

**EXPLANATORY MEMORANDUM TO**  
**THE INCOME TAX ACT 2007 (AMENDMENT) ORDER 2010**  
**2010 No. 588**

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 Social Security Contributions and Benefits Act 1992 ("SSCBA 1992"), the Social Security Contributions and Benefits (Northern Ireland) Act 1992 ("SSCB(NI)A 1992") and the Charities Act 1993.
- 2.2 The instrument makes consequential amendments to paragraph 1(c) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 and to section 10(2)(c) of the Charities Act 1993 that were inadvertently omitted from the Income Tax Act 2007 ("ITA 2007"). It also corrects a minor error in paragraph 3(5) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992.

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 sections 1028(4) and 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 rewriting the main provisions 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.

***Schedule 2 to SSCBA 1992 and Schedule 2 to SSCB(NI)A 1992***

- 4.4 There are two sets of amendments to Schedule 2 to SSCBA 1992 (levy of Class 4 contributions with income tax) and to Schedule 2 to SSCB(NI)A 1992, which reproduces Schedule 2 to SSCBA 1992.

- 4.5 Section 16 of SSCBA 1992, which introduces Schedule 2 to that Act, provides that all the provisions of the Income Tax Acts apply with the necessary modifications in relation to Class 4 National Insurance Contributions (NICs) under SSCBA 1992 and under SSCB(NI)A 1992.

***Paragraph 1(c) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992***

- 4.6 This missed consequential amendment relates to the definition of “year” in Schedule 2 to SSCBA 1992 and SSCB(NI)A 1992 which provides that in the Schedule ““year” means year of assessment within the meaning of the Act of 1988”, that is, of the Income and Corporation Taxes Act 1988 (“ICTA”). Prior to ITA 2007, section 832(1) of ICTA, which contains the definition of “year of assessment”, provided that the definitions contained in it applied in the Tax Acts. The expression “the Tax Acts” was defined by section 831(2) of ICTA as meaning ICTA “and all other provisions of the Income Tax Acts and the Corporation Tax Acts”.
- 4.7 Section 989 of ITA 2007 defines “year of assessment” for the purposes of the Income Tax Acts. ITA 2007 also amends section 832(1) of ICTA so that the expressions which it defines are defined only for the purposes of the Corporation Tax Acts. As a result, “year of assessment” is no longer defined as such for the purposes of ICTA. This means that the definition of “year” in paragraph 1(c) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 is no longer entirely apt and so not as helpful to users as is desirable. Articles 2(2) and 3(2) of the instrument make the appropriate consequential amendments to paragraph 1(c) of Schedule 2 to SSCBA 1992 and to paragraph 1(c) of Schedule 2 to SSCB(NI)A 1992 respectively.

***Paragraph 3(5) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992***

- 4.8 This error consists in the repeal by ITA 2007 of paragraph 3(5)(a) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992, which were wrongly thought to be unnecessary. The error affects the calculation of the amount of Class 4 NICs.
- 4.9 Class 4 NICs are payable under SSCBA 1992 and SCB(NI)A 1992 on the profits of a trade, profession or vocation. Expenses that are incurred wholly and exclusively for the purpose of the trade, profession or vocation (section 34 of the Income Tax (Trading and Other Income) Act 2005 (“ITTOIA 2005”)) reduce the amount on which Class 4 contributions are payable.
- 4.10 There is a special relief for income tax purposes for certain payments from which income tax is to be deducted but which are not made wholly and exclusively for the purposes of the trade, profession or vocation. The taxpayer gets relief by retaining the tax deducted.
- 4.11 Prior to ITA 2007, in relation to charges on income and patent royalties, there was an entitlement or obligation to deduct tax from the

payments and an accompanying relief for income tax purposes in sections 348, 349(1) and 350 of ICTA.

- 4.12. The income tax relief was mirrored for NICs purposes by paragraph 3(5)(a) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 which allowed relief in respect of payments under section 348 or 349(1) of ICTA. This relief was allowed only so far as the payments were “incurred wholly or exclusively for the purposes of any relevant trade, profession or vocation”.
- 4.13. ITA 2007 replaced the approach to charges on income with a deduction in calculating net income, coupled with provision for deduction of tax at source from the payments involved. ITA 2007 also aligned the treatment of patent royalties with that of charges on income.
- 4.14. The view was taken in ITA 2007 that the “wholly or exclusively” test in paragraph 3(5) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 was synonymous with the “wholly and exclusively” test in ITTOIA 2005 and that paragraph 3(5)(a) was only relevant to payments of royalties. Accordingly, with the alignment of the treatment of royalty payments with that of charges on income, paragraph 3(5)(a) was no longer required. That view was erroneous.
- 4.15. The relief given by sections 348 and 349(1) of ICTA is now given by section 448 of ITA 2007 to individuals for payments from which income tax is to be deducted under section 900(2) or 903(5) of ITA 2007. Payments within section 900 of ITA 2007 are payments made “for genuine commercial reasons in connection with the individual’s trade, profession or vocation”. Section 903(5) of ITA 2007 requires individuals to deduct income tax from payments of patent royalties.
- 4.16. It is, therefore, necessary to re-instate a provision in paragraph 3(5) of Schedule 2 to SSCBA 1992 and Schedule 2 to SSCB(NI)A 1992 referring to these payments. But sections 900(2) and 903(5) are not the only provisions of ITA 2007 based on section 348 or 349(1) of ICTA. In order to restore the effect of the law in paragraph 3(5) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 to what it was before ITA 2007, it is necessary to include reference to three other provisions of ITA based on section 348 or 349(1) of ICTA, as they are capable of applying to a payment incurred “wholly or exclusively for the purposes of any relevant trade, profession or vocation” which is made by an individual. The provisions are sections 906(5) (certain royalties etc where usual place of abode of owner is abroad), 910 (proceeds of sale of patent rights; payments to non-UK residents) and 944 (directions for deduction from payments to non-UK residents).
- 4.17. The erroneous repeals of paragraph 3(5)(a) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 are potentially adverse to taxpayers as they may result in increased amounts of Class 4 NICs being payable. Articles 2(3) and 3(3) of the instrument make the appropriate amendments to paragraph 3(5) of Schedule 2 to SSCBA

1992 and to paragraph 3(5) of Schedule 2 to SSCB(NI)A 1992 respectively.

***Section 10(2)(c) of The Charities Act 1993***

- 4.18 This missed consequential amendment concerns powers to disclose information to the Charity Commission.
- 4.19 Section 10(1) of the Charities Act 1993 (“the 1993 Act”) authorises a “relevant public authority” (including HMRC) to disclose information to the Charity Commission. But HMRC may only disclose information in relation to certain classes of institution, undertaking or body, including “an institution by or in respect of which a claim for exemption has at any time been made under section 505(1) of the Income and Corporation Taxes Act 1988” (section 10(2)(c) of the 1993 Act).
- 4.20 Section 505(1) of ICTA provides that certain exemptions from tax are to be granted on a claim being made to the Commissioners for HMRC. These provisions have been rewritten for income tax purposes in Part 10 of ITA 2007. After ITA 2007, section 505(1) of ICTA (as amended by Schedule 1 to ITA) remains in force for corporation tax purposes only.
- 4.21 The making of a consequential amendment in ITA 2007 to add an express reference to Part 10 of ITA 2007 in section 10(2)(c) of the 1993 Act was overlooked. By virtue of the general continuity of law provision in paragraph 5(1) of Schedule 2 to ITA 2007, the reference to a claim for exemption under section 505(1) of ICTA is to be read as including a claim for exemption from income tax made on or after 6 April 2007 under the corresponding provisions of Part 10 of ITA 2007. In order to make this position clear on the face of the legislation, article 4 of the instrument adds the appropriate reference to Part 10 of ITA 2007 in section 10(2)(c) of the 1993 Act.

**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) Order 2010 are compatible with the Convention rights.

**7. Policy background**

- 7.1 ITA 2007 is the third Act prepared by the Tax Law Rewrite project rewriting the main provisions relating to income tax. The powers in sections 1028 and 1029 were 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 insertion of the missed consequential amendments in paragraph 1(c) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 and in section 10(2)(c) of the Charities Act 1993 are purely clarificatory. The correction of the error in paragraph 3(5) of Schedule 2 to SSCBA 1992 and of Schedule 2 to SSCB(NI)A 1992 restores the generally understood meaning of the provision. 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. Equally, as stated in Explanatory Notes to section 1028 of ITA 2007, the project is committed to obtaining the agreement of those Committees to the exercise of the power contained in that section.
- 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 these powers 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**

**Benjamin Aldred** at HM Revenue and Customs Tel: 020 7147 2400 or e-mail: [benjamin.aldred@hmrc.gsi.gov.uk](mailto:benjamin.aldred@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.