 6 of Schedule 33 to FA 2002.

#### **Section 319: Sections 314 to 318: supplementary**

934. This section supplements the preceding sections. It is based on paragraph 7(1), (2) and (5) of Schedule 33 to FA 2002.

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### **Section 320: Meaning of “VCT-in-liquidation”**

935. This section provides a definition and allows regulations to specify when winding up starts or ends in certain cases. It is based on paragraph 1 of Schedule 33 to FA 2002.

### **Section 321: Power to facilitate mergers of VCTs**

936. This section, in the case of certain mergers of VCTs, allows regulations to be made covering matters set out in section 322. It is based on paragraph 8(1) and (2) of Schedule 33 to FA 2002.

### **Section 322: Provision that may be made by regulations under section 321**

937. This section sets out what regulations under section 321 may provide. It is based on paragraph 9 of Schedule 33 to FA 2002.

### **Section 323: Meaning of “merger” and “successor company”**

938. This section defines certain terms for the purposes of the Chapter. It is based on paragraph 10 of Schedule 33 to FA 2002.

### **Section 324: Regulations under Chapter**

939. This section sets out further matters that may be dealt with by regulations under this Chapter. It is based on paragraph 16 of Schedule 33 to FA 2002.

### **Section 325: Interpretation of Chapter**

940. This section defines some terms used in this Chapter. It is based on paragraph 17 of Schedule 33 to FA 2002.

## **Chapter 6: Supplementary and general**

### **Overview**

941. This Chapter:

- deals with two cases in which a company’s holding may be treated as a qualifying holding (where it would not otherwise be);
- gives power to make regulations having a similar effect in other cases; and
- contains supplementary material.

### **Section 326: Restructuring to which section 327 applies**

942. This section sets out the conditions for section 327 to apply (treating some requirements in Chapter 4 (qualifying holdings) as met) where a company is issued with a holding in a new company (Newco) in exchange for a qualifying holding in another company (Oldco). The section also sets out limitations on such application of section 327. It is based on paragraph 10C(1) to (3), (11) and (13) of Schedule 28B to ICTA.

943. These provisions are similar to provisions in Part 5 (Enterprise investment scheme) under which, assuming that EIS relief is attributable to shares in Oldco held by an individual, the EIS relief would carry over to the shares in Newco received by the individual in exchange (see section 247). Companies do not get EIS relief or VCT relief for a holding in Oldco. But the company’s holding in Oldco may represent a “qualifying holding” and thus influence the

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VCT approval of that company. This section may permit the company's holding in Newco (received in exchange for the holding in Oldco) to be treated as a qualifying holding.

**Section 327: Certain requirements of Chapter 4 to be treated as met**

944. This section sets out the requirements of Chapter 4 (qualifying holdings) that are treated as met, and the periods for which they are so treated, in cases to which this section applies. It is based on paragraph 10C(4) to (10) of Schedule 28B to ICTA.

945. If this section applies, a holding in Newco may be treated as a qualifying holding of a company where that holding has been received in exchange for a qualifying holding in Oldco.

**Section 328: Supplementary**

946. This section extends the previous two sections so that they apply to securities as well as shares and defines certain terms. It is based on paragraph 10C(12) and (14) to (17) of Schedule 28B to ICTA.

**Section 329: Conversion of convertible shares and securities**

947. This section sets out cases in which shares in company A, acquired by company B on the conversion of other shares or securities in company A, can be treated as meeting certain requirements in Chapter 4 (qualifying holdings). It is based on paragraph 10D of Schedule 28B to ICTA.

948. If this section applies, the shares in company A acquired on the conversion may be treated as part of company B's qualifying holdings.

**Section 330: Power to facilitate company reorganisations etc involving exchange of shares**

949. This section allows regulations to be made which treat certain requirements in Chapter 4 (qualifying holdings) as met where company reorganisations involve the replacement of shares or securities that meet those requirements with shares or securities that do not. It is based on paragraph 11B of Schedule 28B to ICTA.

950. This power has been used in making the Venture Capital Trust (Exchange of Shares and Securities) Regulations 2002 (SI 2002/2661).

**Section 331: Meaning of a company being "in administration" or "in receivership"**

951. This section explains references to a company being in administration or in receivership. It is based on paragraphs 6(2AH), 10(4C) and 11A(2) of Schedule 28B to ICTA.

952. Paragraph 11A(1) and (3) of Schedule 28B to ICTA is rewritten in section 292.

953. The reference to Northern Ireland legislation in *subsection (2)(a)* takes into account amendments to the Insolvency (Northern Ireland) Order 1989 by the Insolvency (Northern Ireland) Order 2005. The reference in *subsection (2)(b)* to the law of a country or territory outside the United Kingdom accords with the insolvency law in force in Great Britain and in Northern Ireland. See *Change 56* in Appendix 1.

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### **Section 332: Minor definitions etc**

954. This section contains various definitions that apply to the whole Part. It is based on sections 842(4) and 842AA(11) of, and paragraph 6(2) of Schedule 15B and paragraph 5(1) and (5) of Schedule 28B to, ICTA and paragraph 17 of Schedule 33 to FA 2002. Other definitions are new.

955. A single definition of “company” and “shares” is applied for the whole Part. That follows their usage for investment trusts (section 842 of ICTA) from which various provisions are applied to VCTs (section 842AA(11) of ICTA). As the general application of these two definitions is not explicit this might represent a change in the law. See *Change 65* in Appendix 1.

956. The definitions of “group”, “group company”, “parent company” and “single company” are new.

### **Part 7: Community investment tax relief**

#### ***Overview***

957. This Part provides for community investment tax relief, that is income tax reductions to individuals for investments in community development finance institutions (CDFIs). It is based on Schedule 16 to FA 2002.

958. Schedule 16 to FA 2002 continues in force so far as it relates to relief for companies by way of reduction of corporation tax.

959. Schedule 1 to this Act inserts new sections 151BA, 151BB and 151BC in TCGA, which replace paragraphs 40 and 41 of Schedule 16 to FA 2002 and, so far as they apply for purposes of capital gains tax or corporation tax on chargeable gains, paragraphs 47 and 48(2) of that Schedule. Paragraphs 47(1) to (4), (7) and (8) and 48(2) of Schedule 16 to FA 2002 continue in force for the purposes of corporation tax relief under that Schedule. Sections 377 and 379(2) are based on those paragraphs for the purposes of income tax relief under this Part.

### **Chapter 1: Introduction**

#### ***Overview***

960. This Chapter quantifies the tax reduction potentially available to an individual, labels certain concepts and provides signposts to material contained elsewhere.

### **Section 333: Meaning of “CITR”**

961. This section sets out a general description of the nature of the relief, an entitlement to tax reductions, and defines it as “CITR”. It is based on paragraph 51(1) of Schedule 16 to FA 2002.

### **Section 334: Eligibility for CITR**

962. This section summarises the general conditions which need to be met for an individual (“the investor”) to be eligible for CITR. It is based on paragraph 1 of Schedule 16 to FA 2002.

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### **Section 335: Form and amount of CITR**

963. This section specifies the amount of the income tax reduction available and the tax years for which it may be claimed. It is based on paragraph 19 of Schedule 16 to FA 2002.

964. The provision in paragraph 19(2) of Schedule 16 to FA 2002 (limiting the tax reduction to the amount which reduces the investor's tax liability to nil) has not been included in this section. *Subsection (2)* is expressed simply in terms that the investor is entitled to a tax reduction for the relevant tax year of 5% of the amount invested. The provision limiting the tax reduction is included in section 29(2) (tax reductions: supplementary).

965. The provisions of paragraph 19(6) of Schedule 16 to FA 2002 are included in section 27(4) (order of deducting tax reductions: individuals). That section sets out the order of priority of all the tax reductions (including CITR) that may be available to an individual.

### **Section 336: Meaning of “making an investment”**

966. This section provides that an investment in a CDFI may take the form of a loan or an issue of securities or shares. It is based on paragraph 2 of Schedule 16 to FA 2002.

### **Section 337: Determination of “the invested amount”**

967. This section sets out rules for determining the amount invested for the purposes of section 335. In particular, it deals with the complications which arise where a loan may be drawn down in tranches, by requiring the average capital balance of the loan in relation to the tax year to be calculated. It is based on paragraph 21 of Schedule 16 to FA 2002.

### **Section 338: Meaning of “the 5 year period” and “the investment date”**

968. This section provides the definitions of two significant terms. It is based on paragraph 3 of Schedule 16 to FA 2002. “The 5 year period”, which begins with “the investment date”, is the period during which conditions as to the repayment or redemption of the investment are imposed.

### **Section 339: Overview of other Chapters of Part**

969. This section indicates the subject matter of the Chapters of this Part not previously mentioned in Chapter 1. It is new.

## **Chapter 2: Accredited community development finance institutions**

### ***Overview***

970. For an investment in a CDFI to qualify for relief, the CDFI must be accredited by the Secretary of State. Part 2 of Schedule 16 to FA 2002 sets out the criteria for accreditation. It also contains powers to determine the manner of making applications and the terms and conditions of accreditation, and authorises delegation of the Secretary of State's functions. These functions have been assigned to the Secretary of State for Trade and Industry.

971. This Chapter is based on Part 2 of Schedule 16 to FA 2002. So that there is only one set of provisions relating to accreditation, Schedule 1 to this Act substitutes for paragraphs 4 to 7 of Schedule 16 to FA 2002 a new paragraph 4 applying Chapter 2 of this Part for the purposes of corporation tax relief for companies under that Schedule.

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### **Section 340: Application and criteria for accreditation**

972. This section sets out the way in which an application for accreditation as a CDFI is to be made and the basis on which it is to be admitted. It is based on paragraph 4 of Schedule 16 to FA 2002.

973. *Subsection (2)(b)* contains powers for the Treasury to make regulations. Under the powers in paragraphs 4 and 5 of Schedule 16 to FA 2002, the Treasury have made the Community Investment Tax Relief (Accreditation of Community Development Finance Institutions) Regulations 2003 (SI 2003/96).

974. Regulations may make different provision for bodies whose principal objective in providing finance is to invest in enterprises whose business does not consist of financing other enterprises or does so only to the extent permitted by the regulations. If such a body is accredited, it is designated as a retail community development finance institution (a “retail CDFI”). See *subsections (6)(b) to (8)*.

975. The distinction between a retail CDFI and an accredited CDFI which is not a retail CDFI (a “wholesale CDFI”) is relevant to the limits on the total value of investments which a CDFI can make for an accreditation period and which are set out in section 348(4). SI 2003/96 provides different limits on the value of investments which a retail CDFI and a wholesale CDFI may make in any enterprise.

### **Section 341: Terms and conditions of accreditation**

976. This section provides that the terms and conditions for accreditation are to be those set out in regulations and any other terms or requirements the Secretary of State considers appropriate, and specifies what regulations may contain. It is based on paragraph 5 of Schedule 16 to FA 2002. SI 2003/96 contains regulations made under that paragraph.

### **Section 342: Period of accreditation**

977. This section sets out the period for which an accreditation has effect. It is based on paragraph 7 of Schedule 16 to FA 2002.

978. Paragraph 7(2) of Schedule 16 to FA 2002 (relating to applications for accreditation made before 6 April 2003) has been omitted, as it no longer has any relevance.

### **Section 343: Delegation of Secretary of State’s functions**

979. This section is based on paragraph 6 of Schedule 16 to FA 2002.

## **Chapter 3: Qualifying investments**

### ***Overview***

980. This Chapter sets out the conditions which must be met if an investment is to be a qualifying investment.

### **Section 344: Qualifying investments: introduction**

981. This section introduces:

- the respective conditions which apply to loans (section 345), to securities (section 346) and to shares (section 347); and

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- the provisions which apply to all kinds of investment (sections 348 and 349).

It is based on paragraph 8 of Schedule 16 to FA 2002.

#### **Section 345: Conditions to be met in relation to loans**

982. This section sets out the three conditions applicable to loans. It is based on paragraph 9 of Schedule 16 to FA 2002.

#### **Section 346: Conditions to be met in relation to securities**

983. This section sets out the two conditions applicable to securities. It is based on paragraph 10 of Schedule 16 to FA 2002.

984. Condition A (*subsection (1)*) requires that securities must be subscribed for wholly in cash and fully paid for on the investment date. It is in similar terms to section 347(1) which sets out identical requirements in relation to shares.

985. Section 347(3) (based on paragraph 11(1) of Schedule 16 to FA 2002) provides that shares are not fully paid up for the purposes of section 347(1) if there is any undertaking to pay cash to the CDFI at a future date in connection with the acquisition of the shares. The effect of this is to distinguish the meaning of “paid up” for that purpose from the meaning of those words for the purposes of the Companies Act 1985. Section 738(2) of that Act provides that a share is deemed paid up in cash, or allotted for cash, if the consideration for the allotment or payment up is an undertaking to pay cash to the company at a future date.

986. There is no similar provision in the Companies Act 1985 applicable to the issue of securities, but the position in relation to securities has been made explicit by the inclusion of *subsection (3)*, equivalent to section 347(3). This clarification is not a change in either law or practice.

#### **Section 347: Conditions to be met in relation to shares**

987. This section sets out the two conditions applicable to shares. It is based on paragraph 11 of Schedule 16 to FA 2002.

#### **Section 348: Tax relief certificates**

988. This section sets limits on the value of investments in respect of which a CDFI may issue tax relief certificates in an accreditation period (as defined in section 342). It is based on paragraph 12 of Schedule 16 to FA 2002. Without a tax relief certificate, an investor may not claim CITR (see section 335(5)(b)).

989. *Subsections (2) and (3)* provide that the limit applies to the total value of investments in the CDFI made in the accreditation period by individuals under this Part and by companies under Schedule 16 to FA 2002.

990. *Subsection (4)* provides different limits for retail and wholesale CDFIs. See the commentary on section 340.

991. In *subsection (8)*, the words “wholly or partly”, which appear before “in contravention” in paragraph 12(6) of Schedule 16 to FA 2002, have been omitted as being unnecessary.

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### **Section 349: No pre-arranged protection against risks**

992. This section is an anti-avoidance provision concerned with ensuring that the investor is subject to all usual investment risks and is not protected from their effect by insurance, indemnity, guarantee or other means. It is based on paragraph 13 of Schedule 16 to FA 2002.

## **Chapter 4: General conditions**

### *Overview*

993. This Chapter contains various general conditions to be met by the investor. It is based on Part 4 of Schedule 16 to FA 2002, with the exception of paragraph 16 of that Schedule which applies only to investors that are companies.

### **Section 350: No control of CDFI by investor**

994. This section provides that the investor will not qualify for CITR in relation to an investment if the investor or a person connected with the investor controls the CDFI at any time in the 5 year period. It is based on paragraph 14 of Schedule 16 to FA 2002.

995. The legal structure of a CDFI may take a number of forms. It may be a company or some other form of body corporate or it may be a partnership or some other form of unincorporated association. The different meanings of control needed to deal with the possible different forms of a CDFI's constitution are set out in *subsections (3) to (6)*.

### **Section 351: Investor must have beneficial ownership**

996. This section provides that the investor must be the sole beneficial owner of the investment. It is based on paragraph 15 of Schedule 16 to FA 2002. Trustees and joint investors are thus precluded from obtaining CITR. But see section 375 which enables investments to be made by a nominee or a bare trustee for an individual.

### **Section 352: No acquisition of share in partnership**

997. This section provides that an investor cannot obtain CITR for capital contributed to a CDFI which is a partnership, including loan capital accounted for as partners' capital. It is based on paragraph 17 of Schedule 16 to FA 2002.

### **Section 353: No tax avoidance purpose**

998. This section denies CITR if the investment is part of a scheme or arrangement the main purpose or one of the main purposes of which is the avoidance of tax. It is based on paragraph 18 of Schedule 16 to FA 2002.

999. Equivalent provisions are to be found in sections 165 and 178 (enterprise investment scheme) and 261 (venture capital trusts).

## **Chapter 5: Claims for and attribution of CITR**

### *Overview*

1000. This Chapter is based on those paragraphs of Part 5 of Schedule 16 to FA 2002 which apply to individual investors other than paragraphs 19 and 21. Sections 335 and 337 in Chapter 1 are based on those two paragraphs.

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**Section 354: Loans: no claim after disposal or excessive repayments or receipts of value**

1001. This section prevents a claim being made for any tax year in respect of an investment by way of loan in certain circumstances. It is based on paragraph 22 of Schedule 16 to FA 2002. This section links to the provisions in sections 360, 362 and 363 which provide for a tax reduction already given to be recaptured in similar circumstances.

**Section 355: Securities or shares: no claim after disposal or excessive receipts of value**

1002. This section sets out two conditions to be met before a claim can be made for any tax year in respect of a subscription for securities or shares. It is based on paragraph 23 of Schedule 16 to FA 2002.

1003. The first condition (*subsection (1)*) is that the investor has not disposed of the securities or shares before the first anniversary of the investment date which occurs after the end of the tax year.

1004. The second condition (*subsection(2)*) is that the investor has not received or is not treated as having received value from the CDFI in excess of the limits allowed under section 364.

**Section 356: No claim after loss of accreditation by the CDFI**

1005. This section provides that no claim may be made if the CDFI ceases to be accredited. It is based on paragraph 24 of Schedule 16 to FA 2002. Depending on the investment date and the date upon which the CDFI ceased to be accredited, this section may prevent a claim being made for the tax year before that in which the CDFI ceased to be accredited (see *subsection (2)*).

**Section 357: Attribution: general**

1006. This section sets out the general rules dealing with the attribution to the loan, securities or shares included in the investment of the reduction in the investor's income tax liability for any tax year made as a result of the investor's entitlement to CITR. It is based on paragraph 26 of Schedule 16 to FA 2002.

1007. Attribution is required for the purpose of determining the amount of the tax reduction which must be withdrawn or reduced in accordance with Chapter 6 of this Part.

**Section 358: Attribution: bonus shares**

1008. This section sets out additional rules relating to attribution, to deal with the consequences of an issue of "corresponding bonus shares" (see *subsection (4)*) to the investor in respect of the original shares included in the investment. It is based on paragraph 26 of Schedule 16 to FA 2002.

1009. The CITR attributable to the original shares is to be re-attributed across the bonus shares and the original shares proportionately and the bonus shares are to be treated as having been issued at the time the original shares were issued and as having been held by the investor from that date.

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## **Chapter 6: Withdrawal or reduction of CITR**

### ***Overview***

1010. This Chapter sets out the circumstances in which CITR attributable to an investment for any tax year must be reduced to nil (withdrawn) or reduced proportionately. It is based on Part 6 of Schedule 16 to FA 2002, with the exception of paragraph 27(4) of that Schedule which applies only to investors that are companies.

### **Section 359: Overview of Chapter**

1011. This section provides an overview of the Chapter and contains signposts to its principal provisions. It is new.

1012. *Subsection (3)* defines the term, “the 6 year period”. This new term replaces the term “the period of restriction” defined in the same way in paragraph 33 of Schedule 16 to FA 2002. The 6 year period is relevant to sections 363 and 364 which deal with receipts of value. As an anti-avoidance measure, receipts of value in the year before the investment date are taken into account, as well as those in the 5 year period, which begins with the investment date. See the commentary on section 338 for the meaning of “the 5 year period” and “the investment date”.

### **Section 360: Disposal of loan during 5 year period**

1013. This section provides that the CITR attributable to a loan must be withdrawn if, within the 5 year period, the investor disposes (otherwise than by receiving repayment) of part of the loan or, unless it is by way of a permitted disposal, of the whole of the loan. It is based on paragraph 28 of Schedule 16 to FA 2002.

1014. A permitted disposal is defined in *subsection (2)*. If the disposal is a permitted disposal, any tax reduction already obtained is not withdrawn, but no further tax reduction may be claimed (see sections 335(6) and 354).

### **Section 361: Disposal of securities or shares during 5 year period**

1015. This section provides for the withdrawal or reduction of CITR attributable to securities or shares, if the investor disposes of the whole or part of the investment in the securities or shares (except upon repayment, redemption or repurchase by the CDFI) within the 5 year period and the CDFI is accredited at the time of the disposal. It is based on paragraph 29 of Schedule 16 to FA 2002.

1016. *Subsections (2) and (3)* provide for different consequences depending upon whether the disposal is a qualifying disposal.

1017. *Subsection (4)* defines what is a qualifying disposal. It is based on paragraph 29(4) of Schedule 16 to FA 2002 with the omission of the words “for full consideration” in paragraph (a). See *Change 20* in Annex 1.

1018. *Subsection (5)* provides for circumstances where 5% of the invested amount is greater than the income tax liability of the investor for the tax year.

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### **Section 362: Repayment of loan capital during 5 year period**

1019. This section provides for the circumstances in which the CITR attributable to a loan must be withdrawn as a consequence of a repayment other than a “non-standard” repayment (see *subsections (3) to (5)*). It is based on paragraph 30 of Schedule 16 to FA 2002.

### **Section 363: Value received by investor during 6 year period: loans**

1020. This section applies if the investment consists of a loan and the investor or a person connected with the investor receives any value, other than an amount of insignificant value (as defined in *subsection (5)*), from the CDFI or a person connected with the CDFI in the 6 year period. It is based on paragraph 31 of Schedule 16 to FA 2002.

1021. *Subsection (2)* provides that, if value is so received, the invested amount (see section 337) is adjusted by the amount treated as repaid and the investor is treated as having received a repayment other than a non-standard repayment for the purposes of section 362(see *subsection (4)*).

### **Section 364: Value received by investor during 6 year period: securities or shares**

1022. This section applies if the investment consists of securities or shares and the investor or a person connected with the investor receives any value, other than an amount of insignificant value (as defined in *subsection (4)*), from the CDFI or a person connected with the CDFI in the 6 year period. It is based on paragraph 32 of Schedule 16 to FA 2002.

1023. *Subsection (2)* provides, that if value is so received and its amount wholly or partly exceeds the permitted level (see *subsection (3)*) by more than an amount of insignificant value, the CITR attributable to the investment must be withdrawn.

### **Section 365: Receipts of insignificant value to be added together**

1024. This section applies at a time when the investor receives value, if the investor has also received value earlier in the 6 year period and the total amount of the value received earlier was of insignificant value. It is based on paragraph 34 of Schedule 16 to FA 2002.

1025. The amount of the receipt in question is to be added to the amounts of value previously received. If the total value of the amounts received is not an amount of insignificant value, the total value is treated as received at that time for the purposes of this Part, including in particular sections 362, 363 and 364.

### **Section 366: When value is received**

1026. This section explains when value is received. It is based on paragraph 35 of Schedule 16 to FA 2002.

### **Section 367: The amount of value received**

1027. This section, which determines the respective values received in relation to the respective transactions listed in section 366(1), is set out in tabular form for clarity. It is based on paragraph 36 of Schedule 16 to FA 2002.

### **Section 368: Value received if there is more than one investment**

1028. This section provides that, if there is more than one investment, any value received is to be apportioned among the investments according to the respective amounts invested and

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sets out how those amounts are to be calculated. It is based on paragraph 37 of Schedule 16 to FA 2002.

### **Section 369: Effect of receipt of value on future claims for CITR**

1029. This section applies if an investor holding securities or shares receives value (other than an amount of insignificant value) but, because that value is less than the permitted level, the CITR attributable to those securities or shares is not withdrawn under section 364. It is based on paragraph 38 of Schedule 16 to FA 2002.

1030. *Subsection (2)* reduces the amount invested (see section 337) in respect of which CITR may be claimed for the tax years specified in *subsection (3)*.

### **Section 370: Receipts of value by or from connected persons**

1031. This section extends the meaning of “the investor” and “the CDFI” in sections 363 to 369. It is based on paragraph 39 of Schedule 16 to FA 2002.

1032. This section includes the words “if the context permits”, which do not appear in paragraph 39 of Schedule 16 to FA 2002. The inclusion of these words does not change the law but makes sections 363 to 369 clearer, by stating explicitly what is implicit in the source legislation.

### **Section 371: CITR subsequently found not to have been due**

1033. This section provides the basis for making an assessment under section 372 in cases where a claim for a tax reduction has been incorrectly allowed. It is based on paragraph 27(1) of Schedule 16 to FA 2002.

### **Section 372: Manner of withdrawal or reduction of CITR**

1034. This section authorises the making of assessments to recapture CITR attributable to an investment which has been withdrawn or reduced, except where the event giving rise to the withdrawal or reduction of the CITR occurs after the death of the investor. It is based on paragraph 27 of Schedule 16 to FA 2002.

## **Chapter 7: Supplementary and general**

### ***Overview***

1035. This Chapter contains miscellaneous provisions and definitions applicable to Part 7.

### **Section 373: Information to be provided by the investor**

1036. This section imposes obligations on the investor to notify an officer of Revenue and Customs of events giving rise to the withdrawal or reduction of any CITR attributable to a loan or any securities or shares. It is based on paragraph 42 of Schedule 16 to FA 2002.

### **Section 374: Disclosure**

1037. This section authorises disclosure of information between HMRC and the Secretary of State for the purpose of discharging their respective functions under this Part. It is based on paragraph 43 of Schedule 16 to FA 2002.

1038. Reference to “the Income Tax Acts” has been substituted in *subsection (1)(a)* for the reference to “the Tax Acts” in paragraph 43(1)(a) of Schedule 16 to FA 2002. That paragraph

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will continue in force for the purposes of corporation tax relief with the substitution of “the Corporation Tax Acts” for “the Tax Acts”.

**Section 375: Nominees**

1039. This section allows for loans, securities or shares to be acquired, held and disposed of by nominees or bare trustees. It is based on paragraph 44 of Schedule 16 to FA 2002.

**Section 376: Application for postponement of tax pending appeal**

1040. This section ensures that the investor cannot claim to postpone any payment of tax under section 55 of TMA on the grounds that the investor is eligible for CITR unless a claim has actually been made. It is based on paragraph 45 of Schedule 16 to FA 2002.

**Section 377: Identification of securities or shares on a disposal**

1041. This section provides rules for the identification of the securities or shares disposed of for the purposes of this Part. It is based on paragraph 47(1) to (4), (7) and (8) of Schedule 16 to FA 2002.

1042. Paragraph 47(1) to (4) of Schedule 16 to FA 2002 provide identification rules not only for the purposes of that Schedule but also for the purposes of capital gains tax and corporation tax on chargeable gains. Paragraph 47(7) and (8) supplement paragraph 47(3) and (4) of that Schedule.

1043. This section is based on paragraph 47(1) to (4), (7) and (8) of Schedule 16 to FA 2002 so far as they apply for the purposes of income tax relief. Paragraph 47(1) to (4), (7) and (8) continue in force so far as they apply for the purposes of corporation tax relief.

1044. Paragraph 47(5) and (6) of Schedule 16 to FA 2002 apply only for the purposes of capital gains tax or corporation tax on chargeable gains. Section 151BA of TCGA, introduced by Schedule 1 to this Act, is based on paragraph 47(5) and (6) and, so far as they apply for those purposes, paragraph 47(1) to (4), (7) and (8) of Schedule 16 to FA 2002.

**Section 378: Meaning of “issue of securities or shares”**

1045. This section provides definitions, in relation to a body, of an issue of securities or shares by that body and, in relation to a person, of an issue of securities or shares to that person. It is based on paragraph 46 of Schedule 16 to FA 2002.

**Section 379: Meaning of “disposal”**

1046. This section defines “disposal”. It is based on paragraph 48 of Schedule 16 to FA 2002.

1047. Paragraph 48(1) of Schedule 16 to FA 2002 provides that “disposal” and related expressions have the same meanings in that Schedule as in TCGA. This is subject to sub-paragraph (2) which makes modifications, both for the purposes of that Schedule and for the purposes of capital gains tax or corporation tax on chargeable gains, to take account of paragraph 41 of that Schedule.

1048. Section 151BC(5) of TCGA, introduced by Schedule 1 to this Act, is based on paragraph 48(2) of Schedule 16 to FA 2002 so far as that paragraph applies for the purposes of capital gains tax or corporation tax on chargeable gains.

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1049. *Subsection (2)* is based on paragraph 48(2) of Schedule 16 to FA 2002 so far as that paragraph applies for the purposes of income tax relief. That paragraph continues in force so far as it applies for the purposes of corporation tax relief.

### **Section 380: Construction of references to being “held continuously”**

1050. This section explains what is meant by “held continuously”, for the purposes of those sections of this Part which require the investment to have been “held continuously” by the investor during a specified period (see for example sections 364 and 369). It is based on paragraph 49 of Schedule 16 to FA 2002.

### **Section 381: Meaning of “associate”**

1051. This section provides a definition of associate which is relevant to sections 366 and 367. It is based on paragraph 50 of Schedule 16 to FA 2002.

### **Section 382: Minor definitions etc**

1052. This section explains various terms used in this Part. It is based on paragraph 51 of Schedule 16 to FA 2002.

1053. With the exception of “body”, the terms defined in paragraph 51(1) of Schedule 16 to FA 2002 have been omitted, as they are either no longer required or are defined generally for the purposes of this Act.

1054. A definition of “bonus shares” has been added in *subsection (1)*. This term is used in section 358. Section 358 deals with similar issues relating to corresponding bonus shares to those dealt with, for the purposes of the EIS legislation in Part 5, by section 201(4). A definition of “bonus shares” has been in place since 2004 for those purposes (see section 257(1)). Inclusion of the same definition, which does no more than state the normal meaning of the term, ensures consistency between this Part and Part 5.

1055. Paragraph 51(3) of Schedule 16 to FA 2002, which applies section 839 of ICTA (connected persons) for the purposes of that Schedule, has been omitted. Section 993 (connected persons), based on section 839 of ICTA, is applied generally for the purposes of this Act by section 1021(1).

## **Part 8: Other reliefs**

### ***Overview***

1056. This Part contains rules about a number of other reliefs.

### **Chapter 1: Interest payments**

#### ***Overview***

1057. Chapter 1 contains the rules relating to relief for interest paid given by deduction in calculating net income. It is based on sections 353 to 368 of ICTA.

1058. The Mortgage Interest Relief At Source provisions in sections 369 to 379 of ICTA and the related provisions in section 365 of ICTA for relief for interest on a loan to purchase a life annuity are obsolescent. They are not rewritten in this Act, but remain in ICTA.

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### **Section 383: Relief for interest payments**

1059. This section is an introduction to the Chapter. It is based on sections 353, 359, 360, 361, 362 and 364 of ICTA.

1060. *Subsection (2)* lists the seven provisions about the purposes for which loans have to be used if the interest on them is to be eligible for relief. Those purposes do not include the generality of purposes for which loans are taken out in the course of a trade or property business, as interest will normally be an allowable deduction in computing the income from that source.

1061. Relief is given as a deduction in computing net income of the year in which payment is made. So if the interest exceeds the income from which it can be deducted, relief for the excess interest is generally lost. The exception from this rule in section 405 is signposted by *subsection (5)(e)*.

### **Section 384: General restrictions on relief under Chapter**

1062. This section sets out two restrictions on relief for interest paid. It is based on section 353(3) of ICTA.

### **Section 385: General provisions about loans**

1063. This section brings together some general rules which apply to the loan itself. It is based on sections 359, 360, 361, 362, 364 and 367 of ICTA.

1064. With the exception of section 367 of ICTA, the source legislation provides a condition in each of the rules that the loan must be to defray money applied for a particular purpose. The rewritten provisions simply refer to a loan being “used”.

1065. *Subsection (1)* expands on what “used” is to be taken to mean. In particular, with the exception of a loan to pay inheritance tax, it covers the case of expenditure already incurred.

1066. The restrictions in *subsections (2) and (3)* do not apply to loans to buy plant or machinery (sections 388 and 390 of this Act).

### **Section 386: Loans partly meeting requirements**

1067. This section explains what happens if a loan (“the mixed loan”) is only partly used for a qualifying purpose. It is based on section 367(4) of ICTA.

1068. *Subsection (1)* explains that the qualifying part of the loan is itself treated as a loan within this Chapter.

1069. *Subsection (2)*, read with *subsection (4)*, provides that in respect of a mixed loan within subsection (1) only interest on the part of the loan used for qualifying purposes is eligible for relief. The apportionment is made in a way that reflects the application of the money at the time the loan is used.

1070. *Subsection (3)*, read with *subsection (4)*, provides that if part of the loan is repaid, then the qualifying and non-qualifying parts of the original loan are treated as repaid in the same proportions that the loan was first used. A stricter rule applies in a case where there is a recovery of capital which was the subject of a qualifying investment (see section 406(4)).

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1071. The rule dealing with partial repayments is based on section 367(4) of ICTA, but modified so as to apply to all cases. See *Change 66* in Annex 1.

### **Section 387: Exclusion of double relief etc**

1072. This section contains restrictions which ensure that relief is only given once for a particular interest payment, and penalise attempts to switch between claiming relief as a trade etc expense and as a deduction from income under this Chapter. It is based on section 368 of ICTA.

1073. *Subsection (1)* contains the main rule. It denies relief elsewhere for any payment of interest for which relief is given under this Chapter.

1074. *Subsections (2) to (6)* contain further rules which prohibit relief under this Chapter in cases where the interest or “connected” interest is claimed as a trading etc expense. They derive from section 368(3) and (5) of ICTA. Section 52 of ITTOIA, based on section 368(4) and (5) of ICTA, makes similar provision in relation to restricting relief for interest in calculating the profits of a trade.

1075. *Subsection (7)* is based on section 368(6) of ICTA but has been adapted to fit better with Self Assessment. See *Change 67* in Annex 1.

1076. Section 368(2) of ICTA is redundant and has not been rewritten. See the commentary on section 404.

### **Section 388: Loan to buy plant or machinery for partnership use**

1077. This section is the first of two dealing with a loan used by a partner in providing plant or machinery for partnership use. It is based on section 359(1) of ICTA.

1078. The reference to a vocation being carried on by a partnership contained in the source legislation has not been included in this section, or elsewhere, because a partnership cannot carry on a vocation.

1079. *Subsection (2)* makes it clear that the plant or machinery must be in use and that the partnership must be entitled to a capital allowance or balancing charge in respect of it for the period of account in which the interest is paid. The “in use” requirement is not explicitly specified in section 359(1) of ICTA, but is clear from section 359(2) and the wording of section 264 of CAA. The requirement in section 359(1) of ICTA that the plant or machinery must belong to the individual partner is not included as it is contained in section 264 of CAA.

1080. It is also made clear that ordinary property businesses (if carried on in partnership) are within the types of partnership business that qualify. See *Change 68* in Annex 1.

1081. *Subsection (3)* ensures that relief remains available where the plant remains within the capital allowances regime, even if no allowance or balancing charge arise in the period of account. See *Change 69* in Annex 1.

1082. *Subsection (4)* makes it explicit that the appropriate definitions of “capital expenditure” and “period of account” are those in sections 4 and 6 of CAA, which apply generally for capital allowances purposes, rather than the definitions in section 989 of this Act.

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### **Section 389: Eligibility requirements for interest on loans within section 388**

1083. This section contains two conditions which have to be met if the interest is to be eligible for relief. It is based on section 359(1) and (2) of ICTA.

1084. Both conditions relate to circumstances at the time the interest is paid.

1085. *Subsections (4) and (5)* provide an apportionment rule if the plant or machinery is used partly for the purposes of the trade, profession or ordinary property business and partly for other purposes. As regards the inclusion of ordinary property businesses, see *Change 68* in Annex 1 and the commentary on section 388.

### **Section 390: Loan to buy plant or machinery for employment use**

1086. This section is the first of two dealing with a loan used by an individual to provide plant or machinery for use as an employee or office-holder. It is based on section 359(3) of ICTA.

1087. *Subsection (2)* makes it clear that the plant or machinery must be in use, that it must belong to the individual and that the individual must be entitled to a capital allowance or balancing charge in respect of it for the tax year in which the interest is paid. The “in use” requirement is explicitly specified in section 359(3) of ICTA. It is necessary to retain the “belonging to” test here as that is not a requirement of eligibility to capital allowances.

1088. *Subsection (3)* corresponds to section 388(3). See *Change 69* in Annex 1 and the commentary on section 388.

1089. Section 37 of CAA (exclusion where sums payable in respect of depreciation) may operate to deny entitlement to capital allowances in respect of the expenditure met by the employee. In such a case *subsection (4)* preserves entitlement to relief for the interest if a contribution to the expenditure has been made by the individual’s employer.

### **Section 391: Eligibility requirements for interest on loans within section 390**

1090. This section contains two conditions which have to be met if the interest is to be eligible for relief. It is based on section 359(3) and (4) of ICTA.

1091. Both conditions relate to circumstances at the time the interest is paid.

### **Section 392: Loan to buy interest in close company**

1092. This section deals with conditions for relief for interest on a loan to buy an interest in a close company. It is based on section 360(1), (3A) and (4) of ICTA.

1093. The section is the first of four dealing with this relief.

1094. *Subsection (2)* provides that the company in which the investment is made with the borrowed money must be a close company, but must not be a close investment-holding company within section 13A(1) of ICTA. In addition, the investment must either be in the ordinary shares of the company, or in the form of a loan (or a replacement loan) which is used for specified business purposes, or both.

1095. It is clear from section 363(4) of ICTA, under which a replacement loan and the original loan are treated as one, that a replacement loan only qualifies under this section if it

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replaces an earlier loan for the same qualifying purpose. This point has been made explicit in this section.

1096. *Subsection (3)* contains a further condition that the investment must not be in ordinary shares for which relief is given under the enterprise investment scheme income tax or capital gains tax provisions. See Schedule 2 Part 9 for transitional provisions where the shares were acquired before 6 April 1989.

### **Section 393: Eligibility requirements for interest on loans within section 392**

1097. This section sets out conditions relating to circumstances at the time the interest is paid, or during the period of the loan. It is based on section 360(1), (2) and (3) of ICTA.

1098. The first such condition, in *subsection (1)(a)*, is that at the time the interest is paid, the company must not be a close investment-holding company. It says nothing about whether the company is to be a close company. This accords with Statement of Practice 3/78, which explains that section 360(2)(a) of ICTA does not require the company to be close at the time the interest is paid.

1099. The second condition, in *subsections (1)(b)* and *(2)*, is that during the period of the loan the borrower must not have recovered any capital from the company apart from any amount taken into account under section 406(2) of this Act.

1100. The final condition, in *subsections (1)(b)*, *(3)* and *(4)*, is in two parts, and it is sufficient that either part is satisfied.

1101. The first part is in subsection (3) and requires the borrower to hold some ordinary shares in the company and to have worked full time for the company during the period from the use of the loan to the payment of the interest.

1102. The second part, in subsection (4), requires the borrower to have a material interest in the company and also that, if the company exists for the purposes of holding investments or other property, none of that property is a residence of that individual, unless (broadly speaking) that individual has worked full time for the company. (For the meaning of “material interest” see section 394 and the commentary on that section.)

1103. The source legislation for the material interest condition does not specify over what period the individual has to have worked full-time for the company. The reference to subsection (3)(b) makes it explicit that regard is to be had to the same period as is referred to in the full-time working condition itself.

### **Section 394: Meaning of “material interest” in section 393**

1104. This section defines “material interest” for the purposes of section 393(4)(a). It is based on section 360A(1) of ICTA.

1105. The source legislation does not give the meaning of “control”. *Subsection (5)* makes it clear that it is the definition in section 416 of ICTA which applies. The same definition is applied in section 395.

### **Section 395: Meaning of “associate” in section 394**

1106. This section defines the term “associate”. It is based on section 360A(2), (4) to (7) and (10) of ICTA.

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1107. The reference in section 360A(5) to Schedule 8 to ICTA has been replaced by a reference to the relevant provisions in ITEPA.

1108. Section 360A(8) and (9) of ICTA relate to loans made before 14 November 1986. Those rules are contained in Part 9 of Schedule 2 to this Act.

1109. Section 360A(3) of ICTA is redundant and has not been rewritten.

### **Section 396: Loan to buy interest in employee-controlled company**

1110. This section deals with conditions for relief on interest on a loan to buy an interest in an employee-controlled company. It is based on section 361(3) to (8) of ICTA.

1111. This section deals with the conditions relating to the employee-controlled company and ways of investing in it. Section 397 deals with the conditions that relate to circumstances at the time the interest is paid.

1112. The condition in *subsection (2)* is that the loan is applied in acquiring part of the ordinary share capital of a company that has recently become or becomes an employee-controlled company. As with section 392, relief is available for a loan replacing one that met the conditions in this section.

1113. *Subsection (3)* defines when a company is “employee-controlled”. The definition requires more than 50% of the issued ordinary share capital and more than 50% of the voting power to be held by persons who are full-time employees of the company.

1114. *Subsection (4)* provides that, if an individual holds more than 10% of either the ordinary share capital or the voting power, the excess over 10% is regarded as owned by a person who is not a full-time employee of the company and so does not count towards the 50% test in subsection (3).

### **Section 397: Eligibility requirements for interest on loans within section 396**

1115. This section sets out four conditions relating to circumstances at the time the interest is paid, or during the period of the loan. It is based on section 361(3), (4) and (8) of ICTA.

1116. Condition B requires the company to be employee-controlled for at least nine months in the tax year in which the interest is paid (or to become employee-controlled first in that year).

1117. Condition C is that the claimant is a full-time employee of the company throughout the period between the date on which the loan is used (“the use date”) and the date the interest is paid. If the individual ceased to be a full-time employee no more than 12 months before the interest payment date, then it is sufficient that the employee worked full time for the company from the use date until that date.

### **Section 398: Loan to invest in partnership**

1118. This section deals with conditions for relief for interest on a loan to invest in a partnership. It is based on section 362(1) of ICTA.

1119. This section deals with the conditions relating to ways of investing in the partnership. Section 399 deals with the conditions that relate to circumstances at the time the interest is paid.

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1120. *Subsection (2)* provides that the loan qualifies for relief if the proceeds are used in either buying a share in a partnership or contributing or advancing money to a partnership that is used for a trade or profession carried on by the partnership. As explained in the commentary on section 388, no reference is made to “vocation” as a partnership cannot carry on a vocation. As with section 392, relief is available for a loan replacing one that met the conditions in this section.

### **Section 399: Eligibility requirements for interest on loans within section 398**

1121. This section sets out two conditions relating to circumstances during the period of the loan, both of which must be met. It is based on section 362 of ICTA and, in relation to film partnerships, on section 75(1) of FA 2006.

1122. Condition A is that the individual to whom the loan is made must be a partner in the partnership throughout the period from the making of the investment to the payment of the interest. Relief is not available if the partnership is an investment LLP or a limited partnership in which the individual is a limited partner.

1123. Where the special rules for film partnerships in section 400 apply, *subsection (4)* provides that relief is restricted to 40% of the interest that would otherwise be eligible for relief.

1124. *Subsection (5)* provides that certain senior employees of the partnership may count as partners for the purposes of this section, enacting Statement of Practice SP A33. See *Change 70* in Annex 1.

### **Section 400: Film partnerships**

1125. This section sets out the circumstances in which relief is restricted to 40% of the interest that would otherwise be eligible for relief. It is based on section 75 of FA 2006.

1126. The restriction applies only if the money is invested in a film partnership and secured on an asset or activity of a second partnership, the “investment partnership”, of which the individual is or has been a member. The individual must also be entitled to a lower proportion of the profits of the investment partnership than the proportion of capital that he or she contributed to that partnership.

1127. In relation to the calculation of the latter proportion, *subsection (3)* provides rules about what constitutes the partnership capital and *subsection (4)* provides rules for identifying which part of that capital has been contributed by the claimant. In *subsection (4)* it is made explicit that only amounts that actually form part of the total investment partnership’s capital are taken into account.

### **Section 401: Loan to invest in co-operative**

1128. This section deals with conditions for relief for interest on a loan to invest in a co-operative. It is based on section 361(1) and 363(5) of ICTA.

1129. This section is the first of two dealing with this relief and deals with the conditions relating to the co-operative and ways of investing in it. Section 402 deals with the conditions that relate to circumstances at the time the interest is paid.

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1130. *Subsection (2)* provides that the loan qualifies for relief if the proceeds are used in either buying shares in a co-operative or lending money to a co-operative or its subsidiary which is used for the business purposes of that body. As with section 392, relief is available for a loan replacing one that met the conditions in this section.

1131. The condition in section 361(2)(a) of ICTA that the loan only qualifies if it was made after 10 March 1981 has not been reproduced. So, if any loans made on or before that date still exist, the interest on them will now be eligible for relief. See *Change 71* in Annex 1.

#### **Section 402: Eligibility requirements for interest on loans within section 401**

1132. This section sets out three conditions relating to circumstances at the time the interest is paid or during the period of the loan, all of which must be met. It is based on section 361(2) of ICTA.

#### **Section 403: Loan to pay inheritance tax**

1133. This section provides relief for interest on money borrowed by personal representatives to pay certain amounts of inheritance tax. It is based on section 364(1), (3) and (4) of ICTA.

1134. In order for the personal representatives to obtain a grant of representation or confirmation, they have to pay the inheritance tax for which they are liable on delivery of their account under section 226(2) of IHTA. Relief is available for interest on a loan to pay this tax. Relief is not available for interest on a loan to pay inheritance tax that falls due at a later date. The source legislation in section 364(1)(a) of ICTA is written in language relating to estate duty. It has been brought up to date in *subsection (2)*. See *Change 72* in Annex 1.

1135. *Subsection (3)* clarifies that a document from an officer of Revenue and Customs giving details of inheritance tax payable will be accepted in support of a claim under this section. The source legislation refers to a certificate from the Board. See *Change 5* in Annex 1.

#### **Section 404: Eligibility requirements for interest on loans within section 403**

1136. This section provides that interest on loans to pay inheritance tax is eligible for relief only if it is paid in respect of a period ending within 12 months of the loan being made. It is based on section 364(1) and (4) of ICTA.

1137. Section 364(4)(b) of ICTA states that “references to interest in respect of a period ending with a given time apply whether or not interest continues to run after that time”. This has been rewritten by using the words “so far as”.

1138. Section 368(2) of ICTA is redundant and has not been rewritten. See *Change 73* in Annex 1.

#### **Section 405: Carry back and forward of relief for interest on loans within section 403**

1139. This section provides for the carry back or forward of interest eligible for relief by virtue of section 403. It is based on section 364(2) of ICTA.

1140. Relief for interest on a loan to pay inheritance tax is the only interest relief that may be deducted from income of a tax year other than the year in which it was paid.

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### **Section 406: Effect of recovery of capital in the case of some loans**

1141. This section deals with what happens if an individual to whom the loan was made recovers any capital from the business entity in which the investment was made. It is based on section 363(1) of ICTA.

1142. Rules in the particular provisions concerned (eg section 393(2)) disallow relief completely if any capital is recovered unless this section applies. If this section applies, (and it applies to most recoveries), then relief is only reduced in the proportion that the amount of the recovery bears to the amount of the loan (or, where only part of the loan qualified, to the qualifying part of the loan).

1143. The source legislation restricted the application of this rule to cases where the recovered capital was not applied in making a loan repayment. In cases where the recovered capital was so applied relief was, in strictness, lost completely. The rule has been rewritten to ensure that it applies in all cases where capital is recovered. See *Change 74* in Annex 1.

1144. *Subsection (6)* makes it clear that this provision applies only if section 407 treats an amount of capital as having been recovered from the business entity.

### **Section 407: Events counting as recovery of capital for section 406**

1145. This section explains which events count as the recovery of capital for the purposes of section 406. It is based on section 363(2) of ICTA.

1146. *Subsection (1)* identifies the cases relating to an investment in a company (whether a close company or employee-controlled), *subsection (2)* identifies the cases relating to an investment in a partnership and *subsection (3)* identifies the cases relating to an investment in a co-operative.

1147. *Subsection (4)* provides that if there is a sale or assignment that is not at arm's length, market value consideration is used instead of actual proceeds. Section 1008(1) provides that in Scotland "assignment" means "assignation".

### **Section 408: Replacement loans**

1148. This section makes provision for cases where a loan, interest on which would be eligible for relief under some provisions of this Chapter, is used in repaying another qualifying loan. It is based on section 363(4) of ICTA.

1149. *Subsection (3)* ensures that the two loans are treated as a single loan for the purposes of this Chapter. In order that this rule works correctly when looking at how the proceeds are applied, it is subject to *subsection (5)* under which references to the use of a loan are generally taken as referring to the use of the original loan.

1150. *Subsection (4)* makes it clear that any restriction under section 406 (recovery of capital) applies if capital is recovered while the second loan is in place.

### **Section 409: Business successions between partnerships**

1151. This section ensures continuity of relief in certain cases where, in law, a partnership is dissolved. It is based on ESC A43.

1152. Under section 362 of ICTA, relief for interest paid is only available for so long as the individual is a partner in the partnership in which the investment is made. In strictness, the

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admission or departure of a partner results in a new partnership, but it has never been the practice to refuse relief in these circumstances. Indeed, ESC A43 goes further and allows relief to continue when there is a partnership reconstruction involving a merger or demerger.

1153. *Subsections (1) and (2)* of this section gives statutory effect to current practice and ESC A43 to the extent that they relate to partnership changes and reconstructions. See *Change 75* in Annex 1.

1154. *Subsection (3)* builds into the section the extended meaning of “member of a partnership” that is explained in *Change 70* in Annex 1. See also the commentary on section 399.

1155. ESC A43 also deals with other types of business successions including the incorporation of a partnership. These cases are addressed in section 410.

#### **Section 410: Other business successions and reorganisations**

1156. This section ensures continuity of relief in certain cases where a partnership is incorporated into another of the business entities covered by this Chapter. It is based on ESC A43.

1157. Under each of the sections in the source legislation dealing with investments in (including loans to) qualifying business entities, relief for interest paid is only available for so long as the shares are held in or the loan is made to the original business entity. In the case where the investment is in a partnership, the individual must remain a partner in the partnership in which the investment is made.

1158. It follows that relief strictly ceases to be available if a partnership is incorporated into one of the other types of qualifying business entity or there is a reconstruction in which the individual’s original shares are replaced by shares in a different qualifying business entity. This rule is relaxed by ESC A43 which allows relief to continue if this sort of business succession occurs. This section legislates that part of ESC A43. See *Change 75* in Annex 1 and the commentary on section 409.

1159. This section only applies to genuine business successions. It is not considered to apply if an investment in one entity is replaced by another investment within the same entity. An example is the conversion of convertible loan stock into ordinary shares.

#### **Section 411: Ineligibility of interest where business is occupation of commercial woodlands**

1160. This section rules out relief if certain of the business entities covered by this Chapter carry on the business of the commercial occupation of woodlands. It is based on paragraph 3 of Schedule 6 to FA 1988.

1161. The section applies if the loan is invested in a close company, an employee-controlled company or a partnership, and excludes relief for what is in effect an investment into an entity carrying on a tax-exempt activity. This section also provides rules that apply if only part of the business is the exempt activity.

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## **Section 412: Information**

1162. This section makes provision for the lender of a loan covered by this Chapter to provide information to the borrower on request. It is based on section 366 of ICTA.

1163. The source legislation requires the person claiming relief to submit to an officer of Revenue and Customs a written certificate from the lender containing details of the debt and interest. Under Self Assessment, such statements are not generally required. Such a certificate will only be required when an officer raises enquiries into the return or the claim. The provision has therefore been recast in terms of the claimant being able to obtain a certificate from the lender if he or she needs or wants to do so. Lenders will no longer need to issue certificates routinely.

## **Chapter 2: Gift aid**

### ***Overview***

1164. This Chapter gives relief for some gifts of money by individuals to charities. It is based on section 25 of FA 1990, section 98 of FA 2002 and section 83 of FA 2004.

## **Section 413: Overview of Chapter**

1165. This section provides an overview of the Chapter. It is new.

1166. *Subsection (2)* points to section 414, which sets out how the relief works.

1167. Under section 414(2)(a), the gift is treated as paid after deduction of income tax. If the tax treated as deducted from the gift is greater than the income tax and capital gains tax to which the individual is liable, the excess is recovered. Under these rules, signposted by *subsection (3)*:

- the donor may suffer the restriction of certain other reliefs (including personal allowances); and
- if the tax treated as deducted from gifts exceeds the income tax and capital gains tax to which the donor is liable, additional income tax will be charged.

1168. The position of the charity receiving the gift is not addressed in this Chapter. The rules about charitable trusts are in Part 10 of this Act. The rules about charitable companies remain in the source legislation, as indicated by *subsection (5)*.

## **Section 414: Relief for gifts to charity**

1169. This section sets out the relief. It is based on section 25(6) of FA 1990.

1170. *Subsection (1)* sets out the basic requirement for the relief, which is that the gift should be a “qualifying donation” (see section 416).

1171. *Subsection (2)(b)* provides that the individual’s basic rate limit is increased by the amount of the gift grossed up at the basic rate of income tax. As a result, an amount of income up to that amount is taxed at either the dividend ordinary rate, the savings rate or the basic rate, rather than at the higher rate or the dividend upper rate.

1172. If “top slicing relief” is claimed on gains under life assurance policies etc (sections 535 to 537 of ITTOIA), relief under this Chapter is ignored for the purposes of the

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computations required by section 535(1) of ITTOIA. See section 535(7) of ITTOIA, inserted by Schedule 1 to this Act.

#### **Section 415: Meaning of “grossed up amount”**

1173. This section provides the meaning of references to “the grossed up amount” of a gift. It is based on section 25(12)(d) of FA 1990.

#### **Section 416: Meaning of “qualifying donation”**

1174. This section sets out the meaning of “qualifying donation”. It is based on section 25(1) and (2) of FA 1990.

1175. Condition C excludes the possibility of a double claim for relief under these provisions and also under the payroll deduction scheme.

1176. Condition D enacts the principle that, to be a qualifying donation, the payment must not also be deductible in arriving at the individual donor’s income from any source. See *Change 76* in Annex 1.

1177. Condition E denies relief if the donor, or any person associated with the donor, disposes of any property to the charity for any consideration. This prevents any overlap between this relief and the relief for gifts of assets in Chapter 3 of this Part.

#### **Section 417: Meaning of “benefits associated with a gift”**

1178. This section defines what is meant by one or more benefits being “associated with” a gift. It is based on section 25(2) and (4) of FA 1990.

#### **Section 418: Restrictions on associated benefits**

1179. This section sets out two conditions which, if either is met, mean that the restrictions on benefits associated with a gift are breached (condition F of section 416). It is based on section 25(2), (4), (5) and (5A) of FA 1990.

1180. The two conditions are:

- a stepped scale, depending on the amount of each gift (Condition A) – the “benefit per gift” test; and
- an overall monetary limit on benefits associated with the total of any gifts to a single charity in the course of a tax year – the “benefit per year” test (Condition B). This is unrelated to the size of any particular gift.

1181. Both these restrictions apply to any benefit “associated with” a gift. Sections 420 and 421 remove certain benefits consisting of admission rights from the application of both restrictions.

#### **Section 419: Gifts and benefits linked to periods of less than 12 months**

1182. This section modifies the application of section 418(2) where gifts or benefits are linked to periods of less than 12 months. It is based on section 25(5B) to (5D) of FA 1990.

1183. The section provides, according to the case, for annualising:

- the actual amount of the gift; or

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- both the amount of the gift and the value of the benefit(s) associated with the gift.

1184. Only the annualised amount in each case is to be compared with the cash limits given in section 418(2). This prevents periods of less than 12 months being used to exploit the cash limits.

1185. *Subsection (8)* states the formula for annualising in each case. In the source legislation some of the conditions in the section could overlap, so that more than one condition could apply to the gift(s) and associated benefit(s) concerned. A priority rule is, therefore, provided. See *Change 77* in Annex 1.

### **Section 420: Disregard of certain admission rights**

1186. This section ensures that a benefit consisting of a relevant admission right is ignored for the purposes of the Chapter, so that a donation to a charity with which such a benefit is associated may be a qualifying donation regardless of the value of the benefit. It is based on section 25(5E) to (5I) of FA 1990.

1187. Condition B contains no general qualification relating to the purposes of the recipient charity. But property, as defined in *subsection (6)*, must be preserved, maintained, kept or created by the charity for those charitable purposes.

1188. In Condition C (further provisions about which are in section 421(2) to (4)), the right of admission must apply for at least 12 months whenever admission is available to members of the public who have not made such a gift.

1189. But in Condition D there is no time period. For the meaning of the “same right of admission” see section 421(5).

### **Section 421: Admission rights: supplementary**

1190. This section provides supplementary material about Conditions C and D in section 420. It is based on section 25(5I) and (5J) of FA 1990.

1191. *Subsections (2) to (4)* deal with cases when event days could be held to interrupt the availability of a right of admission, reducing it to a period of less than 12 months and thus breaching Condition C. The applicable period is not regarded as broken if there are no more than five event days in it.

### **Section 422: Disqualified overseas gifts**

1192. This section provides the rules for Condition G in section 416(8). It is based on section 25(2) of FA 1990.

1193. In addition to the other conditions for a qualifying donation in sections 416 to 421, this section imposes a specific test that must be met in the case of a gift (an “overseas gift”) made by a donor who is neither UK resident nor in Crown employment.

1194. The source legislation provides that, for the gift to be a qualifying donation, its grossed up amount would, if paid, be “payable out of profits or gains brought into charge to income tax or capital gains tax”. This is rewritten as a reference to the gift being disqualified if it results in the sum of the grossed up amounts of any overseas gifts being more than the individual’s charged amount (see section 427) for the tax year. This is in keeping with the

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approach adopted towards the parallel rule in the source legislation for charges on income in its application to individuals (see *Change 81* in Annex 1 and the commentary on section 425).

### **Section 423: Restriction of certain reliefs**

1195. This section restricts certain reliefs, where necessary to ensure that the individual pays enough tax to match any tax which might be refunded to the charities receiving the gifts. It is based on section 25(6)(c) of FA 1990.

1196. The section operates if the amount of income tax treated as deducted from an individual's gifts, "amount A" in *subsection (2)*, is greater than "amount B".

1197. The source legislation does not expressly say how "amount B" is to be calculated. This section makes clear that the only difference between "amount B" (from section 25(6)(c) of FA 1990) and "amount C" in section 424 (from section 25(9) of that Act) is that "amount B" is calculated before any restriction of personal reliefs under this section. See *Change 78* in Annex 1 and the commentary on section 425.

1198. So "amount B" is:

- the income tax liability as defined in section 425 but *before* applying any reduction in reliefs under this section; plus
- the capital gains tax liability.

1199. Section 25(6)(b) and (7) of FA 1990 are not rewritten. These provisions relate to certain of the tax reductions listed in section 27(5) of this Act. The effect of the relevant provisions in section 25(6)(b) and (7) of FA 1990 is achieved by the operation of sections 23 and 425(2) of this Act.

1200. The reliefs listed in *subsection (5)* are to be reduced only to the extent necessary. If all such available reliefs are extinguished and the liability still falls short of amount A, a charge to income tax arises under section 424.

### **Section 424: Charge to tax**

1201. This section operates to charge the donor with income tax in the amount of any remaining shortfall after the operation of section 423. It is based on section 25(8) of FA 1990.

1202. Instead of "amount B" as in section 423, the comparison is now with "amount C", which is the tax liability *after* applying section 423. That liability includes the income tax liability as adjusted in accordance with section 425.

1203. The charging provision operates directly in terms of an amount of tax, rather than (as in the source legislation) by way of charging an amount of deemed income.

### **Section 425: Total amount of income tax to which individual charged for a tax year**

1204. This section provides for the adjustments to the individual donor's income tax liability in order to arrive at "amount B" in section 423 and "amount C" in section 424. It is based on section 25(9) of FA 1990.

1205. As part of the clarification of how these amounts are calculated, section 25(9)(c) of FA 1990 has been dropped as anomalous. See *Change 78* in Annex 1 and the commentary on section 423.

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1206. Section 25(9)(a) of FA 1990 is not rewritten. That provision dealt with tax charged at the basic rate by virtue of sections 348 or 349 of ICTA. As a result of the new approach to charges on income such tax is no longer dealt with as part of a person's liability. See *Change 81* in Annex 1.

#### **Section 426: Election by donor: gift treated as made in previous tax year**

1207. This section provides that an individual may elect that a qualifying donation made in one tax year be treated as having been made in the preceding tax year ("year P"). It is based on section 98 of FA 2002.

1208. A test similar to that in section 422 must be met in year P for an election to be valid. Because of the possibility that other qualifying donations will have been made in year P, and will not themselves have been carried back to "year P minus 1", the language in which the test is expressed differs slightly from that in section 422. Hence the references to the "increased total of gifts".

1209. *Subsection (4)*, concerning the increased total of gifts, also has to take into account the possibility that elections are made when a notice under section 8 of TMA has not been issued and there is no other legal duty to notify liability to tax or file a self-assessment return. In that case, instead of being included in the self-assessment return under section 42(2) of TMA, elections may be made otherwise (under Schedule 1A to TMA), which opens up the possibility of a number of elections being made in respect of separate donations in the same year.

1210. In the case of non-residents to whom section 422 applies, if a donation does not meet the test set out in section 422(3) in the tax year in which the gift is made, it cannot be carried back in this way. In such a case the donation would not be "qualifying" and so would fail the condition in *subsection (1)(a)* of this section.

1211. An election must be made before the actual filing date of the self-assessment tax return for year P (if a self-assessment return is made for that year), and in any case before the normal self-assessment filing date for year P. The requirement in section 98(2) of FA 2002 that the election "be made by notice in writing to an officer of the Inland Revenue" is catered for by paragraph 2(1) of Schedule 1A to TMA.

1212. In all cases the charity is treated as receiving the donation, not in year P, but in the tax year of payment. It is in respect of the year of payment that the charity will, if appropriate, be entitled to an income tax repayment in respect of the donation.

#### **Section 427: Meaning of "charged amount"**

1213. This section provides the basic calculation rules to establish the individual's charged amount for the purposes of the tests in sections 422 and 426. It is based on section 25(2) of FA 1990 and section 98(3) of FA 2002.

1214. The detailed rules for establishing the individual's modified net income are contained in section 1025 in Part 17, which defines this term (as used in *subsection (2)* of this section) for this and certain other purposes. See the commentary on that section.

1215. The basic rule is to add together the "modified net income" established under section 1025 and the amount on which the individual is chargeable to capital gains tax. This amount

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is then compared with the “overseas gifts total” in section 422(4), or the “increased total of the gifts” in section 426(4), as appropriate.

### **Section 428: Meaning of “gift aid declaration”**

1216. This section provides the definition of “gift aid declaration” in section 416(1)(b), and states the powers under which the Commissioners for Her Majesty’s Revenue and Customs may make related regulations. It is based on section 25(3) and (3A) of FA 1990.

1217. The regulations currently in force for these provisions are:

- the Donations to Charity by Individuals (Appropriate Declarations) Regulations 2000 (SI 2000/2074); and
- the Donations to Charity by Individuals (Appropriate Declarations) (Amendment) Regulations 2005 (SI 2005/2790), which remove the requirement on charities to send to donors a written record of their oral declarations.

### **Section 429: Giving through self-assessment return**

1218. This section makes provision for individuals to require all or part of any tax repayment arising as a result of a self-assessment return to be paid to a listed charity. It is based on section 83 of FA 2004.

1219. For the effect of this provision where the gift is received by a charitable trust, see section 538(3) and the commentary on that section.

### **Section 430: “Charity” to include exempt bodies**

1220. This section provides that the bodies mentioned in *subsection (1)* are to be treated as charities for the purposes of this Chapter. It is based on section 507(1) of ICTA, section 25(12) of FA 1990 and paragraph 9 of Schedule 18 to FA 2002.

1221. References to the Trustees of the British Museum and of the Natural History Museum appear in section 507(1) of ICTA along with the other three bodies named in subsection (1)(a) to (c) of this section. Section 507 gives exemption to all the bodies named there from corporation tax in line with the exemptions afforded to charities under section 505 of ICTA.

1222. By contrast, the ability to receive gift aid donations is given to any charity if the purposes for which it is established are fully charitable. In the case of the British Museum and the Natural History Museum this is so: see the relevant sections of the British Museum Act 1963. But in the other cases it is more doubtful whether their functions as set out in their foundation Acts are solely charitable. So it is only the names of those bodies which are included in this section. See *Change 79* in Annex 1.

1223. Similar provisions apply in the case of gifts of shares, securities and land to charities: see section 446 in Chapter 3 of this Part.

## **Chapter 3: Gifts of shares, securities and real property to charities etc**

### ***Overview***

1224. This Chapter gives relief to individuals making gifts of shares, securities and real property to charities, or disposing of such assets to charities at an undervalue. It is based on sections 587B and 587C of ICTA 1988.

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### **Section 431: Relief for gifts of shares, securities and real property to charities etc**

1225. This section sets out the relief. It is based on section 587B(1) and (2) of ICTA.

1226. *Subsection (1)* provides that relief is available if an individual disposes of the whole of the beneficial interest in a qualifying investment to a charity and makes a claim. The rule in section 587B(2) of ICTA that the claim must “be made to an officer of the Inland Revenue” is catered for by paragraph 2(1) of Schedule 1A to TMA.

1227. *Subsection (2)* provides that relief for the “relievable amount” is given as a deduction in calculating net income.

1228. If “top slicing relief” is claimed on gains under life assurance policies etc (sections 535 to 537 of ITTOIA), relief under this Chapter is ignored for the purposes of the computations required by section 535(1) of ITTOIA. See section 535(7) of ITTOIA, inserted by Schedule 1 to this Act.

### **Section 432: Meaning of “qualifying investment”**

1229. This section lists the types of investment that can attract relief. It is based on section 587B(9) of ICTA.

### **Section 433: Meaning of “qualifying interest in land”**

1230. This section defines “qualifying interest in land”. It is based on section 587B(9A) to (9E) of ICTA.

1231. *Subsections (2) and (3)* clarify the position where an individual with a beneficial interest in an estate in land gives that beneficial interest to a charity along with any easement, servitude or right that benefits the land. For example, A’s land may only be accessible by way of an easement over B’s land. If A gives the charity both the land and the right over B’s land, the disposal of the right is treated as a separate disposal.

1232. If an individual with a freehold or leasehold interest carves out of that interest a lease for the benefit of the charity, the retention of a freehold or leasehold reversion will not prevent the disposal from being “of the whole of the beneficial interest”. But an agreement to acquire a freehold, or an agreement for a lease, is not enough to constitute a disposal.

### **Section 434: The relievable amount**

1233. This section sets out how to calculate the relievable amount, firstly in cases where the qualifying investment is transferred to the charity by way of gift (*subsection (1)*), and then where there is consideration for the transfer (*subsection (2)*). It is based on section 587B(4) to (7) of ICTA.

1234. In each case, the computation starts with the value of the net benefit to the charity (V), either directly (as in *subsection (1)*) or in arriving at E (the excess of V over the consideration for the disposal) in *subsection (2)*.

1235. The detail of how V is calculated is in sections 437 to 440. But it is emphasised in the definition of V in *subsection (1)* that V must be considered both at, and immediately after, the time of the disposal.

1236. *Subsection (3)* makes it explicit that if the amount given by either formula is negative the relievable amount is nil.

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1237. The treatment of incidental costs of disposal depends on whether the transfer is by way of gift or at an undervalue. If it is a gift, all the incidental costs are added in arriving at the relievable amount. But if there is consideration for the disposal, there is an interplay between the capital gains tax treatment and the incidental costs.

1238. Under section 257(2)(a) of TCGA a gift of a qualifying investment to a charity is treated as being for such a consideration as will result in neither a loss nor a gain to the donor. Incidental costs are added only if that deemed consideration is greater than the actual consideration. But the amount added must not be greater than that excess. C is defined (in *subsection (4)*) to achieve this result.

### **Section 435: Incidental costs of making disposal**

1239. This section defines “the incidental costs of making the disposal to the individual making it”. It is based on section 587B(9) of ICTA.

1240. The section reproduces the material in section 38(2) of TCGA to which section 587B(9) cross-refers, with the exception of the reference to stamp duty and stamp duty land tax, which do not apply to transactions within this Chapter.

### **Section 436: Consideration**

1241. This section defines “consideration”. It is based on section 587B(7)(b) of ICTA.

1242. The section reproduces the relevant material in section 48 of TCGA (consideration due after time of disposal), to which section 587B(7)(b) cross-refers. The main thrust of section 48 of TCGA is that full value is to be introduced into the computation of the gain. Only on a subsequent claim is the consideration to be reduced, either because the right to receive any amount is contingent or because any part of the consideration proves to be irrecoverable.

### **Section 437: Value of net benefit to charity**

1243. This section is the first of four sections concerned with defining the value of the net benefit to the charity. It is based on section 587B(8A) and (8B) of ICTA.

1244. In the simple case, where there are no disposal-related obligations, the value of the net benefit to the charity is the market value of the qualifying investment. As indicated in section 434, this has to be considered both at, and immediately after, the disposal.

1245. If the charity is, or becomes, subject to an obligation that is connected with the disposal of the qualifying investment to the charity, the market value of the investment is reduced by the amount of the disposal-related liabilities (see section 440) brought about by the obligation. These obligations also must be considered both at, and immediately after, the disposal.

### **Section 438: Market value of qualifying investments**

1246. This section sets out how the market value of qualifying investments is to be determined. It is based on section 587B(10) and (11) of ICTA.

1247. The methods are those laid down in sections 272 to 274 of TCGA. If an offshore fund publishes buy and sell prices, it is in effect subject to the same treatment as a unit trust

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scheme as laid down by section 272(5) of TCGA. The provisions of that subsection are reproduced here.

#### **Section 439: Meaning of “disposal-related obligation”**

1248. This section defines “disposal-related obligation”. It is based on section 587B(8B) to (8D) and (9) of ICTA.

1249. The obligation undertaken by the charity may be any scheme, arrangement or understanding of any kind, regardless of whether it is legally enforceable. The word “obligation” also includes a reference to a series of obligations, whether or not between the same persons. It may also be contingent (see section 440(2)).

#### **Section 440: Meaning and amount of “disposal-related liability”**

1250. This section defines “disposal-related liability”. It is based on section 587B(8E) to (8G) of ICTA.

1251. *Subsection (2)* deals with contingent disposal-related obligations.

1252. It is in the nature of a contingency that it may occur after the time of disposal; hence the words “at any time”. If a contingency occurs later than immediately after the disposal, but existed as a possibility at the time of disposal, the value of the net benefit to the charity at the time of, or immediately after, the disposal must be reduced; and all necessary adjustments must be made to give effect to this. Conversely, if the contingency does not occur, to that extent there will be no obligation and no liability.

#### **Section 441: Certificate required from charity**

1253. This section, which is the first of four that deal specifically with qualifying interests in land, requires any claim for relief in relation to a qualifying interest in land to be supported by a certificate from the charity. It is based on section 587C(1), (4) and (5) of ICTA.

#### **Section 442: Qualifying interests in land held jointly**

1254. This section deals with land held by joint tenants or by tenants in common. It is based on section 587C(1) to (3) of ICTA.

1255. Relief is given only if each joint tenant, or tenant in common, disposes of the whole of that person’s beneficial interest in the land. This applies whether the relief is claimed by an individual under this Chapter, or by a company under sections 587B and 587C of ICTA.

1256. It is provided that there must be an agreement between all the tenants eligible for relief (whether individuals or not, and whether joint or in common) as to the share of the relief attributable to each tenant. To the extent that there is no such agreement between the owners entitled to relief, there is no relief under this Chapter, or under sections 587B and 587C of ICTA.

1257. The relief is available to individuals under this Chapter and to companies under sections 587B and 587C of ICTA, but not to other persons. So it is necessary in the case of joint disposals to set out a method to determine whether all beneficial interests have been disposed of. To that end, and to ensure that the total relief given under this Chapter and the corresponding provisions of ICTA is not excessive, it is provided that, for this purpose only, the rules defining “qualifying interest in land” in section 433(2) to (4) are to apply to all

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owners as if they were individuals. See also *Change 80* in Annex 1 and the commentary on section 443.

#### **Section 443: Calculation of relievable amount where joint disposal of interest in land**

1258. This section provides details of the method of calculation of the “relievable amount” in cases where there is a joint disposal of an interest in land. It is new.

1259. The method involves calculating the relievable amount as if there is a disposal by a single person, and then adjusting the amount to take account of only those owners who qualify for relief. See *Change 80* in Annex 1.

#### **Section 444: Disqualifying events**

1260. This section provides for the recovery of relief if a “disqualifying event” occurs within the “provisional period”. It is based on section 587C(1) and (6) to (10) of ICTA.

1261. In the simplest case, such an event occurs if any of the persons who made the disposal are entitled to buy the land back from the charity at an undervalue.

#### **Section 445: Prohibition against double relief**

1262. This section establishes the priority of this Chapter over any other provisions under which relief might be claimed. It is based on section 587B(2)(b) of ICTA.

1263. *Subsection (2)* is a signpost to the effect on the chargeable gains position of the charity of the rules in section 587B(3) of ICTA. See section 257 of TCGA as amended by Schedule 1 to this Act.

#### **Section 446: “Charity” to include exempt bodies**

1264. This section extends the relief given by the Chapter to certain bodies set up by Act of Parliament even though they are not charities. It is based on section 587B(9) of ICTA.

1265. The references to the British Museum and the Natural History Museum (originally in section 507(1) of ICTA, to which section 587B(9) of that Act cross-refers) are no longer required, since those bodies are established for charitable purposes. Their omission does not affect the exemption from corporation tax given by section 507 of ICTA. See *Change 79* in Annex 1 and the commentary on section 430.

### **Chapter 4: Annual payments and patent royalties**

#### ***Overview***

1266. This Chapter provides for relief for certain annual payments and patent royalty payments by deduction in calculating net income. These rules are coupled with those providing for deduction of tax at source from the payments: see Chapter 6 of Part 15 and the related commentary.

1267. The scheme of the source legislation relating to charges on income (which owes its origins to the historic concept of alienation of income) is replaced with a deduction in calculating net income. See *Change 81* in Annex 1.

1268. This Chapter distinguishes between individuals and other persons. One reason for this is that section 347A of ICTA provides that, with certain exceptions, an annual payment made by an individual (or personal representatives) is not to be a charge on the income of the

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person liable to make it. And there is a similar rule concerning the recipient in section 727 of ITTOIA. But those rules do not apply to payments by other persons. See the commentary on sections 900, 901, and 903.

1269. In addition, the rules about when payments are regarded as being, or not being, made out of profits or gains brought into charge to income tax distinguish between the position of individuals and other persons in the light of the case law.

#### **Section 447: Overview of Chapter**

1270. This section provides an overview of the Chapter. It is new.

#### **Section 448: Relief for individuals**

1271. This section provides for relief by deduction from income if an individual pays an annual payment for commercial purposes (see section 900) or pays a patent royalty (see section 903). It is based on section 348 of ICTA.

1272. The income tax in respect of the payment is collected as part of the individual's self-assessment by way of Chapter 17 of Part 15. See *Change 81* in Annex 1 and the overview commentary on this Chapter.

1273. The term "gross amount of the payment" is defined in section 452.

1274. In the source legislation a number of types of income are treated as not brought into charge to income tax and so are not available to cover charges on income. To preserve the effect of the source legislation, it is necessary to prevent the deduction being given against such "non-qualifying income". *Subsection (3)* introduces these by referring to *subsection (4)* and to section 451.

1275. *Subsection (4)* gives a signpost to section 1025 which, together with section 1026, provides that such income cannot form part of "modified net income". So it cannot give occasion for relief. See the commentary on section 1025.

#### **Section 449: Relief for other persons**

1276. This section provides for relief by deduction from income in the case of persons other than individuals. It is based on section 348 of ICTA.

1277. *Subsection (1)(c)* works together with the repeal of section 51 of ITTOIA to align the approach to patent royalties with that for annual payments. See *Change 81* in Annex 1.

1278. *Subsection (5)* mirrors the rule about "modified net income" in the previous section.

#### **Section 450: Other persons: payments ineligible for relief**

1279. This section rewrites the rule in the source legislation about when payments are regarded as being, or not being, made out of profits or gains brought into charge to income tax. It is new.

1280. In the case of an individual one need go no further than ask whether the individual has income, as noted in *Change 82* in Annex 1. But the position is more complex in the case of persons other than individuals.

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1281. *Subsection (2)* provides that if a payment can lawfully only be made out of capital, or out of exempt income, relief will not be given: see *Change 82* in Annex 1 in connection with Sugden v Leeds Corporation (1913), 6 TC 211 HL.

1282. *Subsection (3)* provides that, if a person other than an individual makes a payment within this Chapter that is charged to capital, it is to that extent denied relief. This principle appears in Chancery Lane Safe Deposit and Offices Co Ltd v CIR (1965), 43 TC 83 HL and related cases: see *Change 82* in Annex 1.

1283. *Subsection (4)* provides for cases where the taxpayer has treated a payment as having been made out of exempt income, and this has had an effect on the actual or contingent rights or obligations of any person. Relief in such cases is denied on the authority of CIR v Ayr Town Council (1938), 22 TC 381 CS: see *Change 82* in Annex 1 concerning that and related cases.

1284. *Subsection (5)* deals with subsidy cases, where payment is made but the payer is reimbursed for the gross amount in a form that is not taxable in the payer's hands. To permit such cases would in effect give double relief: see *Change 82* in Annex 1 as regards Corporation of Birmingham v CIR (1930), 15 TC 172 HL and related cases.

#### **Section 451: Special rule for persons affected by section 733 of ICTA**

1285. This section is based on section 733(2) of ICTA.

1286. Sections 731 to 735 of ICTA are anti-avoidance provisions. They are concerned with cases where:

- a person (“the first buyer”) buys securities and subsequently sells them to someone else; and
- the first buyer becomes entitled to receive any interest payable on them.

1287. Section 733(2) addresses the case where:

- interest (the “affected income”) is payable to the first buyer;
- that interest, or some part of it, would be exempt, but is not so, because section 733(1) cancels the exemption; and
- the first buyer makes an annual payment in the same tax year as that in which the interest arises.

1288. The source legislation provides that an annual payment is to be treated as paid out of profits or gains not brought into charge. It follows that, even though the exemption is cancelled by section 733(1), leaving interest in charge to income tax, the annual payment must not be treated as paid out of that interest.

1289. This is rewritten so that relief is only given if, and to the extent that, the person has “non-affected income” equal to the annual payment. Non-affected income is defined as modified net income less affected income. On modified net income, see the commentary on sections 448 and 1025.

1290. Because this is a rule relating to a very specific type of income, it is necessary to apply it before applying the provisions referred to in *subsection (4)*.

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## **Section 452: The gross amount of a payment**

1291. This section provides, for the purposes of this Chapter, that the gross amount of a payment is the amount of the payment before deduction of income tax. It is new.

## **Chapter 5: Qualifying maintenance payments**

### ***Overview***

1292. This Chapter provides relief as a tax reduction at Step 6 of the tax calculation (see section 23) for individuals who make qualifying maintenance payments. It is based on section 347B of ICTA.

1293. Maintenance payments have been exempt from income tax since 6 April 2000. And in general no relief is available for those who pay them. But a measure of relief remained available if at least one party to a marriage was 65 or over before 6 April 2000, in line with corresponding changes made at the same time to married couple's allowance.

1294. Since 5 December 2005, when the Tax and Civil Partnership Regulations 2005 came into force, relief has been extended to civil partners. And, in relation to payments for children, it was also extended to cover payments between parents who were never married and payments between any two individuals if the child was treated as a child of their family.

1295. The transitional arrangements in section 38 of FA 1988 for maintenance paid under obligations that existed in 1988 came to an end on 5 April 2000 (see section 36 of FA 1999) and are spent. Accordingly, they are repealed by this Act.

## **Section 453: Tax reduction for qualifying maintenance payments**

1296. This section provides for a tax reduction if an individual makes qualifying maintenance payments. It is based on section 347B(2), (3) and (5A) of ICTA.

1297. Relief has to be claimed and is given for the year in which the payments are due. The relief is 10% of the amount of the payments, but is capped by reference to the minimum amount of married couple's allowance for the year. For 2006-07 that amount is £2,350 so the maximum tax reduction is £235.

1298. The rules in section 347(5A) and (5B) of ICTA giving the priority between this relief and other tax reductions, and providing that relief cannot reduce liability below nil, are not set out here. They are contained in the general rules applying to all tax reductions in Chapter 3 of Part 2.

## **Section 454: Meaning of "qualifying maintenance payment"**

1299. This section sets out the conditions that must be satisfied for relief to be due. It is based on section 347B(1), (1A), (7), (8) and (11) of ICTA.

1300. Condition A requires that the payment be paid either for the maintenance of a party to the marriage or civil partnership or for the maintenance of a child.

1301. In relation to payments for the maintenance of the other party to the marriage or civil partnership, they must be made to the other party.

1302. In relation to payments for the maintenance of a child, they must be made by one parent to the child's other parent or be between any two persons for the maintenance of a

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relevant child of theirs. “Relevant child” is defined in *subsection (9)*. Relief is not due if the order or agreement provides for payments direct to a child.

1303. Condition C requires the payment to be made under certain types of court order or written agreement that apply in member States. Later subsections provide that payments under child support legislation are also included.

1304. Condition D specifies that, in relation to a payment for the other spouse or civil partner, the parties must not be a married couple living together or civil partners living together. If the marriage or civil partnership has formally ceased, the recipient must not have remarried or entered into a new civil partnership (whether or not that new marriage or civil partnership has since come to an end). If the payment is for a child, the condition is that the payer and the recipient are not living together.

1305. Condition E specifies that relief must not be due for the payment under any other provision. This caters for the possibility that the payment of interest on a loan to buy an annuity for the other party (and for which relief is due under section 365 of ICTA) may constitute maintenance.

1306. *Subsections (7) and (8)* provide that maintenance calculations made under the Child Support Act 1991 and maintenance assessments made under the Child Support (Northern Ireland) Order 1991 (SI 1991/2628(NI 23)) are treated as made under a court order. The transitional provision in Part 9 of Schedule 2 ensures that maintenance assessments in the rest of the United Kingdom which have not yet been replaced by maintenance calculations are treated in the same way.

1307. In the source legislation for subsection (7) the reference was to an order made by a court in the United Kingdom. It is here replaced by a reference to a court in a member state to tie in with the wording in subsection (4). This is not a change in the law.

#### **Section 455: Child support maintenance payments**

1308. This section ensures that condition A in section 454 is treated as satisfied in certain cases where the maintenance payment for a child is not made to the other party. It is based on section 347B(9) and (10) of ICTA.

1309. In certain circumstances, the maintenance for a child may be paid instead to the Secretary of State or the Department of Health, Social Services and Public Safety for Northern Ireland. This section treats condition A as satisfied in those cases.

#### **Section 456: Payments under orders for recovery of benefit etc**

1310. This section treats condition A in section 454 as satisfied in relation to certain maintenance payments under “recovery of benefit orders”. It is based on section 347B(12) and (13) of ICTA.

1311. In certain circumstances, the party entitled to the maintenance may receive income support or jobseeker’s allowance which is recovered from the party liable to pay the maintenance under a “recovery of benefit order” (see *subsection (2)*). Such payments are treated as satisfying condition A.

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## **Chapter 6: Miscellaneous other reliefs**

### ***Overview***

1312. The first three sections of this Chapter concern relief for certain payments of an insurance-related nature, either by deduction in calculating net income or as a tax reduction. They are based on sections 266(7), 273, 274 and 278 of ICTA.

1313. Relief is given for parts of certain payments made to trade unions or police service organisations that go to provide life insurance, superannuation or funeral benefits. This relief is given by deduction in calculating net income.

1314. Relief is given for certain payments an individual is required to make to secure an annuity for a spouse or to provide for children after the individual's death. This relief is given as a tax reduction.

1315. The fourth section is the residence condition relating to those reliefs.

1316. The final section in this Chapter is a relief that may be claimed by the recipient of patent royalties. It is based on section 527 of ICTA.

1317. Section 266(6) and (6A) of ICTA provided relief for premiums paid under certain policies issued by friendly societies. These provisions are obsolete. Accordingly they are repealed by this Act.

1318. The remaining provisions of sections 266 to 274 of, and Schedule 14 to, ICTA are obsolescent. They have not been rewritten, and remain in ICTA.

### **Section 457: Payments to trade unions**

1319. This section provides a deduction in calculating net income if an individual makes a payment to a trade union of which part is attributable to the provision of superannuation, life insurance or funeral benefits. It is based on section 266(7) of ICTA.

1320. *Subsection (1)(c)* requires a claim to be made. The general rule in section 266(1), in the context of the relief given at source, is that claims are not required. This section brings the position in relation to section 266(7) of ICTA, which is administered through the self-assessment return, into line with practice. See *Change 83* in Annex 1.

1321. *Subsections (2) and (3)* provide that the amount of relief is one half of the qualifying part of the payment, subject to a maximum of £100. This simplifies many of the complexities of the existing limits provided by section 274(1) and (2) of ICTA. See *Change 84* in Annex 1.

1322. *Subsection (5)* defines a trade union. The 1974 Act referred to in section 266(7) of ICTA was repealed in 1992.

### **Section 458: Payments to police organisations**

1323. This section is based on section 266(7) of ICTA.

1324. The section is similar to section 457. But there is an additional requirement that the qualifying part of all the payments made in a particular tax year must be at least £20.

1325. *Changes 83 and 84* also apply to this section. See the commentary on section 457.

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### **Section 459: Payments for benefit of family members**

1326. This section provides relief as a tax reduction for certain payments an individual is required to make to provide benefits for a surviving spouse, civil partner or children after the individual's death. It is based on section 273 of ICTA.

1327. *Subsection (1)* explains that a tax reduction may be claimed if an individual is required under an Act or the conditions of employment to pay a sum or suffer a deduction from earnings to secure an annuity for a surviving spouse or civil partner or make provision for the individual's surviving children.

1328. The residence requirement from section 278 of ICTA is contained in subsection (1)(c) without any special provision for claims by non-residents to be made to the Commissioners for Her Majesty's Revenue and Customs. Claims may be made to any officer and appeals are not reserved to the Special Commissioners. This is achieved here by not specifying to whom claims are to be made. See *Change 5* in Annex 1.

1329. *Subsections (2) to (4)* specify that the relief operates as a tax reduction of an amount equal to income tax at the basic rate on the amount of all of the payments (or sums deducted) in the tax year, subject to a maximum of £100. The limit provided by section 274(1) and (2) of ICTA requires account to be taken of other qualifying insurance related payments in the year. That requirement has been removed. See *Change 84* in Annex 1 and the commentary on section 457.

1330. *Subsection (7)* defines the term "earnings" in subsection (1). The term "stipend" in the source legislation is interpreted in the context of the terms "salary" and "employment" and is therefore covered by the term "earnings". "Stipend" does not embrace income in the nature of a pension.

### **Section 460: Residence etc of claimants**

1331. This section sets out the residence-related requirement referred to in each of the previous three sections. It is based on section 278 of ICTA. *Subsections (2) and (3)* are the same as in section 56.

1332. Individuals who, under the source legislation, were able to claim the reliefs only by virtue of meeting the condition in section 278(2)(a) of ICTA are catered for by provisions remaining in ICTA, as amended by this Act. See the overview commentary on Part 3.

### **Section 461: Spreading of patent royalty receipts**

1333. This section allows the recipient of a lump sum patent royalty to claim a tax reduction if the royalty was for the use of the patent over a period of two years or more. It is based on section 527 of ICTA.

1334. The amount of the royalty is notionally spread equally over the number of complete years for which the use of the patent extended (up to a maximum of six). The total additional tax that would have been due on that basis is compared to the tax attributable to the whole royalty in the year of receipt. If it is less, a tax reduction equal to the difference is given.