

EXPLANATORY MEMORANDUM TO
THE INCOME TAX ACT 2007 (AMENDMENT) (NO. 2) ORDER 2009
2009 No. 2859

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

- 2.1 This instrument makes amendments to the Income and Corporation Taxes Act 1988 ("ICTA"), the Finance Act 2006 ("FA 2006") and the Income Tax Act 2007 ("ITA 2007").

- 2.2 The instrument corrects three minor errors in ICTA, one in FA 2006 and four in ITA 2007. One error concerns section 576D of ICTA, another concerns section 139 of FA 2006 and a third concerns section 424 of ITA 2007. The remaining errors fall into two groups, one concerning Chapter 3 of Part 2 of ITA 2007 and section 796 of ICTA and the other concerning section 777(13) of ICTA and sections 772(1) and 777(7) of ITA 2007.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

The amendments that are contained in the instrument take effect retrospectively from the date on which ITA 2007 came into force. The authority for this is contained in section 1029(4) of ITA 2007.

4. **Legislative Context**

- 4.1 The Tax Law Rewrite project was established in 1996. ITA 2007 was the project's fourth Act and the third relating to income tax.

- 4.2 The project's aim is to rewrite the United Kingdom's primary direct tax legislation to make it clearer and easier to use, without changing the law (apart from minor identified changes).

- 4.3 The amendments made by the instrument concern the following.

Section 576D of ICTA

- 4.4 Section 576D of ICTA (share loss relief: the control and independence requirement) was introduced by Schedule 1 to ITA 2007 for corporation tax purposes. It is based on section 293(8) in Chapter 3 of Part 7 of ICTA. Section 576D(1)(a) and (2)(a)(ii) of ICTA include references to connected persons. Before ITA 2007, section 312(2) of

ICTA provided that section 839 of ICTA (connected persons) applied, with certain exceptions not including section 293(8), for the purposes Chapter 3 of Part 7 of ICTA.

- 4.5 Section 839 of ICTA is rewritten for income tax purposes in section 993 of ITA 2007. It remains in force for corporation tax purposes, but only for the purposes of those provisions of the Corporation Tax Acts which apply it. Section 576D of ICTA, in error, did not include a provision applying section 839. Article 2(2) of the instrument amends section 576D of ICTA to apply section 839 of that Act for the purposes of section 576D.

Section 139 of FA 2006

- 4.6 This error relates to the rules about giving statements with information about manufactured dividends.
- 4.7. Paragraph 2 of Schedule 23A to ICTA makes provision about manufactured dividends on UK equities. In particular, before paragraph 2 was amended by ITA 2007, paragraph 2(6) to (8) required a dividend manufacturer, on paying a manufactured dividend to which paragraph 2(3) applied, to give the recipient a written statement with the information set out in paragraph 2(7). Paragraph 2(8) enabled the recipient to enforce this obligation. Paragraph 2(3) of Schedule 23A to ICTA restricted paragraph 2(6) to (8) to manufactured dividends to which paragraph 2(2) did not apply.
- 4.8. Section 139 of FA 2006 makes provision about manufactured dividends to the extent that they are “manufactured property income dividends”, ie representative of dividends paid by UK REITs to which the special rules about dividends paid by such companies apply. In particular, to the extent that they are manufactured property income dividends, section 139(2) of FA 2006 provides that paragraph 2(2) of Schedule 23A applies to them in modified form. Accordingly, before paragraph 2 of Schedule 23A to ICTA was amended by ITA 2007, paragraph 2(6) to (8) did not apply to manufactured dividends to the extent that they were manufactured property income dividends.
- 4.9. ITA 2007 split Schedule 23A to ICTA between income tax and corporation tax and, as part of this, paragraph 238(3)(d) of Schedule 1 to ITA 2007 omitted the words “to which sub-paragraph (3) above applies” in paragraph 2(6)(a) of Schedule 23A. Arguably, this has inadvertently extended the scope of paragraph 2(6) to (8) of that Schedule to manufactured dividends to the extent that they are manufactured property income dividends. Article 3 of the instrument amends section 139 of FA 2006 to exclude the application of paragraph 2(6) to (8) of Schedule 23A to ICTA to manufactured property income dividends.

Chapter 3 of Part 2 of ITA 2007 and section 796 of ICTA

- 4.10 This error concerns the limits on amounts of tax reducer reliefs imposed under four provisions (“the limiting provisions”).

- 4.11 Three of the limiting provisions relate to venture capital scheme reliefs. They are section 289A(5)(e) of ICTA (enterprise investment scheme: form of relief), paragraph 1(6)(f) of Schedule 15B to ICTA (venture capital trusts: entitlement to claim relief on investment) and paragraph 19(6)(d) of Schedule 16 to the Finance Act 2002 (community investment tax relief: form of relief: individual investors) as in force before ITA 2007. These limiting provisions are in similar terms and provide that, in determining the amount of tax to which the taxpayer would have been liable before the relief by way of tax reduction given by that section or those paragraphs, no account is to be taken of any tax at the basic rate on so much of that person's income as is income the income tax on which he is entitled to charge against any other person or to deduct, retain or satisfy out of any payment. All these three limiting provisions were repealed by ITA 2007 without being rewritten. This was on the basis that they were no longer necessary since, in section 23 of ITA 2007, relief for charges on income is given at Step 2 before EIS relief, VCT relief and community investment tax relief are given at Step 6.
- 4.12 The fourth limiting provision is section 796(3) of ICTA which as in force before ITA 2007 provided that the total credit for foreign tax to be allowed to a person against income tax for any year of assessment under all arrangements having effect by virtue of section 788 of ICTA shall not exceed the total income tax payable by him for that year of assessment, less any income tax which he is entitled to charge against any other person. By virtue of section 790(3) of ICTA, section 796(3) of that Act also applied to limit unilateral relief under section 790(1).
- 4.13 Section 29(2) of ITA 2007 is based on, among other provisions, section 796(3) of ICTA. In that context, section 29(2) and (3) of ITA 2007 serve to provide that, in the calculation under section 23 of ITA 2007, relief under section 788 or 790(1) of ICTA may be restricted to below the amount calculated in accordance with the provisions of Part 18 of ICTA other than section 796(3). Section 796(3) of ICTA was omitted by paragraph 193 of Schedule 1 to ITA 2007, and repealed by Schedule 3 to ITA 2007, in the erroneous belief that providing for this restriction was the sole purpose of section 796(3) and that the words "less any income tax which he is entitled to charge against any other person" were no longer necessary since, in section 23 of ITA 2007, relief for charges on income is given at Step 2 before relief under section 788 or 790(1) of ICTA is given at Step 6. But section 796(3) of ICTA is integral to the calculation of the amount of relief under section 788 or 790(1) of ICTA that is to be brought into the calculation under section 23 of ITA 2007 before any further restriction by virtue of section 29(2) and (3) of ITA 2007. It is, therefore, necessary to re-instate section 796(3) of ICTA for income tax purposes.
- 4.14 In the case of all the limiting provisions, section 25(6)(b) and (7) of FA 1990 (gift aid) appear to have been overlooked. Those provisions of FA 1990, which were also repealed by ITA 2007, required that,

where any gift made by the donor in a year of assessment was a qualifying donation, then, for that year the limiting provisions were to have effect, in their application to him, as if any reference to income tax which he is entitled to charge against any person included a reference to the tax treated as deducted from the gift. The effect of the references included in the limiting provisions by section 25(6)(b) of FA 1990 is not affected by the revised treatment of charges on income. The failure to rewrite the limiting provisions as they have effect as extended by section 25(6)(b) of FA 1990 results in the amount of relief under section 788 or 790(1) of ICTA or under Chapter 1 of Part 5 (EIS relief), Chapter 2 of Part 6 (VCT relief) or Chapter 1 of Part 7 (community investment tax relief) of ITA 2007 no longer being limited to the extent required by the source legislation in cases where the taxpayer has made a qualifying donation in the same tax year.

- 4.15 Subsequent to the enactment of ITA 2007 it was realised that section 277(1) of the Taxation of Chargeable Gains Act 1992 (“TCGA 1992”) applied section 796(3) of ICTA for the purposes of capital gains tax. Article 3(5) and (6) of the Income Tax Act 2007 (Amendment) (No. 3) Order 2007 (S.I. 2007/3506) amended paragraph 193 of Schedule 1 to ITA 2007 and Schedule 3 to ITA 2007 in order to make it clear that section 796(3) of ICTA remained in force as applied for capital gains tax purposes. That correction also overlooked the effect of section 25(6)(b) of FA 1990.
- 4.16 Article 4(2) of the instrument amends section 29 of ITA 2007 to preserve for income tax purposes the effect of the three limiting provisions relating to the venture capital scheme reliefs as they are required to be read in accordance with section 25(6)(b) of FA 1990. Article 4(6) and (7) re-instate section 796(3) of ICTA, as so required to be read, so that it continues to have effect for income tax purposes and, as extended by section 277(1) of TCGA 1992, for capital gains tax purposes. Article 5 of the instrument makes a consequential amendment to the Income Tax Act 2007 (Amendment) (No. 3) Order 2007.

Section 424 of ITA 2007

- 4.17 Section 424 of ITA 2007 provides for a charge to income tax in a case where the amount of tax treated as deducted from qualifying donations to charity made by an individual in a tax year under section 414 of ITA 2007 is greater than the amount of income tax and capital gains tax for which the individual is charged for the tax year. It is based on section 25(8) of FA 1990. Section 25(9) of FA 1990 provides that “In calculating for the purposes of subsection (8) above the total amount of income tax and capital gains tax with which the donor is charged for the year of assessment, there shall be disregarded” the matters listed in paragraphs (a) to (f).
- 4.18 The majority of the matters listed in paragraphs (a) to (f) of section 25(9) of FA 1990 relate solely to income tax, but paragraph (d)

includes reference to section 788 of ICTA (relief by agreement with other countries) and section 790(1) of that Act (unilateral relief). Section 277(1) of TCGA 1992 provides that, for the purposes of giving relief from double taxation in relation to capital gains tax and tax on chargeable gains charged under the law of any territory outside the United Kingdom, in Chapters 1 and 2 of Part 18 of ICTA, as they apply for the purposes of income tax, references to capital gains are to be substituted for references to income and references to capital gains tax are to be substituted for references to income tax. Chapter 2 of Part 18 of ICTA contains sections 788 and 790(1).

- 4.19 Section 425 of ITA 2007 provides how the total amount of income tax to which the individual is charged for the tax year is to be calculated for the purposes of section 424. It is based on section 25(9) of FA 1990. In error, section 424 of ITA 2007 does not reflect the fact that section 25(9) of FA 1990 requires sections 788 and 790(1) of ICTA, as extended by section 277(1) of TCGA 1992, to be disregarded when calculating, for the purposes of section 25(8) of FA 1990, the total amount of capital gains tax with which the donor is charged. Article 4(3) of the instrument amends section 424 of ITA 2007 to provide for such disregard.

Section 777(13) of ICTA and sections 772(1) and 777(7) of ITA 2007

- 4.20 These errors are linked and arise out of the rewriting for income tax purposes only of section 776 of ICTA in Chapter 3 of Part 13 of ITA 2007 (transactions in land) and the rewriting of section 775 of ICTA in Chapter 4 of that Part (sales of occupation income).
- 4.21 Prior to its amendment by ITA 2007, section 777(13) of ICTA (provisions supplementary to sections 775 and 776) defined “capital amount” for the purposes of sections 775 to 777 of ICTA as any amount, in money or money’s worth, which, apart from sections 775 and 776, does not fall to be included in any computation of income for purposes of the Tax Acts, and provided that other expressions including the word “capital” shall be construed accordingly.
- 4.22 Section 772(1) of ITA 2007 defines “capital” in Chapter 3 of Part 13 of that Act as meaning, in relation to a gain, that the gain does not fall to be included in any calculation of income for income tax purposes apart from that Chapter. Section 777(7) of ITA 2007 defines “capital amount” in Chapter 4 of Part 13 of that Act as meaning an amount in money or money’s worth which does not fall to be included in a calculation of income for income tax purposes apart from that Chapter.
- 4.23 Section 776 of ICTA continues in force for corporation tax purposes and section 777 of that Act continues to have effect for the purposes of supplementing that section. Schedule 1 to ITA 2007 consequentially amended section 777(13) of ICTA by substituting for the definition of “capital amount” a provision stating that for the purposes of sections 776 and 777 of ICTA “capital”, in relation to a gain, means that, apart

from section 776, the gain does not fall to be included in any calculation of income for corporation tax purposes.

- 4.24 The substitution for "purposes of the Tax Acts" of "corporation tax purposes" made by ITA 2007 in section 777(13) of ICTA was in error. As was the substitution for "purposes of the Tax Acts" of "income tax purposes" when rewriting, in sections 772(1) and 777(7) of ITA 2007, the definition of "capital" from section 777(13) of ICTA. The errors have the effect of excluding receipts which in the case of sections 776 and 777 of ICTA are income for income tax purposes and in the case of Chapters 3 and 4 of Part 13 of ITA 2007 are income for corporation tax purposes. Article 2(3) of the instrument amends section 777(13) of ICTA, and article 4(4) and (5) amend sections 772(1) and 777(1) of ITA 2007 respectively, in order to restore the position to what it was before ITA 2007.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to The Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Income Tax Act 2007 (Amendment) (No. 2) Order 2009 are compatible with the Convention rights.

7. Policy background

- 7.1 ITA 2007 completed the main work of the Tax Law Rewrite project in relation to the rewrite of income tax. The power in section 1029 was included to ensure that amendments could be made quickly and easily and without recourse to a Finance Bill.
- 7.2 The amendments that are contained in the instrument take effect retrospectively from the date on which ITA 2007 came into force. The correction of the errors restores the generally understood meaning of the provisions. Making the instrument retrospective ensures that there will be no period of time during which the law is unclear.

8. Consultation outcome

- 8.1 At the meeting of the Joint Committee on Tax Law Rewrite Bills on 24 January 2007 the then Financial Secretary to the Treasury, John Healey, gave an assurance that the power in section 1029 of ITA 2007 would not be used without the agreement of the Tax Law Rewrite Consultative and Steering Committees.
- 8.2 Papers explaining the reasons for the amendments made by this instrument have been considered by those Committees. The

Committees considered whether each amendment should be made, and in particular whether, if made, each amendment should have effect retrospectively from the date on which ITA 2007 came into force. They concluded that it is appropriate in all cases that the amendments should be made and take effect from that date. The agreement of the Committees has accordingly been obtained to the exercise of this power as required.

9. Guidance

A copy of the instrument and this explanatory memorandum will be placed on the Tax Law Rewrite section of the HMRC website.

10. Impact

- 10.1 No impact on the private or voluntary sectors is foreseen.
- 10.2 There is no impact on the public sector.
- 10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

- 11.1 The legislation applies to small business.
- 11.2 To minimise the impact of the requirements on businesses, including firms employing up to 20 people, the approach taken is to introduce these amendments with retrospective effect, so that there is no uncertainty at any time about the effect of the rewritten legislation. This fulfils the aim of the Tax Law Rewrite project which is to make the legislation clearer and easier to use, without changing the law (apart from minor, identified changes).
- 11.3 The basis for the final decision on what action to take to assist small business includes consideration by the Tax Law Rewrite Consultative Committee of the impact on such businesses. The membership of this committee includes representatives of a number of organisations and professional bodies which represent, or whose members' clients include, small businesses.

12. Monitoring & review

No monitoring or review is required as a result of this instrument.

13. Contact

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