These notes refer to the Corporation Tax Bill
as introduced in the House of Commons on 4 December 2008 [Bill 1]

CORPORATION TAX BILL

EXPLANATORY NOTES

[VOLUME IV]

The Explanatory Notes are divided into four volumes.

Volume I contains the Introduction to the Bill and Notes on Parts 1 to 5 (Clauses 1 to 476).
Volume II contains Notes on Parts 6 to 8 (Clauses 477 to 906).
Volume III contains Notes on Parts 9 to 21 (Clauses 907 to 1330) and the Schedules to the Bill.
Volume IV contains Annexes to the Notes.

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CORPORATION TAX BILL

EXPLANATORY NOTES – VOLUME 4
(ANNEXES)

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ANNEX 1: MINOR CHANGES IN THE LAW

Change 1: References to "officer of Revenue and Customs": clauses 11, 88, 106, 236, 389, 460, 617, 753, 756, 916, 917 and 1282

This change replaces references to the "Board of Inland Revenue" in the source legislation with references to "an officer of Revenue and Customs".

It brings the income and corporation tax codes back into line.

References in the source legislation to the "Board of Inland Revenue" are treated by section 50(1) of the Commissioners for Revenue and Customs Act 2005 (CRCA) as references to "the Commissioners for Her Majesty's Revenue and Customs". The rest of this note accordingly refers to the Commissioners for Her Majesty's Revenue and Customs ("the Commissioners") rather than to the Board of Inland Revenue.

The provisions affected by this change will in future authorise or require things to be done by or in relation to an officer of Revenue and Customs rather than by or in relation to the Commissioners. This reflects the way in which Her Majesty's Revenue and Customs is organised and operates in practice. Section 13 of CRCA allows nearly all functions conferred on the Commissioners to be exercised by any officer. All of the functions affected by this change, which are in the main concerned with administrative processes, are in fact exercised by officers of the Commissioners, and the Commissioners themselves are not personally involved in their exercise.

Where the source legislation provides for a claim or election to be made to the Commissioners, this Bill does not expressly state to whom such a claim or election is to be made. Where a notice to deliver a corporation tax return has been issued paragraphs 57 and 58 of Schedule 18 to FA 1998 require the claim to be made in the return or by amendment of the return if possible. A return must be made to the officer who issued it. A notice amending a return must be made to an officer. Similarly, where the claim is made outside a return or amendment, paragraph 2(1) of Schedule 1A to TMA requires the claim to be made to an officer.

Each provision affected by the conversion of references to the Commissioners will be identified in the Table of Origins by a cross-reference to this change.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 2: Trading income: omission of references to a company carrying on a profession or a vocation: clause 35 (and other clauses)

This change omits references to a profession and to a vocation where the source legislation refers to the carrying on by a company of a trade, profession or vocation.

The change is reflected in numerous clauses in Part 3, the trading income Part. It is included in the origins of the main provisions affected.

The meaning of "company"

"Company" in the Tax Acts means "any body corporate or unincorporated association but does not include a partnership, a local authority or a local authority association" (section 832(1) of ICTA). This note accordingly looks at corporate bodies and then at unincorporated associations.

The definition in section 832(1) of ICTA is subject to:

- some qualifications that deal with particular topics; and
- a general proviso that the definition "does not apply where the context otherwise requires because some other definition of "company" applies".

Both the qualifications and the general proviso are in section 832(2) of ICTA. They do not affect the discussion in this note.

Corporate bodies and professions

"Profession" is not defined for tax purposes. As long ago as 1919 Scrutton L J said:

> it seems to me as at present advised that a "profession" in the present use of language involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production, or sale, or arrangements for the production or sale of commodities. The line of demarcation may vary from time to time. The word "profession" used to be confined to the three learned professions - the Church, Medicine and Law. It has now, I think, a wider meaning. It appears to me clear that a journalist whose contributions have any literary form, as distinguished from a reporter, exercises a "profession"; and that the editor of a periodical comes in the same category. CIR v Maxse (1919), 12 TC 41 CA on page 61.

The question whether or not a corporate body can carry on a profession for the purposes of corporation tax is one of interpretation of the corporation tax legislation. This is apparent from the general rules under which the acts of individuals are attributed to corporate bodies.

A wide variety of acts performed by individuals are in law attributed to corporate bodies under rules derived from the constitutions of the bodies, from company law and from general principles which also operate between individuals, such as agency and vicarious liability. These rules of attribution enable the rights and liabilities of corporate bodies arising out of the acts of individuals to be defined.

Under these principles many acts carried out by a corporate body's agents in conducting its business may be treated as acts of the body for the purposes, for instance, of liability in contract or tort. But an act that is treated as an act of the corporate body for one purpose would not necessarily be treated as the body's act for another purpose. For example, a corporate body generally has no criminal liability for the acts of its agents.

The rules of attribution are of little help when considering whether a corporate body is capable of carrying on a profession for the purposes of corporation tax. To begin with, the question is not obviously one of attribution. What is in doubt is not whether particular activities should be attributed to the corporate body, but whether a particular activity carried on by the body (namely the carrying on of a business consisting of the provision of professional services) should be classified as trading or as a profession. The principles of agency are not designed to answer questions such as whether a principal may carry on a profession by virtue of the fact that the principal's agent carries on a profession. And because it is arguable that the language of the corporation tax legislation implicitly excludes the application of the rules about professions to companies (see below), the question must in any case be approached as one of interpretation.

There are two main grounds for arguing that there are no acts which would, for the purposes of corporation tax, constitute the carrying on of a profession by a corporate body. The first is based on the nature of a profession. The second is based on internal evidence in the corporation tax legislation.

Before turning to those arguments this note looks briefly at some decided cases.

Case law

HMRC know of no case in which it was necessary to decide whether a corporate body can carry on a profession for tax purposes.

William Esplen, Son and Swainston Ltd v CIR (1919), 2 KB 731 concerned a corporate body whose shareholders and directors were three naval architects who had previously carried on their profession in partnership. Their activities had not changed in any way since incorporation.

There was an exception from Excess Profits Duty for:

> Any profession, the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on …

Rowlatt J said in his judgment that the company was not carrying on a profession for the purpose of that provision. But his reasoning was that "profession" in that provision means a profession the profits of which are mainly dependent on the personal qualifications of the person who carries it on, and only an individual can have professional qualifications. In CIR v Peter McIntyre Ltd (1926), 12 TC 1006 CS on page 1014 the Lord President (Clyde) explained Rowlatt J's decision as follows:

> It follows from what has been said that the profits of a profession may, or may not, fall within the statutory exemption, according as the person who carries it on is an individual on the one hand, or a

> corporate person on the other hand. For a professional business may be carried on by a company as well as by an individual; but, if by a company, it is difficult to see how the profits can be dependent on the company's personal qualifications, for the simple reason that a company is incapable of personal qualifications. That is all, as I understand, that was decided by Mr. Justice Rowlatt in William Esplen, Son and Swainston, Ltd. v The Commissioners of Inland Revenue, (1919) 2 K.B. 731, and I respectfully think his decision was right.

The decision in the Esplen case was referred to by Scrutton L J in Brighton College v Marriot (1925), 10 TC 213 HL. He said on page 226:

> It is clear that a private schoolmaster would be assessed as carrying on a profession, but it has been decided in Esplen's case, (1919) 2 K.B. 731, that a limited company employing professional men to do professional work does not carry on a profession; it must be assessed, if at all, as carrying on a trade…...

And on page 227:

> The question then is: Do the Company in carrying on the school carry on a trade? In my view, when any person habitually and as a matter of contract supplies money's worth for full money payment, he "trades" within the meaning of Schedule D.

But his interpretation of that decision appears to go too wide and should probably not be given much weight.

So these cases contribute little to the question whether a corporate body can carry on a profession for the purposes of corporation tax.

The nature of a profession

A profession is carried on by a person who uses his or her professional skills, knowledge and training to carry on the distinctive work of the profession, whether it is sculpting, school teaching, the work of an architect etc. Although a professional person can delegate some of his or her work, it is never the case that the possession of knowledge, or the carrying on of activities, by one individual can constitute the carrying on of a profession by another individual. There is no reason why the position should be any different between a company and an individual.

Since the person who has the skills and knowledge and does the professional work must be an individual, it appears that only an individual can carry on a profession. This conclusion is founded on ordinary notions of what is involved in carrying on a profession, and coincides with the instinct that a person who carries on the profession of architecture must be the person who is by qualification an architect (and similarly with other professions).

This suggests that the starting point ought to be that a company cannot carry on a profession for the purposes of corporation tax legislation. But there is a contrary argument. The view is sometimes taken that a business of supplying professional services may be equated with a profession. On this view it is proper to say that a person who carries on such a business carries on a profession even if that person does not personally provide the professional services.

Since references to carrying on a profession may be used either in the strictest sense, or in a looser sense to include a business of providing professional services, the first argument based on the nature of a profession is not conclusive.

"Profession" in the corporation tax legislation

The second argument that there are no acts which would, for the purposes of corporation tax, constitute the carrying on of a profession by a corporate body is based on internal evidence in the corporation tax legislation.

FA 1965

The drafters of FA 1965 proceeded on the basis that a corporate body cannot carry on a profession.

It is true that section 53 of FA 1965 (see now section 9 of ICTA) provided that:

> …. any income shall for purposes of corporation tax be computed in accordance with income tax principles, all questions as to the amounts which are or are not to be taken into account as income, or in computing income ... being determined in accordance with income tax law and practice….
>
> ….
>
> (3) Accordingly, for purposes of corporation tax income shall be computed, and the assessment shall be made, under the like Schedules and Cases as apply for the purposes of income tax …

Therefore, if a corporate body were to have profits from carrying on a profession those profits could be calculated and taxed under Schedule D Case II as applied for corporation tax purposes:

> Case II: tax in respect of any profession or vocation not contained in any other Schedule (section 18(3) of ICTA)

But it is significant that professions are not anywhere catered for explicitly in the corporation tax code introduced by FA 1965.

So, for example, the following provisions of FA 1965 did not cater for professions:

- Section 50 brought non-UK resident companies within the charge to corporation tax, but only if they carried on a trade in the United Kingdom through a branch or agency. (See now section 11 of ICTA.)

- Section 51 set out the rules for determining when a company's accounting period begins and ends.

  - Subsection (3)(c) provided that an accounting period ends on "the company beginning or ceasing to carry on a trade, or to be, in respect of a trade, within the charge to tax". (See now section 12(3)(c) of ICTA.)

  - Subsection (5) set out the rule that applies if "a company carrying on more than one trade makes up accounts of any of them to different dates". (See now section 12(5) of ICTA.)

- Section 54(2) provided that "where a company begins or ceases to carry on a trade, or to be within the charge to corporation tax in respect of a trade" the profits computation was on the basis that the trade commenced or ceased. (See now section 337(1) of ICTA.)

- Section 56(2) dealt with capital allowances to be made "in taxing a trade". They were to be treated "as a trading expense". (See now sections 247 and 251 of CAA where the income tax and corporation tax rules are combined.)

- Sections 58 and 59 set out the loss relief rules, wholly in terms of trades. The special rule for "trade charges" in section 58(8) referred to "payments made wholly and exclusively for the purposes of a trade". (See now sections 393 and 393A of ICTA.) This carries through to group relief as a result of the reference to section 393A in section 403ZA of ICTA.

- Section 61 provided for continuity in the case of a company reconstruction without change of ownership - "The trade shall not be treated as permanently discontinued". (See now section 343(2) of ICTA.)

Section 89 (see now section 6(4)(b) of ICTA) provides that in the provisions discussed above:

> "trade" includes "vocation", and includes also an office or employment…

but there is no general extension to include professions.

If the corporation tax code was intended to cover professions it is extraordinary that the references to trades in these key provisions were not extended to professions. Nor is there any mention of professions in the 1965 Notes on Clauses.

In line with the apparent intentions of the 1965 legislation, it has long been the Inland Revenue/HMRC view that a corporate body cannot carry on a profession for corporation tax purposes. Where a corporate body carries on a business consisting of the provision of professional services the practice is to treat it as carrying on a trade.

References to "profession" in the current corporation tax legislation

A significant number of references to "profession" in the current legislation (some two dozen or more) arise as a result of the ITTOIA split of income tax from corporation tax. Where the source legislation applied to both income tax and corporation tax and concerned professions the reference to profession was maintained in the corporation tax only rule. This was done on the basis that if companies cannot carry on professions the references do no harm, and because the issue was seen as one to address in the context of the rewrite of corporation tax.

A slightly smaller number appear in provisions that apply to both income tax and corporation tax. They are clearly needed until these provisions are split into income tax and corporation tax rules.

A dozen or so are concerned with partnerships that might be made up of both income and corporation taxpayers. If a partnership consists of an individual and a corporate body and exists to exploit the professional services of the individual it may well be correct to regard the individual as carrying on the profession but the company as carrying on a trade.

A small number cannot be explained in any of the above ways.

Corporate bodies and professions - conclusions

There are three conclusions:

- the nature of a profession and some comments in the case law suggest that corporate bodies cannot carry on a profession for corporation tax purposes – when they provide professional services they are trading;

- consistent with that, the 1965 corporation tax code made no explicit provision for professions; and

- references in the current legislation arise for a mixture of reasons, are inconsistent and therefore shed no great light on the issue.

So there are strong grounds for concluding that for the purposes of the charge to corporation tax under Schedule D Case II there are no activities that should be taken to constitute the carrying on of a profession by a corporate body.

Corporate bodies and vocations

The nature of a vocation

"Vocation" is not defined for tax purposes.

According to the Oxford English Dictionary a vocation is:

- the fact or feeling of being called to undertake some specific career, function or occupation;

- a strong feeling of fitness or suitability for a particular career;

- a mode of life or employment regarded as requiring dedication.

The thread that ties all of these definitions together is that the exercise of a vocation requires a personal commitment to a particular activity.

Corporate bodies are artificial persons. They are not animated by callings. They do not have careers, still less can they be said to have feelings of fitness and suitability as regards a particular set of activities. Nor do they have a mode or a way of life and they do not engage in activities out of a sense of dedication.

That being the case it does not appear possible for a corporate body to carry on a vocation.

FA 1965

Section 89(2)(j) of FA 1965 provided that "trade" includes "vocation" for the purpose of Part 4 of the Act (taxation of companies and of company distributions). (See now section 6(4)(b) of ICTA.) Notes on Clauses explain that this is because:

> an old Court decision suggests that a bookmaking business may have to be considered as a vocation rather than a trade in the strict sense.

That decision is found in Partridge v Mallandaine, 2 TC 179. That case was heard in the High Court in 1886. Today there is little doubt that a company carrying on a bookmaking business is trading.

Corporate bodies and vocations – conclusions

There are two conclusions:

- corporate bodies cannot carry on a vocation; and
- although the 1965 corporation tax code makes explicit provision for vocations this is the result of an excess of caution for reasons that are no longer relevant.

Unincorporated associations

The meaning of "unincorporated association"

In Conservative and Unionist Central Office v Burrell (1981), 55 TC 671 CA on page 699 Lawton LJ considered the meaning of "unincorporated association" for the purposes of s.832(1) of ICTA:

> It is sufficiently like a "company" for it to be put in the charging section within the ambit of that word. The interpretation section makes it clear that the word "company" has a meaning extending beyond a body corporate but not as far as a partnership or a local authority. I infer that by "unincorporated association" in this context Parliament meant two or more persons bound together for one or more common purposes, not being business purposes, by mutual undertakings, each having mutual duties and obligations, in an organisation which has rules which identify in whom control of it and its funds rests and on what terms and which can be joined or left at will. The bond of union between the members of an unincorporated association has to be contractual.

The HMRC view of unincorporated associations differs from this in two main respects. These are that the union between the members need not be legally enforceable and that there is no reason why an unincorporated body should not have trading or business objectives or carry on significant commercial activities.

Unincorporated association or partnership?

In the case of Blackpool Marton Rotary Club v Martin (1989), 62 TC 686 CA the club argued that it fell within the definition of a partnership because it was an association of persons "carrying on a business in common with a view of profit" (section 1 of the Partnership Act 1890). This was rejected by the Commissioners and their decision was confirmed by Hoffman J. He contrasted the position of partners, who are individually entitled to some proportion of profits, with the members of the club, who were not individually entitled to share in any profits which might arise from its activities. Their entitlement was to whatever privileges were conferred upon them by the rules of the club and no more.

Unincorporated associations and professions

The Blackpool case shows that if individuals come together to carry on a profession and are entitled to share the profit as it arises the arrangement will be a partnership liable to income tax rather than an unincorporated association liable to corporation tax.

HMRC are not aware of any instance of an unincorporated association being assessed to corporation tax as carrying on a profession.

Unincorporated associations and vocations

HMRC are not aware of any instance of an unincorporated association being assessed to corporation tax as carrying on a vocation.

Unincorporated associations – conclusions

The corporation tax charge under Schedule D Case II on the profits of a profession or vocation of an unincorporated association does not have any practical effect.

It is theoretically possible that the application of trading income rules to activities that a company could argue is a profession or a vocation could lead to a change in the measure of taxable profits.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 3: Trading income: profits of mines, quarries and other concerns: clause 39

This change identifies two consequences of the approach taken to the rewrite of section 55 of ICTA.

It brings the income tax and corporation tax codes back into line.

Section 55 of ICTA provides that profits arising out of land in the case of certain listed concerns shall be charged to tax under Schedule D Case I (Schedule D Case 1 rules are rewritten largely in Part 3 of this Bill). The concerns listed include mines, quarries, railways and canals.

Section 55 of ICTA is rewritten as clause 39. It treats the profits and losses of the concern as if they were the profits or losses of a trade. This has two consequences.

(A) Section 55 of ICTA does not specify how the profits to be taxed under Schedule D Case I are to be calculated. Clause 39(1) makes clear that the profits are calculated in the same way as trade profits. This means that the calculation rules in Part 3 of this Bill will apply. It is possible that the calculation rules in Part 3 might produce a result less favourable than the result which would have been produced by the calculation rules contemplated by section 55. But since it is not possible to say which calculation rules were contemplated by section 55, it is impossible to be certain whether or not this is indeed so.

(B) Section 55 of ICTA refers only to profits. In practice loss relief is allowed for losses of concerns as if they were trade losses. Clause 39(4) gives that practice statutory effect. Legislating this practice will invariably be favourable.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 4: Trading and property income: caravan sites where trade carried on: clauses 43 and 213

This change gives statutory effect to ESC C36 (caravan sites where there is both trading and letting income).

It brings the income tax and corporation tax codes back into line.

ESC C36 states:

> Where the proprietor of a caravan site carries on material activities associated with the operation of that site which constitute trading, there may be included as receipts of that trade any site income from the letting of pitches for static or touring caravans, and any income from letting caravans where the letting does not of itself amount to a trade.

In practice there is an element of trade, such as the operation of a site shop or the provision of leisure facilities such as a café, included in the operation of most caravan sites.

This change gives a company which meets the qualifying conditions a statutory right to treat receipts from letting caravans or pitches as receipts of the trade of operating a caravan site. So trading losses (including those brought forward) may be available against the caravan site receipts.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 5: Trading and property income: surplus business accommodation: clauses 44 and 213

This change gives statutory effect to the HMRC practice on receipts from surplus business accommodation known as Revenue Decision 9.

It brings the income tax and corporation tax codes back into line.

The case of <u>Salisbury House Estate Ltd v Fry</u> (1930), 15 TC 266 HL is authority for the proposition that the income tax Schedules are mutually exclusive so any amount received by a company from the letting of premises surplus to the requirements of the company's trade should not be taken into account in calculating the profits of the trade but assessed separately to tax as income from property under Schedule A. Similarly, any outgoings in respect of the premises should be apportioned between the part which is let and the part used for the purposes of the trade.

In practice, HMRC do not object to a company including receipts from letting surplus business accommodation in trade receipts provided certain conditions are met. This practice, published in the February 1994 edition of Tax Bulletin under the heading "Revenue Decisions – Schedule D Cases I and II – Letting Surplus Business Accommodation", is referred to in some reference books as Revenue Decision 9. The practice extends to trades within Schedule D Case V.

The conditions in Revenue Decision 9 are:

- the accommodation is temporarily surplus to the current requirements of the trade;

- part of the accommodation is used for trade purposes;

- the rental income is comparatively small; and

- the rent is in respect of the letting of surplus business accommodation only – not surplus land.

In legislating the conditions in Revenue Decision 9, clause 44 sets out rules for determining whether accommodation is temporarily surplus to requirements. These are:

- that the accommodation must have been used for the purposes of the trade within the last three years (or acquired within that period);
- that the accommodation must be let for a term of not more than three years; and
- that the company must intend to use the accommodation for trade purposes at a later date.

This gives taxpayers increased certainty as to whether the condition is met.

If the conditions are met, trading losses (including those brought forward) may be available against the receipts from letting the surplus business accommodation.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 6: Trading and property income: rents in respect of wayleaves where associated with a trade: clauses 45, 213, 279 and 288

This change shifts the charge on rents from certain wayleaves associated with a trade from Schedule D Case V and Case VI to a charge on trade profits.

It brings the income tax and corporation tax codes back into line.

Section 120 of ICTA makes provision about rent payable in respect of "any easement enjoyed in the United Kingdom in connection with any electric, telegraphic or telephonic wire or cable" other than an easement of a kind mentioned in section 119(1) of ICTA. Section 119 of ICTA applies to certain easements which are or might be used or enjoyed in connection with any of the concerns listed in section 55 of ICTA. Those concerns include mines, quarries, certain industrial concerns, canals, docks, markets, bridges, ferries, and railways. "Rent" and "easement" both have wide meanings for this purpose (see section 119(3) of ICTA).

Section 120(1) of ICTA provides for the rent from electric-line easements to be charged under Schedule D unless other income from the land to which the easement relates is charged under Schedule A. In that case the rent is charged to tax under Schedule A, section 120(1A) of ICTA.

Section 120(1) of ICTA does not specify under which Case of Schedule D the rent is to be charged. In practice, where the easement relates to land on which a person carries on a trade, the rent is charged under Schedule D Case I and, in other cases, under Case VI. In the absence of section 120 of ICTA the rent would be charged to tax under Schedule A. Section 120 of ICTA does not apply to rent from easements relating to land outside the United Kingdom, which is charged to tax under Schedule D Case V.

Section 120(1) of ICTA as it applies to trades is rewritten in clause 45. Under clause 45:

- the word "easement" is rewritten as "wayleave". The rest of this note refers to wayleaves;

- rents from wayleaves related to land associated with a trade will be charged to corporation tax under Part 3 of this Bill (as profits of the trade) if the taxpayer so chooses and has no other income from the land in question; and

- all other rents from wayleaves will be charged to income tax under Part 4 of this Bill (property income).

This enacts the existing non-statutory practice for easements to which section 120 of ICTA applies which are associated with a trade but represents a change both in practice and in the law as respects:

- wayleaves other than those connected with "electric, telegraphic or telephonic wire or cable";

- wayleaves relating to land outside the United Kingdom; and

- wayleaves of a kind mentioned in section 119(1) of ICTA.

Clause 45 makes clear that any expenses incurred in respect of the wayleave can also be allowed as deductions in calculating the profits.

Section 119(1) of ICTA is rewritten in Chapter 7 of Part 4 of this Bill. Under the law as it applies before the commencement of this Bill, rent in respect of a wayleave that meets the conditions in both sections 119(1) and 120(1) of ICTA is taxed under section 119 of ICTA. Clause 288(3) of this Bill reverses that order of priority. This is necessary to allow the company to have such rent taxed as the profits of a trade. It will not prevent a claim for relief under clause 273 of this Bill (relief in respect of mineral royalties) as rent for an electric-line wayleave would not qualify for such relief.

All rents that are in practice charged to tax under Schedule D Case VI (see the table in section 834A of ICTA) by virtue of section 120(1) of ICTA, as that section applies before the commencement of this Bill, will be charged under clause 277 (charge to tax on rent receivable for a UK electric-line wayleave). The table in section 834A is inserted by Part 1 of Schedule 1 to this Bill, and is a list of places where some of the Schedule D Case VI charges are rewritten.

The application of trading income rules to income which previously was subject to Schedule D Case V or Case VI could increase access to allowable deductions and to loss relief.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 7: Trading and property income: relationship between rules prohibiting deductions and rules allowing deductions: clauses 51 and 214

This change resolves any conflict between the rules prohibiting a deduction in calculating trade profits and the rules allowing a deduction in calculating trade profits in favour of the rule allowing the deduction. But any conflict is unlikely.

The change brings the income tax and corporation tax codes back into line.

Parts 3 and 20 of this Bill set out a number of rules that restrict the deductions allowed in the calculation of trade profits. Each of these is a "prohibitive rule".

Part 3 of this Bill also sets out a number of rules that allow deductions in the calculation of trade profits. Most of these rules are in Chapter 5 of Part 3 of this Bill. Each of these is a "permissive rule".

In some cases the source legislation for a permissive rule overrides a specific prohibitive rule. In other cases the source legislation provides that a deduction is allowed "notwithstanding anything in section 74 [of ICTA]". Such a form of words overrides all the restrictive rules in section 74 of ICTA. See, for example, section 82A of ICTA rewritten as clause 87. In other cases the source legislation says merely that a deduction is allowed.

Clause 51 makes clear that the permissive rule has priority over any prohibitive rule with the four exceptions set out in subsection (1)(b) of the clause.

In the case of car and motor cycle hire section 578A of ICTA makes clear that the provision restricts the amount of any deduction.

In the cases of unpaid remuneration and employee benefit contributions section 43 of FA 1989 and paragraph 1 of Schedule 24 to FA 2003 impose a timing rule that naturally overrides any permissive rule. And, in an instance where a conflict may arise, section 86 of ICTA (seconded employees) allows the deduction only "to the like extent" as if the employee had not been seconded.

In the case of crime-related expenditure the order of priority reflects the view that in enacting section 577A of ICTA Parliament intended that there should be no circumstances in which anyone should obtain a tax deduction by making a crime-related payment.

The order of priority given by clause 51 is relevant only if the expenditure is capable of falling within both a permissive rule and a prohibitive rule. This is most likely to happen in the case of the general restriction in clause 54. In these cases the source legislation leaves no uncertainty about the extent to which the prohibitive rule is overridden. The only area of uncertainty is where the restriction is imposed by a provision other than section 74 of ICTA. For example, the restriction that section 577 of ICTA imposes on business expenditure.

There is rarely scope for overlap between a specific permissive rule and a specific prohibitive rule. This is because the terms for either rule to apply are so closely defined. As a question of fact the expenditure will fall into one category or the other. But in the event of any overlap clause 51 changes the law by giving priority to the permissive rule.

For example, it is unlikely that expenditure that meets the conditions for section 83 of ICTA (patent fees etc) to apply would also be business expenditure disallowed by section 577 of ICTA. If it does the source legislation is silent on which rule takes priority. Clause 51 gives priority to the permissive rule.

Clause 214 applies the same order of priority to the profits of a property business.

If there is any doubt in the source legislation about which rule takes priority this change resolves the doubt in favour of the rule that allows the deduction.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 8: Trading income: align rules for debts proving irrecoverable after trade deemed to have ceased with general rules for bad debts: clause 55 and Schedule 1

This change aligns the relief given for bad debts by section 89 of ICTA with the relief given by section 88D of ICTA.

Section 337(1) of ICTA sets out what happens if a company begins or ceases to carry on a trade or begins or ceases to be within the charge to corporation tax. Its trade profits are calculated as if the trade begins or ceases to be carried on.

Section 89 of ICTA provides relief for bad debts if there is an "event" within section 337(1) of ICTA or if there is a change in the persons carrying on the trade. It gives relief for bad debts which meet certain conditions. Since the trade carried on before the event or change is deemed to be different from the trade carried on after the event or change section 74(1)(e) of ICTA would otherwise prohibit a deduction for bad debts. The desired effect is to treat the trade as continuing as far as bad debts are concerned.

Although the aim of section 89 of ICTA is the same as that of section 88D of ICTA (that is, to give relief for bad trade debts), there are significant differences between the two sections and the nature of the relief given. Specifically:

- section 89 gives relief for debts which are irrecoverable, whereas section 88D gives relief for an impairment loss;
- section 89 requires proof that a debt is irrecoverable, whereas section 88D has no corresponding requirement; and
- section 88D refers to debts released as part of a "statutory insolvency arrangement", whereas section 89 makes no mention of this.

The approach adopted in this Bill is to focus on the company carrying on the trade rather than on the trade. So it does not matter whether the debt was created when another taxpayer was carrying on the trade and this Bill repeals section 89 of ICTA without rewriting it (see Schedule 1). The change extends the more generous provisions of section 88D of ICTA to debts within section 89 of ICTA. This simplifies the law by bringing the bad debt relief provisions for companies into one clause.

This change is in taxpayers' favour in principle and may in practice benefit some. But the numbers affected and the amounts involved are likely to be small.

Change 9: Trading income: car hire: release of debt after debtor has ceased trading: clause 56

This change reduces the amount charged as a post-cessation receipt when a debt relating to the hire of a car with a new retail value of more than £12,000 is released after the debtor has ceased trading.

It brings the income tax and corporation tax codes back into line.

Section 578A of ICTA restricts the amount which a company carrying on a trade can deduct in respect of the cost of hiring a car or motor cycle with a retail value, when new, of more than £12,000. The restriction takes the form of a reduction calculated by reference to the difference between the £12,000 limit and the retail price.

Section 578A(4) of ICTA provides that where there is a rebate of a hire charge, or a debt to which section 94 of ICTA applies is released, the amount brought into account in respect of the rebate or release is reduced in the same proportion as that in which the trading deduction was restricted.

Section 578A(4) of ICTA deals only with a continuing trade. This change extends the same treatment to debts wholly or partly released after the debtor has ceased to trade and taxed as post-cessation receipts under clause 193 of this Bill.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 10: Trading income etc: car hire: hire agreements without option to purchase: clauses 57 and 1251 and Schedule 1

This change extends the definition of "qualifying hire car" for the purpose of restricting the amount allowed as a deduction for the cost of hiring a car to include cars hired under a hire-purchase agreement where there is no option to purchase.

The change brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Section 578A of ICTA restricts the amount which a company can deduct in respect of the cost of hiring a car or motor cycle with a retail value, when new, of more than £12,000. Section 578A of ICTA does not apply to a car or motor cycle which is a "qualifying hire car" as defined in section 578B(2) of ICTA.

Section 578B(2) of ICTA defines a "qualifying hire car" as a car which is:

> (a) … hired under a hire-purchase agreement … under which there is an option to purchase exercisable on the payment of a sum equal to not more than 1 per cent. of the retail price … when new, or
>
> (b) … a qualifying hire car for the purposes of Part 2 of the Capital Allowances Act (under section 82 …)

The definition of "qualifying hire car" in section 578B(2) of ICTA does not extend to cars hired under a hire-purchase agreement where there is no option to purchase. In practice, HMRC do not apply the restriction in section 578A of ICTA on the amount of deduction to cars hired under such agreements. This clause legislates that practice by including cars hired under a hire-purchase agreement where there is no option to purchase in the definition of hire car in subsection (2)(a) of the clause. So the hirer gets a deduction for the full amount of the hiring costs.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZN of ICTA (inserted by Schedule 1 to this Bill).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 11: Trading income: lease premiums etc: deduction for tenant under taxed lease if land is outside the United Kingdom: clauses 62 and 66

This change makes relief available for tenants under taxed leases of land used in connection with a trade, where the land is outside the United Kingdom.

It brings the income tax and corporation tax codes back into line.

Section 87(2) of ICTA provides in certain cases for a trading deduction to be given to a tenant under a lease, if previously an "amount chargeable" had arisen in relation to the lease concerned.

Section 87(1) of ICTA defines "amount chargeable" to include:

> (a) any amount [that] falls to be *treated as a receipt of a Schedule A business* by virtue of section 34 or 35, …
>
> (c) any amount [that] falls to be treated as a receipt of a UK property business by virtue of any of sections 277 to 282 of ITTOIA 2005…

Section 70A(5) of ICTA provides that:

> The income from an overseas property business shall be computed for the purposes of Case V of Schedule D in accordance with the rules applicable to the computation of the profits of a Schedule A business.

So if the lease is of land outside the United Kingdom, sections 34 and 35 of ICTA may apply to a landlord/assignor by virtue of section 70A(5) of ICTA. The amount given by section 34 or 35 of ICTA in cases where the land is outside the United Kingdom is treated as a receipt of an overseas property business.

But section 70A(5) of ICTA does not deem an overseas property business receipt to be a receipt of a Schedule A business. So a company occupying land outside the United Kingdom under a lease in respect of which the landlord has been treated as receiving an overseas property business receipt is not entitled to relief, under section 87(2) of ICTA (see the italicised words in the above extract from section 87(1) of ICTA), in circumstances in which it would have been entitled to relief if the land had been in the United Kingdom.

Similarly a company which occupies land outside the United Kingdom under a lease in respect of which the landlord has been treated as receiving an overseas property business receipt under sections 277 to 282 of ITTOIA is not entitled to relief in circumstances in which it would have been entitled to relief if the land had been in the United Kingdom. That is because section 87(1)(c) of ICTA refers to amounts which are treated as receipts of a UK property business under sections 277 to 282 of ITTOIA.

Clause 62(1) provides for a tenant to be treated as incurring expenses by reference to a taxed receipt under clause 63 regardless of where the land in question is situated. Clause 66(1) restricts, regardless of where the land in question is situated, the expenses that clause 65 (land not occupied by tenant but employed for purposes of tenant's trade) treats a tenant as incurring under clause 63 where there is a reduction under the additional calculation rule by reference to that taxed receipt. The same changes were made for income tax in sections 60 and 64 of ITTOIA (see Change 13 of Annex 1 to ITTOIA).

This change will result in a company receiving relief under clause 63 where there is currently no entitlement to relief.

Section 295 of ITTOIA (as amended by Schedule 1 of this Bill) and clause 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. This means that widening entitlement to relief under clause 63 may, in certain circumstances, reduce the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Bill.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

Change 12: Requiring an apportionment to be just and reasonable: clauses 63, 67, 78, 229, 234, 255, 1185, 1194 and 1241 and Schedule 1

This change requires certain apportionments that are not required to be made on a just and reasonable basis in the source legislation to be made on that basis.

It brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Apportionments are sometimes to be made on a specified basis, such as time apportionment. But often they are left to be made according to what is reasonable in the particular circumstances. This change is concerned with such apportionments.

In some cases where there is an apportionment under legislation rewritten in this Bill, the apportionment is required by the source legislation to be made on a just and reasonable basis. In other cases, it is required to be made only on a just basis or only on a reasonable basis, or there are no requirements. It is now the practice to require an apportionment to be just and reasonable. There is no reason why an apportionment should not be on a just and reasonable basis. And it is desirable that all apportionments of this nature should be made on the same basis.

Accordingly, where an apportionment under legislation rewritten in this Bill is not required to be made on a just and reasonable basis, the rewritten provision requires the apportionment to be made on a just and reasonable basis. The changes are as follows:

- section 30(2)(a) of ICTA (apportionment of deemed payment in respect of expenditure on sea walls, as may be just) (see clause 255(2));

- section 37(3) of ICTA (apportionment of appropriate fraction of the amount chargeable on the superior interest attributable to a part of premises required to be just) (see clause 229(3));

- section 37(6) of ICTA (amount chargeable on the superior interest to be proportionately adjusted between parts of premises; no explicit requirements as to the basis on which the adjustment is to be made) (see clause 234(7));

- section 87(3) of ICTA (apportionment of deemed rent attributable to part of land not occupied for the purposes of a trade, profession or vocation required to be just) (see clause 63(5));

- section 87(5) of ICTA, which applies section 37(6) of ICTA (amount chargeable on the superior interest to be proportionately adjusted between parts of premises; no explicit requirements as to the basis on which the adjustment is to be made) (see clause 67(6));

- section 579(5) of ICTA (apportionment of a redundancy payment where the employee is employed in different capacities; no requirements as to the basis on which the apportionment is to be made) (see clauses 78(2) and 1241(2));

- section 35(2) of FA 2006 (apportionment of expenditure as between UK expenditure and non-UK expenditure, for purposes of film production provisions, required to be fair and reasonable) (see clause 1185(2)); and

- paragraph 8 of Schedule 4 to FA 2006 (estimates for purposes of film production company provisions required to be fair and reasonable) (see clause 1194).

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZH of ICTA (inserted by Schedule 1 to this Bill).

It is difficult to identify even a theoretical difference between a just and reasonable apportionment and an apportionment on another basis. But this change is presented on the basis that there may be such a difference.

This change makes minor amendments to a number of existing rules, but is expected to have no practical effect as it is in line with generally accepted practice.

Change 13: Trading and property income: lease premiums etc: restrictions on expenses under clauses 63 and 232 in respect of taxed receipt: clauses 66, 67, 233 and 234

This change clarifies how expenses that a tenant is treated under section 37(4) of ICTA (property business) or section 87(2) of ICTA (trade) as incurring by reference to a taxed receipt are affected in certain cases. Those cases are where there is a reduction, under section 37(2) of ICTA (later chargeable amount) or under section 288 of ITTOIA (additional calculation rule), by reference to that taxed receipt.

It brings the income tax and corporation tax codes back into line.

Section 37(4) of ICTA provides:

> Subject to subsection (5) below, a company which is for the time being entitled to the head lease shall be treated for the purpose, in computing the profits of a Schedule A business, of making deductions in respect of the disbursements and expenses of that business as paying rent for those premises (in addition to any actual rent), becoming due from day to day, during any part of the period in respect of which the amount chargeable on the superior interest arose for which the company was entitled to the head lease, and, in all, bearing to that amount the same proportion as that part of the period bears to the whole.

Section 37(5) of ICTA modifies section 37(4) of ICTA if the reduced amount of a later chargeable amount has been calculated under section 37(2) of ICTA by reference to the amount chargeable on the superior interest (“ACSI”). Section 37(5) of ICTA provides:

> Where subsection (2) above applies, subsection (4) above shall apply for the period in respect of which the later chargeable amount arose only if the appropriate fraction of the amount chargeable on the superior interest exceeds the later chargeable amount, and shall then apply as if the amount chargeable on the superior interest were reduced in the proportion which that excess bears to that appropriate fraction.

The appropriate fraction is defined in section 37(7) of ICTA.

The general principle behind section 37(5) of ICTA is that, if part of ACSI has been used under section 37(2) of ICTA to reduce a later chargeable amount, only the balance of the ACSI should be available under section 37(4) of ICTA. This is achieved by reducing the amount of rent that the tenant is treated, in relation to the ACSI, as paying under section 37(4) of ICTA for the period in respect of which the later chargeable amount arose. And if (in the calculation under section 37(2) of ICTA) the appropriate fraction of the ACSI was fully used to reduce the later chargeable amount, no rent is treated as incurred under section 37(4) of ICTA for the period in respect of which the later chargeable amount arises.

The same general principle applies under section 37A of ICTA where part of ACSI has been used under section 288 of ITTOIA (additional calculation rule). The appropriate fraction is defined in section 37A(6) and (7) of ICTA.

Section 87(5) of ICTA applies section 37(5) of ICTA (part of ACSI used under section 37(2) of ICTA) if a tenant under a taxed lease is treated as paying rent under section 87(2) of ICTA in circumstances in which section 87(4) of ICTA applies.

Section 87A of ICTA applies section 37A of ICTA (part of ACSI used under section 288 of ITTOIA) if a tenant under a taxed lease is treated as paying rent under section 87(2) of ICTA in circumstances in which section 87(4) of ICTA applies.

The following explanation is in terms of sections 37 and 87 of ICTA but is equally applicable to sections 37A and 87A of ICTA.

Later chargeable amount reduced by more than one ACSI

It is possible that:

- the reduced amount, under section 37(2) of ICTA, of a later chargeable amount is nil, and

- the reduced amount of nil has been calculated by reference to more than one ACSI, but

- the appropriate fraction of each ACSI does not exceed the later chargeable amount.

In these circumstances, section 37(5) of ICTA prevents any relief under section 37(4) of ICTA for the period in respect of which the later chargeable amount arose.

But it is more consistent with the principle behind section 37(5) of ICTA that if the *total* of the appropriate fractions of the ACSI involved exceeds the later chargeable amount, rent equal to that excess should be treated as paid for the period in respect of which the later chargeable amount arose. Otherwise, that excess will not be available to provide relief under section 37(4) of ICTA. It will be lost, unless it can be used in the calculation of a reduced amount for a different later chargeable amount.

To deal with such a case, clause 233(3) uses the test that the "daily amount" of the taxed receipt must exceed the "daily reduction" of the lease premium receipt. Then clause 233(6) (by reference to clause 230(6)) limits the "daily reduction" of the lease premium receipt to the reduction that is attributable to the taxed receipt in question. The same change was made for income tax in section 293 of ITTOIA (see Change 15(A) of Annex 1 to ITTOIA).

Overlap in periods for which more than one later chargeable amount is reduced by one ACSI

It is also possible that the reduced amount of more than one later chargeable amount has been calculated under section 37(2) of ICTA by reference to an ACSI and that the amount of each of the later chargeable amounts has been reduced to nil. In these circumstances, section 37(4) and (5) of ICTA work satisfactorily if there is no overlap between the periods in respect of which each of the later chargeable amounts arose. But it is not at all clear how section 37(4) and (5) of ICTA are intended to operate if there is such an overlap.

If there is an overlap between the periods in respect of which each of the later chargeable amounts arose, it is reasonable that section 37(5) of ICTA should apply so that the *total* of the reductions in all later chargeable amounts by reference to the ACSI should be taken into account in determining how much, if any, rent should be treated as paid under section 37(4) of ICTA.

To deal with such a case, clause 233(2) and (5) make explicit provision if there is an overlap in the periods for which more than one lease premium receipt is reduced under clause 228 or under section 288 of ITTOIA by reference to a taxed receipt. The same change was made for income tax in section 293 of ITTOIA (see Change 15(A) of Annex 1 to ITTOIA).

Without these changes, clause 233 would produce the same result as section 37(5) of ICTA if there is one taxed receipt and one lease premium receipt. These changes make clause 233 work if:

- a lease premium receipt is reduced by reference to *more than one* taxed receipt; or

- a taxed receipt reduces *more than one* lease premium receipt and there is an overlap in the periods in relation to which those lease premium receipts arise.

Clause 66(2), (5) and (6) is based on that part of section 87(5) of ICTA that applies section 37(5) of ICTA. It includes similar changes to those in clause 233. The same change was made for income tax in section 64 of ITTOIA (see Change 15(A) of Annex 1 to ITTOIA).

Later chargeable amounts arise in relation to different parts of the premises covered by the head lease

Section 37(6) of ICTA provides for the application of section 37(4) and (5) of ICTA if the later chargeable amount is in respect of a lease of only part of the premises subject to the head lease.

Section 37(6) of ICTA does not deal with the possibility that:

- more than one lease of part of the premises is granted out of the head lease;

- later chargeable amounts in respect of each such lease are reduced under section 37(3) of ICTA by reference to ACSI; and

- there is an overlap in the receipt periods of those later chargeable amounts.

This possibility is dealt with in clause 234(5). The same change was made for income tax in section 294 of ITTOIA (see Change 15(B) of Annex 1 to ITTOIA).

Clause 67 is based on that part of section 87(5) of ICTA that applies section 37(6) of ICTA. Clause 67(4) includes a similar change to that in clause 234. The same change was made for income tax in section 65 of ITTOIA (see Change 15(B) of Annex 1 to ITTOIA).

Section 295 of ITTOIA (as amended by Schedule 1 of this Bill) and clause 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. So if, as a result of this change, the relief to which a company is entitled is increased or decreased, this may affect the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Bill.

This change is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 14: Trading income etc: clarification of position of employees seconded to charities: clauses 70 and 1235 and Schedule 1

This change provides that a company which seconds an employee to a charity or educational establishment is entitled to a deduction in calculating its profits, irrespective of the duties undertaken by the employee while on secondment.

The change brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Section 86 of ICTA gives relief for companies which second employees to charities or educational establishments. It does this by providing that, notwithstanding anything in the general rules on deductions not allowable in section 74 or 75 of ICTA, the cost of the seconded employee:

> shall continue to be deductible in the manner and to the like extent as if, during the time that his services are so made available … they continued to be available for the purposes of the employer's trade …

So if the costs of the employee would not be allowed under the normal rules – for example because the employee is employed on a capital project – the employer is not entitled to any deduction under section 86 of ICTA.

In practice, the costs of the secondment are allowed whatever the nature of the work carried out by the employee during the secondment. So if, for example, an employee is seconded to a medical charity to help build a hospice, the company is allowed to deduct the cost of employing the seconded person. This change gives statutory effect to that practice.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZB of ICTA (inserted by Schedule 1 to this Bill).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 15: Devolution: clauses 71, 81, 83, 155, 1243, 1284, 1320 and 1321 and Schedules 1 and 2

This change concerns the effect of the devolution settlements.

The change brings the income tax and corporation tax codes back into line. It also applies to management expenses and to the establishment of marketing authorities and similar statutory bodies.

Clauses 81 and 1243

The references to the Department for Employment and Learning in these clauses reflect:

- the transfer of functions from the Department of Economic Development to the Department of Higher and Further Education, Training and Employment under Part II of Schedule 2 to SR (NI) 1999 No. 481; and
- the renaming of that Department as the Department of Economic Development by the Department for Employment and Learning Act (Northern Ireland) 2001.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZJ of ICTA (inserted by Schedule 1 to this Bill).

Clause 83

The approval function in section 79(4) of ICTA conferred on the Secretary of State is exercisable in relation to Scotland by the Scottish Ministers (see SI 1999/1750 made under section 63 of the Scotland Act 1998).

Clause 83 of this Bill reflects that transfer of functions. So far as the function under section 79(4) of ICTA is concerned, SI 1999/1750 is partly superseded by this Bill. One consequence is that any change in the persons by whom those functions are exercisable will have to be made by primary legislation.

Clause 155

Section 509 of ICTA provides special rules for the treatment of the statutory reserve funds which must in certain circumstances be maintained by certain statutory authorities. Section 509(3) of ICTA defines the terms "Minister of the Crown" and "government department" to include a "Head of Department or a Department in Northern Ireland".

Clause 155(1) of this Bill maintains parity of treatment throughout the United Kingdom following the recent devolution settlements by rewriting the definition of “Minister of the Crown” to refer to a Minister of the Crown, the Scottish Ministers or the Welsh Ministers. Similarly, clause 155(2) rewrites the definition of “government department” to refer to a government department, a Northern Ireland department, a part of the Scottish Administration, and a part of the Welsh Assembly Government.

Some functions that are relevant for the purposes of section 509 of ICTA were, as a result of transfers of functions, exercisable in relation to Wales by the Welsh Ministers (see SI 1969/388, SI 1978/272, SI 1999/672 and the Government of Wales Act 2006). Some functions that may be relevant for the purposes of section 509 of ICTA (but not the function of making schemes under section 13 of the Agriculture Act 1967) were, as a result of transfers of functions, exercisable for Scotland by the Scottish Ministers (see SI 1999/1747).

The effect of section 85(1) of the Government of Wales Act 2006 is that, so far as statutory functions that are relevant for the purposes of section 509(1) or (2) of ICTA are exercisable by the Welsh Ministers, the corresponding references in those subsections to “a Minister of the Crown or government department” include the Welsh Ministers.

Section 117 of the Scotland Act 1998 (construction of references to Ministers of the Crown in pre-commencement enactments) does not appear to be relevant for present purposes, as it relates only to the exercise of functions within devolved competence.

Clause 1284

In Schedule 1 to the Interpretation Act 1978 “Act” is defined to mean an Act of Parliament and “enactment” is defined as not including “an enactment comprised in, or in an instrument made under, an Act of the Scottish Parliament”. The definitions in that Schedule apply “unless the contrary intention appears” (see section 5 of the 1978 Act).

Section 578 of ICTA confers an exemption from tax in relation to housing grants made under any enactment. Under the Interpretation Act 1978 it is not clear that “enactment” covers Acts of the Scottish Parliament (“ASPs”) or Scottish statutory instruments. And it is not clear that “enactment” covers all of the different kinds of legislation which may apply to Northern Ireland.

Clauses 1320 and 1321 of this Bill provide that ASPs, Scottish statutory instruments and Northern Ireland legislation are covered by the reference to “enactment” in clause 1284. So payments under them are capable of falling within the exemption in that clause. If this is a change, it is in line with practice, reflects the intention of the devolution settlement and widens the scope of the exemption.

It is very unlikely that these changes have any effect on any tax liabilities.

The changes are in line with current practice and reflect the devolution settlements.

Change 16: Trading income etc: retraining courses: deduction no longer dependent on employee's exemption: clauses 74 and 1238 and Schedule 1

This change removes the link in the source legislation between the employee's exemption and the employer's entitlement to a deduction.

This change brings the income tax and corporation tax codes back into line. It also applies to management expenses.

Section 588(3)(b) of ICTA permits a deduction when:

> by virtue of section 311 of ITEPA 2003, no liability to income tax arises in respect of the payment or reimbursement [of retraining course expenditure].

The requirement for the deduction to be allowed in clause 74(1) or 1238(1) is that the "relevant conditions" must be met. "Relevant conditions" is defined in clause 74(2) or 1238(3) which cross-refer to the detail of the conditions in section 311 of ITEPA. That does not include the employee's exemption from tax under that provision.

This change removes the requirement that the employee must be exempt on the benefit under section 311 of ITEPA. An employee may not be taxable on the employment income at all. That may be on account of the employee's residence position or on account of where the duties of the employment are performed. In such a case there is no need to deny relief to the employer.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZD of ICTA (inserted by Schedule 1 to this Bill).

The effect is that the employer's entitlement to a deduction ceases to be dependent, in part, on the employee's exemption.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 17: Trading income etc: redundancy payments: legislate the practice of allowing voluntary payments made in connection with a cessation of part of a trade or business: clauses 79 and 1242 and Schedule 1

This change legislates the practice of allowing as a deduction voluntary redundancy payments made in connection with the cessation of part of a trade or business.

The change brings the income tax and corporation tax codes into line. It also applies to management expenses.

Statement of Practice 11/81 extends the operation of section 90 of ICTA to payments in connection with the cessation of *part* of a trade. Clause 79(1) and (4) of this Bill gives effect to that practice. And clause 1242(1) and (4) extends the rule to the case where a part of an investment business ceases to be carried on.

Schedule 1 to this Bill amends ITTOIA to make clear that the practice applies to the cessation of part of a trade even if there is a change in the membership of a partnership.

If part of the trade or business continues, it would be possible to allow the deduction in the period of account in which the payment is made. But it is logical, and usually beneficial to the taxpayer, to make the deduction in the last period of account in which the part of the trade or business was carried on.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 18: Trading income etc: contributions to local enterprise organisations or urban regeneration companies: disqualifying benefits: clauses 82, 1244 and 1253 and Schedule 1

This change concerns the anti-avoidance rules in sections 79(3) and (9), 79A(3) and (4) and 79B(3) and (4) of ICTA.

The change brings the income tax and corporation tax codes back into line. It also applies for management expenses.

The aim of the anti-avoidance rules is to stop companies obtaining a deduction for contributions that have strings attached. For example, a company may give money to a local enterprise agency which is used to meet the costs of a shareholder's relative setting up in business. These costs would normally not be tax deductible. So the anti-avoidance rules are designed to prevent the costs becoming tax deductible by passing the money through a local enterprise organisation.

The denial of the deduction in the source legislation is "all or nothing". This may cause a problem. For example, a company gives £1 million to a training and enterprise council, but asks that employees be given free places on a word processing course (worth say £5000). The anti-avoidance rule bars any deduction under these provisions.

When section 79A of ICTA was enacted in 1990 an assurance was given that in a case such as this a deduction would be allowed. In practice HMRC ignore such benefits, or treat the payment as split into two, one part for the training and one for the donation.

Paragraph 47610 of the HMRC Business Income Manual makes it clear that relief is not denied if the costs of obtaining the benefit provided would have been allowable as a deduction if incurred directly on an arm's length basis. So the clause disallows a deduction only if there is a "disqualifying benefit".

Even if there is a "disqualifying benefit" the deduction may not be lost entirely. Instead, the deduction is restricted to take account of the benefit.

This change applies also to the corresponding rule for expenses of insurance companies in section 76ZK of ICTA (inserted by Schedule 1 to this Bill).

The change may give some relief in a case where the source legislation denies it because there is a benefit to the company making the contribution.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 19: Trading income etc: income charged on withdrawal of relief after source ceases: clauses 82, 101, 108 and 1277

This change treats certain amounts as post-cessation receipts and other amounts as if the source had not ceased.

It brings the income tax and corporation tax codes back into line.

Sections 79(9), 79A(4), 79B(4), 83A(4), and 84(4) of ICTA and section 55(4) of FA 2002 create a charge under Schedule D Case VI if the trader is not chargeable under Schedule D Case I or II in the accounting period in which a benefit is received. Section 491(3) of ICTA creates a similar charge on a distribution by a mutual concern. Section 584(4) of ICTA creates a charge under Schedule D Case VI if overseas income becomes remittable after the trade or other source of income has ceased.

This Bill unpacks Schedule D Case VI charges and deals with the income where it logically belongs. If the income becomes trading income, by treating the benefit or distribution as a post-cessation receipt, this Bill:

- allows the trader to make the same deductions as those available from other post-cessation receipts;
- removes any possibility that the benefit is charged both by the specific rule about benefits and by any general rule; and
- preserves the loss relief position by amending section 396 of ICTA and listing Chapter 15 of Part 3 of this Bill in section 834A of ICTA (see Schedule 1 to this Bill).

Clause 1277(4) of this Bill contributes to the unpacking of Schedule D Case VI charges. It treats the source of the overseas income as not having ceased, where income that was relieved under clause 1275 ceases to be unremittable after the source has actually ceased. The income is then charged under the provision that would apply had clause 1276 (withdrawal of relief) applied instead. The loss relief position under section 396 of ICTA is again preserved by Schedule 1 to this Bill.

In some cases this change may allow relief for deductions from post-cessation receipts that are not available in the source legislation.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 20: Trading income: patent fees paid: clauses 89 and 90
This change sets out the basis on which a deduction is allowed for patent fees. It brings the timing of the deduction into line with the vast majority of deductions allowed in calculating trading income.

It brings the income tax and corporation tax codes back into line.

Section 83 of ICTA allows a deduction for "fees paid or expenses incurred" in connection with the grant of patents etc. It is thought that the "fees paid" are those paid when a patent application is made. Such fees are incurred only when they are paid. So it is unlikely that business accounts would recognise the fees until they are paid.

There is no doubt that "expenses" include "fees".

These clauses allow a deduction for all expenses on the basis of the amounts incurred. In principle the rule in these clauses may allow companies to take a deduction for fees earlier than the ICTA rule.

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 21: Trading income: payments to Export Credits Guarantee Department: clause 91

This change allows payments to the Export Credits Guarantee Department ("ECGD") to be deducted in calculating the profits of a trade when the expense is payable rather than when it is paid.

It brings the income tax and corporation tax codes back into line.

Section 88 of ICTA allows a company carrying on a trade to deduct "sums paid" to the ECGD in calculating the profits of that trade.

Clause 91 follows accounting treatment in allowing traders to deduct a payment to the ECGD at the time it is payable.

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 22: Trading income etc: allow all FISMA levies and costs: clauses 92, 104 and 1246 and Schedule 1

This change ensures that all payments of levies and costs under FISMA are allowed as deductions.

Trading income

Section 76A of ICTA allows a deduction for "any sum expended … in paying a levy". "Levy" is defined in section 76A(2) by listing the sorts of payment that may be required under FISMA.

- The first sort of payment relates to the legal assistance scheme in connection with hearings before the Financial Services and Markets Tribunal (see sections 134 to 136 of FISMA).

- The second sort of payment relates to the Financial Services Compensation Scheme. A levy in connection with this scheme may be made on an "authorised person" (see section 31 of FISMA) by the "scheme manager" (see section 212 of FISMA). The power to do this is in section 213(3)(b) of FISMA.

- The third sort of payment relates to the ombudsman scheme (see sections 225 to 234 of FISMA). The expenses of the scheme are funded by payments required from authorised persons by the Financial Services Authority under section 234 of FISMA.

- The fourth sort of payment relates to the ombudsman's "compulsory jurisdiction" (see section 226 of FISMA). Under paragraph 15 of Schedule 17 to FISMA the scheme operator may require a respondent (defined in section 226(1) to mean the person complained of) to pay a fee.

- The fifth sort of payment relates to the ombudsman's "voluntary jurisdiction" (see section 227 of FISMA). Under paragraph 18 of Schedule 17 to FISMA the scheme operator sets "standard terms" for dealing with complaints dealt with under the voluntary jurisdiction. Paragraph 18(3) of Schedule 17 allows the standard terms to require the making of payments to the scheme operator (paragraph (a)) and to include the award of costs (paragraph (b)).

The first four sorts of payment may be described as contributions towards the costs of running the schemes that are set up by FISMA. And, within the fifth sort of payment, the payments to the scheme operator also have the character of a contribution to running costs (in that case, of the voluntary jurisdiction).

It is clear that the contributions to running costs are allowable. But the position of "costs" is unclear. Section 76A(2)(e) excludes payments "other than an award which is not an award of costs under costs rules". "Costs rules" are defined in subsection (6) as rules made under section 230 of FISMA (which are not relevant to the voluntary jurisdiction) and rules contained in the "standard terms" for the voluntary jurisdiction. The standard terms published by the Financial Standards Authority do not distinguish between:

- the levies to be paid on the same basis as those for the compulsory jurisdiction; and

- the costs that may be awarded against a respondent.

Management expenses
Section 76B of ICTA allows a deduction for "any sums paid … by way of a levy or as a result of an award of costs under the costs rules". The definitions of "levy" and "costs rules" are imported from section 76A.

As with the trading income rule, it is clear that the contributions to running costs are allowable. But, unlike in the trading income rule, all "costs" are also allowable.

What the Bill does

If section 76A(2)(e) of ICTA means that some costs are not allowable as a trading deduction it is difficult to explain why this is the case. So the trading income rule in clause 92 is brought into line with the management expenses rule.

Section 76A of ICTA applies only to an "authorised person". But section 76B apparently applies more widely. It is conceivable that an unauthorised person may make a payment within section 76A. There is no reason why such a person should not have a trading deduction. So clause 92 is not restricted to authorised persons.

Section 76A of ICTA does not apply to an "investment company". This rule was not changed when most of the rules about investment companies were amended to refer to companies with investment business. The rule applies only to give a deduction under Schedule D Case I. In the rare case of an investment company carrying on a trade there is no reason why it should not have a trading deduction. So clause 92 does not exclude investment companies.

Amendments to section 155 of ITTOIA (see Schedule 1 to this Bill) keep the income tax and corporation tax codes in line.

This change allows a deduction for some levies or costs that are not allowed by the source legislation.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 23: Trading income: reverse premiums: excluded cases: clause 97

This change restores an exemption that was incorrectly removed by ITTOIA.

Paragraph 6 of Schedule 6 to FA 1999 exempted from the charge on reverse premiums a premium relating to an individual's only or main residence. The rule was rewritten for income tax in section 100(2) of ITTOIA. Paragraph 509(5) of Schedule 1 to ITTOIA omits paragraph 6 of Schedule 6 from FA 1999 on the assumption that the exemption is not relevant for corporation tax.

But paragraph 1(1)(a) of Schedule 6 to FA 1999 caters for different persons receiving the reverse premium and entering into the transaction. So it is possible for an individual to enter into a property transaction which relates to a residence but for a (connected) company to receive the reverse premium. In such a case the exemption is relevant to companies and this change reinstates it.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 24: Trading income: assets of mutual concerns: exclude distributions of chargeable gains from the charge to tax: clause 101
This change defines the profits out of which a chargeable distribution is made so as to exclude distributions of chargeable gains.

It brings the income tax and corporation tax codes back into line.

Section 491(1) of ICTA excludes distributions of assets representing capital from the charge in subsection (3). Subsection (8) explains what is meant by such assets. It is generally understood that chargeable gains made by the concern do not represent capital as described in subsection (8). So distributions of such gains are within the charge in subsection (3).

Nevertheless, HMRC do not in practice seek to apply section 491 of ICTA to distributions of chargeable gains. The clause adopts a positive approach to defining the distributions to which the clause applies. The condition in clause 101(1)(d) of this Bill refers to profits of the mutual business. Chargeable gains are not profits of the mutual business and so the clause reflects the current practice. So such gains are no longer within the charge in subsection (3).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 25: Trading income: sums recovered under insurance policies etc: clause 103
This change gives statutory effect to the accountancy treatment for crediting a sum recovered under an insurance policy.

It brings the income tax and corporation tax codes back into line.

Section 74(1) of ICTA lists various items in respect of which no deduction is allowed in computing profits to be charged to corporation tax including:

> (l) any sum recoverable under an insurance or contract of indemnity

A sum recovered under an insurance policy or contract of indemnity is a receipt and not therefore an item in respect of which a deduction would normally be made in calculating profits for corporation tax.

The courts have interpreted section 74(1)(l) of ICTA and the enactments from which it is derived as prohibiting the deduction of a loss or expense *to the extent that* the loss or expense is recovered under an insurance policy or contract of indemnity (even where that recovery is on capital account). See, for example, Lawrence LJ's description of the meaning of the equivalent provision in the Income Tax Act 1918[1] on page 381 of Green v J Gliksten and Son Ltd (1929), 14 TC 364 HL:

> in arriving at the balance of profits or gains there has to be no deduction in respect of a loss which is covered by insurance to the extent by which that loss is so recovered.

Clause 103 achieves the same effect as section 74(1)(l) of ICTA by bringing a capital amount recovered into account as a trade receipt rather than by prohibiting a deduction in respect of the loss or expense in respect of which it is recovered. This makes the proposition easier to understand without changing the law.

Section 74(1)(l) of ICTA requires a deduction in respect of a loss or expense to be reduced by the amount of any insurance recovery. But where the loss and the recovery fall in different periods the accountancy treatment is to deduct the loss or expense in the period in which it is incurred and to credit the recovery in the period in which it arises.

In practice, HMRC allow traders to follow the accounting treatment in crediting the recovery. This informal concession is set out in paragraphs 40130 and 40755 of the HMRC Business Income Manual. Clause 103 gives the concession statutory effect.

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 26: Trading income: gifts of trading stock: drop the need for the gift to be plant and machinery in the hands of the educational establishment: clause 105

This change removes the requirement that a gift to an educational establishment should qualify as plant and machinery in the hands of the educational establishment.

It brings the income tax and corporation tax codes back into line.

Section 84(1) of ICTA (gifts to educational establishments) gives relief for the gift of an article that "qualifies as plant or machinery". Subsection (2) sets out what those words mean. The similar relief in section 83A of ICTA for gifts of trading stock to charities does not have the same condition. The change brings the relief for gifts to educational establishments into line with the relief for gifts to charities. There is no longer the need for a gift to qualify as plant and machinery before relief can be given.

[1] Paragraph (k) of Rule 3 of the rules applicable to Cases I and II of Schedule D

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 27: Trading income: gifts of trading stock: gifts "for the purpose of" a charity etc: clause 105

This change brings the wording of the relief for a gift to a charity, a registered club or one of the special bodies listed in clause 105(4) of this Bill into line with that for a gift to an educational establishment.

It brings the income tax and corporation tax codes back into line.

Section 84 of ICTA allows relief for a gift of an article "for the purposes of a designated educational establishment". Those words ensure that the relief is available even if the gift is made to a person (such as a local education authority) who becomes the legal owner of the article so that it can be used in a school. In many cases the gift is not "to" the school.

Section 83A of ICTA allows similar relief but in this case the gift must be "to" a charity. The clause, instead, follows the section 84 model and allows relief for a gift "for the purposes of" a charity, a registered club or one of the listed bodies. This widens the circumstances in which relief is available.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 28: Trading income: gifts of trading stock: drop the need for a claim: clause 105 and Schedule 1

This change removes the requirement that a company should make a claim for relief on a gift to an educational establishment.

It brings the income tax and corporation tax codes back into line.

Section 84(3) of ICTA provides that the relief does not apply unless "the donor makes a claim". The general approach of this Bill is not to require a claim for a trading deduction. In this case, the relief takes the form of removing the obligation to include a trade receipt. But the same principle applies here.

Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Bill removes the reference to section 84 of ICTA in paragraph (a) of that subsection and does not replace it.

The similar relief for gifts to charities in section 83A of ICTA does not require a claim. So this change makes the two reliefs consistent.

The provisions that govern claims are not the same as the provisions that govern returns. But in practice dropping the need for a claim has only the following two consequences, both of which relate to the time available for "claiming" the relief.

First, the absolute time limit for making a claim is replaced by a time limit that may vary according to the particular circumstances. That may be because the return is issued late or because the taxpayer makes a late return. Accordingly, HMRC are no longer able to refuse a claim because it is late by reference to an absolute time limit: returns time limits and sanctions apply and they depend on the date the return was issued and submitted.

Second, mistake relief claims under paragraph 51 of Schedule 18 to FA 1998 are possible if too much tax is paid as a result of omitting the relief from the tax return. Claims under paragraph 51 of Schedule 18 to FA 1998 must be made within six years of the end of the accounting period to which the return relates.

This change is in taxpayers' favour in principle and may benefit some taxpayers in practice. But the numbers affected and the practical effects are likely to be small.

Change 29: Trading income: gifts of medical supplies and equipment: clause 107
This change makes clear that the reliefs for gifts out of trading stock of medical supplies apply only for corporation tax purposes.

In FA 2002:

- section 55 applies only to companies;
- the deduction for expenses in subsection (3) applies only for corporation tax purposes;
- subsections (3) and (4) refer to an "accounting period" of the company (which is a defined term only for corporation tax purposes); and
- the charge to tax under subsection (4) on any benefit attributable to the making of the gift is a charge to corporation tax.

This leaves open the theoretical possibility that the relief for the gift in subsection (2) (but not for the associated costs) is available to a non-UK resident company liable to income tax (because it carries on a trade in the United Kingdom other than through a permanent establishment in the United Kingdom). Any charge (under Schedule D Case VI) on a benefit received by such a company would be charged to corporation tax, even though the company is not otherwise within the charge to that tax.

It would be surprising if Parliament's intention was that subsection (2), but not subsection (3), should apply for income tax purposes; or that the charge on a benefit should be to a tax to which a company is not already chargeable.

In practice, it is very unlikely that trading stock could belong to a trade that is carried on in the United Kingdom, but not through a permanent establishment.

So clause 107 of this Bill rewrites section 55 of FA 2002 as providing only corporation tax relief and Schedule 1 to the Bill repeals that section.

The change removes the possibility of income tax relief. But there is a minor theoretical benefit to taxpayers because the change also removes the possibility of a corporation tax charge on a company otherwise liable only to income tax.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 30: Trading income: herd basis rules: meaning of "substantial part of herd": clause 111 and clause 118

This change gives statutory effect to the practice of treating 20% of the herd as substantial.

It brings the income tax and corporation tax codes back into line.

A number of clauses in the herd basis rules refer to "a substantial part of the herd".

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

What constitutes a substantial part of the herd or a substantial difference is primarily a question of fact. But this change gives statutory effect to a long-standing practice set out in paragraph 55525 of the HMRC Business Income Manual. This provides that 20% of the herd will be regarded as substantial. This does not, however, prevent a smaller percentage from being regarded as substantial.

This change assists taxpayers because it provides for certainty and uniformity. It grants relief in circumstances where the test in the source legislation (evaluation of all the facts) might have been denied.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 31: Trading income: herd basis rules: sale of whole or substantial part of herd: clauses 117 and 118

This change merges the rules in paragraph 3(7) to (9) of Schedule 5 to ICTA.

It brings the income tax and corporation tax codes back into line.

Paragraphs 3(7) to (9) of Schedule 5 to ICTA set out the rules relating to the sale of all or most of a herd within 12 months.

Paragraph 3(7) of Schedule 5 to ICTA applies when a herd is sold as a whole and then replaced. Paragraph 3(8) of Schedule 5 to ICTA deals with cases where the whole of a herd is sold "in circumstances in which sub-paragraph (7) above does not apply". Or when a substantial part of a herd is sold. Paragraph 3(9) of Schedule 5 to ICTA sets out rules for the circumstances where paragraph 3(8) but not 3(7) of Schedule 5 to ICTA is relevant, provided that replacement begins to take place within five years.

ICTA does not make clear how quickly a herd must be replaced in order for paragraph 3(7) - rather than paragraph 3(8) of Schedule 5 to ICTA - to apply. This change merges these rules.

There are three practical differences between the application of the rules in paragraph 3(7) and those in paragraph 3(8) and 3(9) of Schedule 5 to ICTA.

First, paragraph 3(8) of Schedule 5 to ICTA directs that neither the profit nor the loss on the sale is to be taken into account. So, in effect, the farmer may obtain a tax-free gain on any profit from the sale. By contrast paragraph 3(7) of Schedule 5 to ICTA does not say how to deal with the proceeds of sale before it is known how many of the old herd will be replaced.

Second, if the farmer subsequently acquires a new production herd (which must be treated as a replacement herd) or animals to replace the part of the herd sold, paragraph 3(9) of Schedule 5 to ICTA recovers any tax-free gain made on the sale of the old animals. To achieve this the proceeds of the sale of each animal are brought into account at the time the replacement animal is acquired. By contrast paragraph 3(7) of Schedule 5 to ICTA contains no timing rule.

Third, in providing for the sale proceeds to be brought into account, paragraph 3(9) of Schedule 5 to ICTA allows the trading receipt to be reduced if the replacement animal is of worse quality than the old animal (on an enforced sale). Paragraph 3(7) of Schedule 5 to ICTA, however, does not permit such a reduction to be made.

Merging these rules removes these differences. It gives a common set of rules where a whole herd is sold, whether at once or over a period of up to a year. These are the rules set out in paragraphs 3(8) and (9) of Schedule 5 to ICTA.

Clause 117 begins the process of merger by providing that in all cases where a herd or a substantial part of a herd is sold within a year the profit or loss which arises from that sale is not to be taken into account. That rule is then made subject to the rules which follow in clause 118 and clause 120 which concern the acquisition of a new herd or replacement of a substantial part of a herd respectively.

It is possible that merging the rules may disadvantage the farmer who sells a herd over a period of 12 months and replaces it with a new, smaller herd. In this case clause 118(4) taxes the profit on the difference if the difference is not substantial. That subsection is based on paragraph 3(11) of Schedule 5 to ICTA and is consistent with herd rules viewed as a whole.

But it is arguable that paragraph 3(11) of Schedule 5 to ICTA does not apply to all disposals within paragraph 3(8) of Schedule 5 to ICTA. This is because paragraph 3(11) applies "Where the herd is sold as a whole" while paragraph 3(8) applies both if the herd is sold "either all at once or over a period not exceeding twelve months". But unless the rule in paragraph 3(11) of Schedule 5 to ICTA is applied to all cases where a herd is sold within a year it would be difficult, if not impossible, to merge the rules in paragraphs 3(7) to 3(9) of Schedule 5 to ICTA. This is because it would be necessary to distinguish between the two circumstances in paragraph 3(8) in which a herd may be sold and apply different results to the two situations. This is likely to involve a more significant change in the law than the approach adopted in clause 118(4).

This change assists taxpayers because it provides a single coherent set of rules.

This change may be adverse to some taxpayers because it removes the possible argument that paragraph 3(11) did not apply to circumstances to which paragraph 3(8) applied. In other words, it removes the possible argument that, where a farmer sells a herd over a period of 12 months and replaces it with a new herd which is not substantially smaller than the old one, the notional profit on the difference is not taxable.

This change may be favourable to some taxpayers because by applying the rule in paragraph 3(8) (that disposal proceeds are taxed only when acquisition costs are allowed) to circumstances to which paragraph 3(7) would have applied, the possibility that disposal proceeds are taxable immediately is removed.

This change is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 32: Trading income: herd basis elections: five year gap in which no production herd kept: clause 123

This change gives statutory effect to the practice in paragraph 55630 of the HMRC Business Income Manual (BIM 55630).

It brings the income tax and corporation tax codes back into line.

Paragraph 4 of Schedule 5 to ICTA provides a special rule for herd basis elections where there is a gap of at least five years when the farmer does not keep a production herd of a particular class. The farmer is treated as never having kept such a production herd at all.

This approach sits oddly with the rule in paragraph 2(4) of Schedule 5 to ICTA that a herd basis election is irrevocable. It is not clear which rule has priority.

HMRC practice is to allow the farmer to decide whether or not the herd basis rules continue to apply. This is achieved by ignoring the previous election for the purposes of allowing the farmer to make a fresh election: farmers can either make a fresh election or do nothing. Clause 123 gives this practice statutory effect.

This change allows the taxpayer to select the basis of taxation.

This change is in the taxpayer's favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 33: Trading income: securities held as circulating capital: clause 129

This change dispenses with the requirement that securities within section 473 of ICTA must be securities to which the company is beneficially entitled.

It brings the income tax and corporation tax codes back into line.

Section 473 of ICTA contains special rules for the tax treatment of certain securities held as circulating capital, the profit on the sale of which would form part of the trading profits of a company. The effect is that neither a profit nor a loss is crystallised on a conversion of the securities.

It is not clear why section 473 of ICTA applies only to securities to which a company is beneficially entitled.

There is no reason to calculate a company's profits from dealing in securities in a fiduciary or representative capacity in a different way from a company's profits from dealing in securities beneficially held by the company.

So clause 129 dispenses with the requirement that the company must be beneficially entitled to the shares in question. This means that clause 129 applies to transactions by companies acting in a fiduciary or representative capacity as well as to companies dealing on their own behalf.

It also means that clause 129 applies to securities in stock lending or sale and repurchase arrangements where beneficial ownership has passed to the company's counterparty but where the company continues to account for profits and losses as if those securities had not been disposed of.

A profit or loss on the conversion of securities to which this change applies is not recognised for tax purposes until the replacement securities are disposed of.

This change affects the timing of the tax liability. It is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 34: Trading income: traders receiving distributions etc: clause 130 and Schedule 1

This change alters the test for bringing a distribution received from a UK resident company ("a UK distribution"), or a payment representative of such a distribution, into account in calculating the profits of a trade for corporation tax purposes from one based on the underlying shares to one based on the character of the receipt or payment.

It brings the income tax and corporation tax codes back into line.

Section 95 of ICTA sets out the circumstances in which a UK distribution or a payment "representative of" a UK distribution, is brought into account in calculating the corporation tax profits of the company by which the distribution is received or to which the payment is made.

Section 95 of ICTA operates by determining whether the company by which the distribution is received or to which the payment made is a dealer in relation to that distribution. Section 95(2) of ICTA tests whether the company is a dealer by reference to whether the proceeds of a notional sale by the company of the shares in respect of which the distribution is received or the payment made would be taken into account in calculating the profits of the company's trade.

This approach is a legacy of the origin of section 95 of ICTA. Section 95 of ICTA is derived from section 54 of FA 1982. Section 54 of FA 1982 was concerned with the tax treatment of a dealer from whom a company purchased its own shares. In that context it was logical to focus on the shares rather than on the distribution. But this has the problem not only that the sale is theoretical but also that the shares may not be held by the dealer when the distribution is received. It is no longer the logical approach now that section 95 of ICTA applies to all distributions received by share dealers.

So clause 130 provides that:

- a UK distribution is brought into account in calculating the profits of a trade if it is a trade receipt; and

- a payment representative of such a distribution is brought into account in calculating the profits of a trade if a deduction for the payment would be disallowed only by clause 1305.

Section 208 of ICTA provides that "except as otherwise provided by the Corporation Tax Acts" corporation tax is not chargeable on dividends and other distributions. Section 95(1A) of ICTA disapplies section 208 of ICTA in the case of a UK distribution, or a payment representative of such a distribution, received by a dealer.

Paragraph 2(2)(b) of Schedule 23A to ICTA provides that an amount representative of a dividend on UK shares (a "manufactured dividend") is treated in relation to the company by which it is paid as if it were a dividend on its own shares.

Section 337A(1)(a) of ICTA provides that "subject to any provision of the Corporation Tax Acts expressly authorising a deduction", a company's profits are to be computed "without any deduction in respect of dividends or other distributions". Section 95 of ICTA expressly provides for a payment representative of a UK distribution made by a company which is a dealer to be taken into account in computing the profits of that company.

Clause 130 does not refer to a "dealer" (defined in section 95(2) of ICTA). So Schedule 1 to this Bill replaces references to that definition. See the entries for section 26(7) of F(No 2)A 2005 and section 121(3) of FA 2006, where the replacement definitions reproduce the exclusion for insurance companies in section 95(2A) of ICTA.

HMRC believe it is highly unlikely that a UK distribution could be a receipt of a trade, or that the payment of an amount representative of a UK distribution could be allowed as a trade deduction, unless the proceeds of any sale of the shares giving rise to the distribution or payment would also be treated as a receipt or allowable expense of that trade. But if this is not the case, the change may in principle be unfavourable to some taxpayers by bringing into account a UK distribution which would otherwise be exempt under section 208 of ICTA and favourable to others by allowing a deduction for a payment representative of a UK distribution which would otherwise be disallowed under section 337A(1) of ICTA.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 35: Trading income etc: combine pools payments rules: clauses 138 and 978

This change combines sections 126 of FA 1990 and 121 of FA 1991.

It brings the income tax and corporation tax codes back into line.

Clause 138 of this Bill does not specify that payments in consequence of the 1990 reduction in pool betting duty must be made for the safety and comfort of football spectators, and that payments in consequence of the 1991 reduction in pool betting duty must be made to the Foundation for Sport and the Arts. Instead payments in consequence of any reduction in pool betting duty for either purpose will qualify.

Lord Justice Taylor's report into the Hillsborough disaster, published on 18 January 1990, recommended that significant capital expenditure should be incurred to improve safety and comfort at football grounds. To facilitate this the rate of pool betting duty was reduced from 42.5% to 40% in FA 1990, in exchange for an agreement that the money saved by pools promoters would be given to the Football Trust 1990, which would use it to implement the Taylor recommendations.

The following year the government agreed to a further reduction of 2.5% in pool betting duty on condition that the money saved was paid to a charitable trust to be set up by the three main pools companies. The trust is called the Foundation for Sport and the Arts. For legal reasons connected with pool betting duty, the Foundation's main purpose is the support of athletic sports and games, but up to one third of its funds may be used to promote the arts.

The objectives of sections 126 of FA 1990 and 121 of FA 1991 are to ensure that the money saved in pool betting duty can flow through to its intended purpose in full, without tax liabilities.

Because the source sections have very similar objectives and consequences, this Bill combines them.

In principle a company could divert payments from one destination to the other and still obtain a deduction, but in practice (because the payments are made under agreements with the bodies concerned) this is not possible. Even if it were possible the payments would still be supporting the defined good causes.

Clause 978 of this Bill adopts the same approach to rewriting section 126(3) of FA 1990 and section 121(3) of FA 1991. The payments made are not treated as annual payments.

The payments covered by this change are allowed as trading deductions. And the payer does not have to deduct income tax from them.

This change is in taxpayers' favour in principle. But is expected to have no practical effect as it is in line with generally accepted practice.

Change 36: Trading income etc: extend pools payments treatment to the 1995 reduction: clauses 138 and 978

This change extends the treatment of payments in consequence of reductions in pool betting duty so that it applies to the reduction in pool betting duty made in any year.

It brings the income tax and corporation tax codes back into line.

Pool betting duty was reduced in 1990 and 1991 in exchange for agreements that the money saved would be paid to particular good causes (the Football Trust 1990 and the Foundation for Sport and the Arts, respectively).

Sections 126 of FA 1990 and 121 of FA 1991 were enacted to ensure that the money could flow through to the beneficiaries without tax consequences.

In 1995 pool betting duty was reduced again, with half of the money saved to be paid to the Football Trust and the other half to the Foundation for Sport and the Arts. But no equivalent tax legislation was enacted. In practice the payments are treated in the same way as those made from the 1990 and 1991 reductions.

Clause 138 of this Bill allows a trading deduction for payments made because of any reduction in pool betting duty. So the 1995 reduction and any further reductions which result in payments being made to the two "good causes" lead to the payments being allowed as a trading deduction.

Clause 978 of this Bill adopts the same approach to rewriting section 126(3) of FA 1990 and section 121(3) of FA 1991. The payments made are not treated as annual payments.

The payments covered by this change are allowed as trading deductions. And the payer does not have to deduct income tax from them.

This change is in taxpayers' favour in principle. But is expected to have no practical effect as it is in line with generally accepted practice.

Change 37: Trading income: use period of account instead of tax year as the basis for certain restrictions on relief in connection with a deemed employment payment: clause 140

This change clarifies the calculation of the restriction of a deduction for a deemed employment payment and of the cap on expenses for partnerships that are treated as making a deemed employment payment.

Paragraph 18 of Schedule 12 to FA 2000 limits the deduction allowed by paragraph 17 of the Schedule in the case of a business carried on "by a partnership". The limit is the amount that reduces the profits of the partnership *for the tax year* to nil. Until 2005, when section 164 of ITTOIA rewrote the income tax rule, the rule was the same for both income tax and corporation tax.

The consequential amendments made by ITTOIA do not affect the wording of the limit, which continues to use "tax year", an expression which is defined only for income tax purposes (see paragraph 17(4) of Schedule 12 to FA 2000 and section 989 of ITA).

The profits of a trade carried on by a company in partnership are calculated as if the trade were carried on by a single company (see section 114(1) of ICTA, rewritten in this Bill as clause 1259). It is not sensible that a rule for calculating the profits of a company should apply to the profits of a tax year. Consistent with the rule in clause 139, this partnership rule refers to the profits of a *period of account*.

Clause 140(3) of this Bill caps the allowable expenses by reference to the steps of the calculation of the deemed employment payment. That calculation is for a tax year (see section 54 of ITEPA). But the expenses are compared with the expenses of the trade carried on by a company in partnership. As with subsection (2), it is unreasonable to require a company to calculate its profits of a tax year. So the comparison is with the expenses for a period of account.

Changes in the period over which profits are calculated could in principle increase or decrease them by small amounts and so affect the amount of tax payable.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 38: Trading income: waste disposal: site preparation expenditure: drop requirements to make claim and submit plans and documents: clause 142 and Schedule 1

This change drops the requirements to make a claim and submit plans and documents when making deductions under clause 142.

It brings the income tax and corporation tax codes back into line.

Section 91B of ICTA allows a revenue deduction for capital expenditure on preparing a waste disposal site for use. The expenditure is spread over the life of the site by means of a formula based on the total capacity of the site and the amount of that capacity which has been used.

The company must make a claim for relief under section 91B(1) of ICTA (in such form as HMRC may direct), and submit such plans and documents as HMRC may require.

The requirement to submit plans and documents sits uneasily with Self Assessment – Part 3 of Schedule 18 to FA 1998 requires companies to keep such information and produce it in the event of an enquiry.

The clause also drops the requirement to make a claim for relief, with the result that relief is simply a deduction in the company's self-assessment. Once the requirement to submit plans and documents is removed, there seems no reason to require a claim for this particular deduction as opposed to any other.

Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Bill removes the reference to section 91B of ICTA in paragraph (a) of that subsection and does not replace it.

The claim under section 91B(1) of ICTA must be made within six years from the end of the accounting period to which it relates (paragraph 55 of Schedule 18 to FA 1998). Removing the need to claim means that companies generally have 12 months from the end of the accounting period in which to include the deduction in their self-assessment. However, mistake claims are available if too much tax has been paid as a result of omitting the deduction from the tax return.

In rare cases (involving the very late issue of a notice to make a return) the time limit for claiming a deduction is extended. In other cases (where there is no mistake in a return) the time limit is shortened.

This change is adverse to some taxpayers and favourable to others in principle but is not expected to have any practical effect.

Change 39: Trading income: valuation of stock: clauses 164 to 167 and Schedule 1

This change relaxes the conditions that apply if stock or work in progress is to be valued at the price actually paid when that stock or work in progress is transferred between persons who carry on trades, professions or vocations. It removes an unnecessary distinction between trades, professions and vocations.

It is possible for the same thing to be stock for one taxpayer but work in progress for another. Examples are the "incomplete services" part of stock (see section 100(2)(b) of ICTA, rewritten as clause 163(2) of this Bill) and the "materials" part of work in progress (see section 183(1) of ITTOIA).

The usual rule is that stock and work in progress are valued when a person ceases to carry on a trade profession or vocation at:

- open market value (stock – section 100(1)(b) of ICTA, rewritten for income tax as section 175(4) of ITTOIA and in this Bill as clause 164(4)); or

- arm's length value (work in progress – section 101(1)(b) of ICTA, rewritten for income tax as section 184(2) of ITTOIA).

But in each case there is an exception if the stock or work in progress is transferred to a person who carries on, or intends to carry on, a trade, profession or vocation in the United Kingdom and is entitled to deduct the cost of the stock or work in progress in calculating the profits of that trade, profession or vocation. In that case, the transfer takes place for tax purposes at the price actually paid (subject to special rules where the buyer and seller are connected or an election is made).

In the case of work in progress, the "actual price" basis of valuation applies only if the transferee carries on, or intends to carry on, a profession or vocation. This means that work in progress of a profession or vocation which is transferred to a trader (for whom it is trading stock) strictly does not qualify for the "actual price" basis of valuation.

In the case of trading stock, the "actual price" basis of valuation applies only if the transferee carries on, or intends to carry on, a trade. This means trading stock of a trade which is transferred to a person carrying on a profession strictly does not qualify for the "actual price" basis of valuation.

Corporation tax

In the case of trading stock transferred to an individual who carries on a profession or vocation, this Bill allows the stock to be valued at the price actually paid (see clauses 164 to 167 of the Bill). That basis of valuation is not available under section 100(1)(a) of ICTA.

Professions and corporation tax

The reference to corporation tax in section 101 of ICTA was inserted by ITTOIA. As Change 2 explains, companies do not carry on professions for corporation tax purposes. So section 101 of ICTA is not needed for corporation tax and this Bill repeals it. Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Bill removes the reference to section 101(2) of ICTA in paragraph (a) of that subsection and does not replace it.

Income tax

This Bill amends ITTOIA (see Schedule 1 to the Bill).

In the case of trading stock transferred to an individual carrying on a profession or vocation, the amendments allow the stock to be valued in accordance with section 176, 177 or 178 instead of section 175(4) of ITTOIA.

In the case of professional work in progress transferred to an individual or a company carrying on a trade, the amendment allows the work in progress to be valued in accordance with section 184(1) instead of section 184(2) of ITTOIA.

Any change in the valuation rules for transfers of stock and work in progress is necessarily favourable to one of the parties to the transfer and adverse to the other. But the overall effect of this change is to give more choice to taxpayers.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

Change 40: Trading income: deductions for unremittable amounts: clauses 172 to 175

This change gives statutory effect to ESC C34 (tax concessions on overseas debts). In doing this the Bill makes a number of changes to the approach in the extra-statutory concession.

It brings the income tax and corporation tax codes back into line.

(A) ESC C34 provides relief for trade debts that cannot be remitted to the United Kingdom. It is similar in scope to section 584 of ICTA, which provides relief for unremittable income arising outside the United Kingdom, including unremittable trade profits. But section 584 of ICTA does not extend to trade debts owed to, or paid to, the company outside the United Kingdom if the profits of the trade arise in the United Kingdom (for example, debts or payments arising from export sales). The extra-statutory concession gives relief for such debts and payments.

Chapter 12 of Part 3 of this Bill gives statutory effect to the extra-statutory concession, extending relief for trade debts.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with current practice.

(B) ESC C34 requires the relief to be claimed. Clause 173 provides for the relief to be allowed as a deduction in calculating the company's trade profits. In practice this makes little difference to the time limits but it simplifies the procedure for giving the relief.

Paragraph 5(d) of the extra-statutory concession gives the time limits for making the claim. Relief can be claimed no earlier than 12 months after the end of the accounting period in which the unremittable payment was received or the unremittable debt arose. If the Bill repeated this time limit a company could not claim the relief before the filing date for the return for the period (assuming a notice to make the return was issued at the normal time). This would be an inconvenience to any company that wanted to file its return before that date.

There is one case in which the time limit for claiming the relief may be extended. The extra-statutory concession requires that the assessment for the accounting period has not become final and conclusive. The corporation tax self assessment equivalent of that is that the time limit for amending the return has not passed. Normally that time limit would expire 12 months after the filing date. Giving the relief as a deduction would allow the company to make a mistake claim up to six years from the end of the accounting period to which the return relates.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

(C) Paragraph 4 of the extra-statutory concession denies any relief for a debt to the extent that the debt is insured. Clause 174(2) (restrictions on relief) denies relief only to the extent that an insurance recovery has been received in respect of the debt. Also clause 175(2)(f) withdraws relief only to the extent that an insurance recovery has been received in respect of the debt.

Accordingly a limitation on the amount of relief available is relaxed.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 41: Trading income: disposal of know-how: restore an express definition of mineral deposits: clauses 176 and 908

This change restores a previous definition of "mineral deposits".

It brings the income tax and corporation tax codes back into line.

The definition of "mineral deposits" in these clauses is in substance the definition that applied for the purposes of the definition of "know-how" in the source legislation for clause 176 of this Bill. That definition applied before certain amendments of Chapter 1 of Part 13 of ICTA were made by CAA.

Section 531 of ICTA makes provision about the tax treatment of certain disposals of know-how. Different provision is made about disposals of know-how that has been used in the course of a trade and other disposals of know-how. The former provision is rewritten in clauses 177 and 178 of this Bill.

Section 533 of ICTA defines know-how for the purposes of section 531 of ICTA as:

> any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Before certain amendments of ICTA were made by CAA, the following definition applied to the expression "mineral deposits" in that definition:

> "mineral deposits" includes any natural deposits capable of being lifted or extracted from the earth and, for this purpose, geothermal energy, whether in the form or aquifers, hot dry rocks or otherwise, shall be treated as a natural deposit.

The history of that definition is as follows. The provisions of section 531 of ICTA derive from section 21 of FA 1968, which included the following definition:

> (7) In this section "know-how" means any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery, or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Subsection (9) of that section required the above definition to be construed as if it were contained in Part 1 of the Capital Allowances Act 1968, so that the following definition of "mineral deposits" applied:

> "mineral deposits" includes any natural deposits capable of being lifted or extracted from the earth.

That definition was amended by paragraph 2(3) of Schedule 13 to FA 1968, which added the words from "and, for this purpose" onwards.

The relevant provisions were consolidated in 1970 and again in 1988. Section 532 of ICTA originally provided for the definition of "know-how" to be construed as if it were contained in Part 1 of the Capital Allowances Act 1968. A reference to "the 1990 Act" was substituted by CAA 1990. This attracted the definition of "mineral deposits" which is set out above in the fifth paragraph of this note, and applied throughout that Act.

CAA rewrote provisions about know-how allowances that were previously in Chapter 1 of Part 13 of ICTA. In consequence of the repeal of CAA 1990, CAA also amended section 532 of ICTA with the result that it provides for the definition of "know-how" to be construed as if it were contained in the 2001 Act. However, no definition of "mineral deposits" applies for the purposes of CAA as a whole. So the consequential amendment failed to preserve the application of CAA 1990 definition of "mineral deposits" to the remaining provisions of Chapter 1 of Part 13 of ICTA (including those on which clauses 176 and 908 are based).

It is noteworthy that a version of the definition of "mineral deposits" is carried forward in CAA to apply to the rewritten material about know-how allowances. See section 452(3) of that Act.

The failure to preserve the application of CAA 1990 definition of "mineral deposits" to the remaining provisions of Chapter 1 of Part 13 of ICTA is believed to have resulted from an oversight. The inclusion of a definition of "mineral deposits" in clauses 176 and 908 corrects this error.

The definition of "mineral deposits" in clauses 176 and 908of this Bill differs from the definition formerly in section 161(2) of CAA 1990 in that the words "whether in the form of aquifers, hot dry rocks or otherwise" are omitted. The definition of "mineral deposits" in section 452(3) of CAA also omits these words. The omission was made in that Act on the basis that the words are merely illustrative and that leaving them out does not change the legal effect of the definition. They are omitted in this Bill for the same reasons. A fuller discussion of this point can be found in Note 46 in Annex 2 to the explanatory notes to CAA.

This change clarifies the law by making it certain that the definition of "mineral deposit" continues to apply for the purposes described above.

This change clarifies the law and removes uncertainty. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 42: Trading and property income: post-cessation receipts: reinstatement of section 108 of ICTA: clauses 198 to 200 and 286

Section 108 of ICTA allowed a taxpayer to elect to have a post-cessation receipt carried back to the year in which the trade ceased. For income tax it is rewritten as section 257 of ITTOIA.

When ITTOIA was enacted it was thought that section 108 of ICTA applied only for income tax. So the section was repealed.

Until 1996 an election to carry a post-cessation receipt back to the year of cessation resulted in an assessment for the year of cessation. So section 108 of ICTA provided that an assessment for that year could be made even if it was otherwise out of time for assessment. That treatment was inconsistent with (income tax) Self Assessment. So the relief is given in terms of tax (see paragraph 5 of Schedule 1B to TMA). The power to make late assessments was removed by FA 1996.

When Self Assessment for corporation tax was introduced Schedule 1B to TMA ceased to apply for corporation tax (see section 117(1)(a) of FA 1998). Paragraph 58 of Schedule 18 to FA 1998 deals in general terms with claims (such as one under section 108 of ICTA) which affect more than one accounting period. But there is no rule corresponding to the income tax rule in paragraph 5 of Schedule 1B to TMA.

Clause 198 gives a company the right to elect to carry back a post-cessation receipt to the accounting period in which it ceased to carry on the trade. Clauses 199 and 200 set out the form of the relief, which is modelled on the income tax relief in paragraph 5 of Schedule 1B to TMA.

Clause 286 applies the relief to UK property businesses.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 43: Property income: lease premiums etc: identifying when a company (not the landlord) takes amounts into account as a receipt in calculating the profits of a property business: clauses 217, 219, 220 and 221

This change explicitly identifies the period in which a company (not being the landlord) is required to take account of a receipt which it is treated as receiving in respect of a lease premium (or an amount that is treated as a lease premium).

It brings the income tax and corporation tax codes back into line.

For corporation tax purposes, section 34(1), (4) and (5) of ICTA provide for cases in which a landlord is treated as receiving rent and also for the time at which the landlord is treated as receiving that rent. Section 34(7A) of ICTA then explicitly deals with the period in which that deemed rent must be brought into account.

If section 34(6) of ICTA applies, the landlord is not treated as receiving an amount of rent but a company (not being the landlord) is treated as receiving an equivalent amount as a receipt of a property business. Section 34(7A) of ICTA does not explicitly deal with the period in which the company (not being the landlord) must bring the equivalent amount into account. That is because section 34(7A) of ICTA is expressed in terms of amounts that section 34 of ICTA treats as rent and section 34(6) of ICTA does not expressly treat the company (not being the landlord) as receiving rent.

In practice, receipts under section 34(6) of ICTA are brought into account as if section 34(7A) of ICTA applied to them (in other words at the same time as the landlord would otherwise have had to bring them into account). Clauses 217(3), 219(3), 220(3) and 221(3) reflect this practice. The same change was made for income tax in sections 277, 279, 280 and 281 of ITTOIA (see Change 69(A) of Annex 1 to ITTOIA).

This change has no implications for the amount of income liable to tax or who is liable for tax on it. In principle it affects the timing of the tax liability but it is expected to have no practical effect as it is in line with generally accepted practice.

Change 44: Property income: lease premiums etc: sums payable instead of rent, or for the variation or waiver of a term of a lease, for periods of 50 years or less: clauses 219 and 221

This change explicitly applies the lease premium rules to certain sums paid instead of rent, or for the variation or waiver of a term of a lease, in cases where:

- the period for which the sum is paid, or the variation or waiver has effect, is 50 years or less, and

- the duration of the lease is more than 50 years.

It brings the income tax and corporation tax codes back into line.

For corporation tax purposes, section 34(1) of ICTA treats part (or all) of certain premiums ("CP"), payable in relation to a lease, as rent received by the landlord. In order for section 34(1) to apply to CP the lease in question must be one whose:

> duration…does not exceed 50 years.

Section 34(4) of ICTA is an anti-avoidance provision. It treats certain sums ("CS") payable in lieu of rent by the tenant as if they were CP. This treatment potentially feeds through to section 34(1) of ICTA. But for section 34(1) to apply the duration of the lease must not exceed 50 years. In this respect section 34(4)(a) of ICTA also provides that:

> in computing the profits of the Schedule A business of which the sum payable in lieu of rent is by virtue of this subsection to be treated as a receipt, the duration of the lease shall be treated as not including any period other than that in relation to which the sum is payable.

On one interpretation the deeming in section 34(4)(a) of ICTA does not affect the duration of the lease for the purposes of section 34(1) of ICTA. If this interpretation were correct, then the treatment of CS for a period of one year would differ depending on whether the duration of the lease was 50 years or 51 years. Then in the case of the lease with a duration of 50 years, all of CS could be treated as a rental receipt by the landlord under section 34(1) of ICTA (with the tenant eligible for relief on CS). But in the case of the lease with a duration of 51 years, none of CS could be treated as a rental receipt under section 34(1) of ICTA (and the tenant might not be eligible for relief on CS).

Since the lease premium legislation was introduced in 1963, HMRC have not accepted such an interpretation. Clause 219(1)(b) follows, for corporation tax, HMRC's interpretation of section 34(4)(a) of ICTA. The same change was made for income tax in section 279(1)(b) of ITTOIA (see Change 68 of Annex 1 to ITTOIA).

Section 34(5) of ICTA is also an anti-avoidance provision. It treats certain sums payable for the variation or waiver of the terms of a lease as if they were CP. This treatment also potentially feeds through to section 34(1) of ICTA. But for section 34(1) to apply the duration of the lease must not exceed 50 years. In this respect section 34(5)(a) of ICTA also provides that:

> in computing the profits of the Schedule A business of which that sum is by virtue of this subsection to be treated as a receipt, the duration of the lease shall be treated as not including any period which precedes the time at which the variation or waiver takes effect, or falls after the time at which it ceases to have effect.

On one interpretation the deeming in section 34(5)(a) of ICTA does not affect the duration of the lease for the purposes of section 34(1) of ICTA. The same considerations apply to this interpretation as have been noted above in relation to section 34(4)(a) of ICTA.

Since the lease premium legislation was introduced in 1963, HMRC have not accepted such an interpretation. Clause 221(1)(c) follows, for corporation tax, HMRC's interpretation of section 34(5)(a) of ICTA. The same change was made for income tax in section 281(1)(c) of ITTOIA (see Change 68 of Annex 1 to ITTOIA).

This change prevents a company from contending, in certain cases, that a property business receipt does not arise or arises in a smaller amount. But correspondingly a tenant under the lease in question will not face a contention that there is no taxed receipt (or a smaller taxed receipt) by reference to which the tenant may be entitled to relief.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 45: Property income: lease premiums etc: sum payable to someone other than the landlord, or a person connected with landlord, for variation or waiver of term of lease: clause 221

This change prevents an amount being treated as a receipt of the landlord's property business, where a sum is payable by the tenant as consideration for the variation or waiver of a term of a lease to somebody other than the landlord or a person connected with the landlord.

It brings the income tax and corporation tax codes back into line.

Section 34(5) of ICTA provides:

> Where, as consideration for the variation or waiver of any of the terms of a lease, a sum becomes payable by the tenant otherwise than by way of rent, the lease shall be deemed for the purposes of this section to have required the payment of a premium to the landlord (in addition to any other premium) of the amount of that sum …

The effect of this deeming may be to treat the landlord as receiving an amount by way of rent. This is subject to section 34(6) and (7) of ICTA.

Section 34(6) of ICTA provides that if a payment falls within section 34 (5) of ICTA but is due to a person other than the landlord, the landlord is not treated as receiving rent. And if the other person is a company, section 34(6) of ICTA treats that company as receiving an income receipt equal to the rent that the landlord would otherwise have been treated as receiving under section 34(5) of ICTA.

But section 34(7) of ICTA provides that section 34(6) of ICTA applies only in relation to a payment within section 34(5) of ICTA if the payment is due to a person who is connected with the landlord.

It follows that section 34(5) of ICTA might treat the landlord as receiving rent in cases where the consideration for the variation or waiver is not payable to the landlord (with the tenant potentially receiving relief for the amount of rent the landlord is treated as receiving). This is not the intention of section 34(5) of ICTA. In practice a landlord has not been treated as receiving, nor the tenant entitled to relief for, rental income in such cases. Clause 221(1)(b) reflects that practice for corporation tax. The same change was made for income tax in section 281 of ITTOIA (see Change 70 of Annex 1 to ITTOIA).

Relief will not be available to a tenant by reference to a property business receipt if, as a result of this change, a property business receipt does not arise to the landlord.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 46: Property income: lease premiums etc: additional calculation rule may reduce receipts in respect of sums payable for variation or waiver of a term of a lease: clauses 221, 227, 228, 229 and 234

This change permits reductions, under the additional calculation rule, in arriving at the amount of a property business receipt arising in relation to the variation or waiver of a term of a lease.

It brings the income tax and corporation tax codes back into line.

Section 37(2) of ICTA (the additional calculation rule) permits a reduction, in certain cases, in arriving at the amount of a property business receipt that would otherwise be given by section 34 or 35 of ICTA. Section 37(2) of ICTA applies if:

> (a) a lease is granted out of, or there is a disposition of, the head lease, and
>
> (b) in respect of that grant or disposition a company would…be treated by virtue of section 34 or 35 as receiving any amount…

Where section 34(5) of ICTA gives rise to a property business receipt the receipt arises in respect of:

> the variation or waiver of any of the terms of a lease

So section 37(2) of ICTA does not appear to allow a reduction in arriving at a property business receipt arising because of section 34(5) of ICTA (amount in respect of variation or waiver). But, in practice, such a reduction is allowed.

Clauses 221(5), 227(1) and (3), 228(2), 229(2) and 234(1) and (2) explicitly provide for a reduction in the calculation of a receipt under clause 221 (sums payable for variation or waiver of terms of lease). The same change was made for income tax in sections 281, 287, 288, 289 and 294 of ITTOIA (see Change 71 of Annex 1 to ITTOIA).

Section 295 of ITTOIA (as amended by Schedule 1 of this Bill) and clause 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. So if, as a result of this change, the relief to which a company is entitled is increased, this may reduce the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Bill.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 47: Property income: lease premiums etc: receipts in respect of sales with right to reconveyance and sale and leaseback transactions: clauses 224 and 225

This change provides that a property business receipt does not arise in respect of a sale with a right to a reconveyance (or a sale and lease back transaction) unless the period between the sale and the earliest date of reconveyance (or leaseback) is 50 years or less.

It brings the income tax and corporation tax codes back into line.

Section 36(1) of ICTA provides for a property business receipt to arise where, broadly, an interest in land is sold (for price "A") and the terms of sale provide for the interest to be reconveyed (for lower price "B") to the vendor or someone connected with the vendor. The property business receipt that arises is, in effect, the following percentage of $(A-B)$:

> 2 *x* (51 –T)%, where:
>
> T is the number of complete years between the sale and the earliest date of reconveyance (but not greater than 51), if the number of complete years is at least 2, and
>
> T is 1, if the number of complete years is less than 2.

If the earliest date of reconveyance is more than 51 years after the sale, the property business receipt under section 36(1) of ICTA will always be zero. The same result is achieved by an approach under which a property business receipt does not arise if the earliest date of reconveyance is more than 51 years after sale (an approach taken by sections 34 and 35 of ICTA).

Sections 34 and 35 of ICTA adopt 50 years as the interval which determines whether a property business receipt arises. Adopting a similar interval for the purposes of section 36(1) of ICTA is taxpayer favourable.

Exactly the same considerations apply in relation to section 36(3) of ICTA (sale and leaseback) as are set out above in relation to section 36(1) of ICTA.

Clauses 224(1)(b) and 225(1)(b) change the law, for corporation tax, by providing an interval of 50 years to determine whether a property business receipt arises in the case of a sale with a right to reconveyance or a sale and leaseback transaction. The same change was made for income tax in sections 284 and 285 of ITTOIA (see Change 72 of Annex 1 to ITTOIA).

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 48: Property income: lease premiums etc: relief for tenant under taxed lease if land is outside the United Kingdom: clause 227

This change restores a relief that was incorrectly removed from ICTA by ITTOIA.

It brings the income tax and corporation tax codes back into line.

Section 37(1) of ICTA provides that:

> This section applies in any case where in respect of a lease of any premises-
>
> (a) any amount falls to be treated as a receipt of a Schedule A business by virtue of section 34 or 35,…
>
> (c) any amount falls to be treated as a receipt of *a UK property business* by virtue of any of sections 277 to 282 of ITTOIA 2005 (receipts in respect of lease premiums, sums payable instead of rent, for surrender of lease and for variation or waiver of term of lease and assignments),…

That subsection sets out the condition for the availability of the reliefs given by section 37(2) or (4) of ICTA (reduction of later chargeable amount or tenant treated as paying rent). Each of those reliefs applies in calculating the profits of a Schedule A business.

Section 70A(5) of ICTA provides that:

> income from an overseas property business shall be computed for the purposes of Case V of Schedule D in accordance with the rules applicable to the computation of the profits of a Schedule A business.

Section 70A(5) of ICTA therefore extends the reliefs under section 37 of ICTA to land outside the UK.

Where section 37(2) or (4) of ICTA applies in relation to land outside the UK, the reference in section 37(1)(a) of ICTA to a receipt of a Schedule A business must be read as a reference to a receipt of an overseas property business.

Section 37(1)(c) of ICTA was inserted by paragraph 20(2)(b) of Schedule 1 to ITTOIA to provide for relief under section 37 of ICTA where the superior landlord is liable to income tax. But because section 37(1)(c) refers to a UK property business (see italicised words above) it excludes relief in the case where the superior landlord was liable to income tax in respect of a property outside the UK.

The relief corresponding to section 37 of ICTA in sections 287 to 295 of ITTOIA applies to property outside the UK in the same way as to property in the UK.

The reference to a "UK property business" in section 37(1)(c) of ICTA was introduced in error when that paragraph was inserted by ITTOIA. Clause 227(4) corrects that error and is in line with the corresponding ITTOIA provision (section 287(4) of that Act, as amended by Schedule 1 to this Bill). The change will result in a company receiving relief in circumstances where there is currently no entitlement to relief.

Section 295 of ITTOIA (as amended by Schedule 1 to this Bill) and clause 235 place a cap on the total amount of relief that can be obtained by reference to a taxed receipt. So if, as a result of this change, the relief to which a tenant is entitled is increased, this may reduce the amount of relief subsequently available to other persons under Chapter 4 of Part 3 of ITTOIA or under Chapter 4 of Part 4 of this Bill.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

Change 49: Property income: lease premiums etc: limiting the reductions in receipts under clause 228 and the deductions for expenses under clause 232: clauses 227, 228, 229, 230, 231 and 235

This change concerns the way section 37(9) of ICTA is rewritten for corporation tax.

It brings the income tax and corporation tax codes back into line.

Section 37(9) of ICTA provides:

> *An amount* or part of an amount *shall not be deducted under this* section more than once from any sum, or from more than one sum, and shall not in any case be so deducted if it has been otherwise allowed as a deduction in computing the income of any person for income tax or corporation tax purposes or if it has been deducted under the rule in section 288 of ITTOIA 2005 (the additional calculation rule) in calculating the amount of a receipt of a property business (within the meaning of that Act) under Chapter 4 of Part 3 of that Act

Those words do not fit well with the rest of section 37 of ICTA and their effect on the rest of that section is not entirely clear. The italicised words "An amount" in section 37(9) of ICTA must refer to the amount chargeable on the superior interest ("ACSI" – see section 37(1) of ICTA) because the reliefs under section 37(2) and (4) of ICTA depend on ACSI. But the italicised words "shall not be deducted under this section" are not, strictly speaking, appropriate since neither of section 37(2) or (4) of ICTA is explicitly expressed as providing a deduction.

In construing section 37(9) of ICTA it is relevant to consider the rationale underlying the rest of section 37 of ICTA. Sections 34, 35 and 37 of ICTA broadly deal with one person (landlord/assignor) who, in relation to a lease, receives a sum from another person (tenant/assignee). Sections 34 and 35 of ICTA may treat a property business receipt (of amount X) as arising to the landlord/assignor. Section 37 of ICTA sets out two ways in which the tenant/assignee (or a successor) may obtain relief, effectively as a property business expense, in respect of X.

The rationale for section 37(9) of ICTA is that the total relief for the tenant/assignee (or successors) under section 37(2) and (4) must not exceed X (as reduced by relief that the tenant/assignee (or successor) has obtained in respect of X under other provisions such as section 87 of ICTA).

Clause 235 makes this rationale explicit for corporation tax. The same change was made for income tax in section 295 of ITTOIA (see Change 73 of Annex 1 to ITTOIA).

Section 37(2) and (4) of ICTA is also difficult to construe because neither subsection explicitly says how section 37(9) of ICTA affects the relief for which it provides.

Clauses 227(5), 228(3), 229(4), 230(1), (5) and (6) and 231(4) make explicit the effect that section 37(9) of ICTA has on section 37(2) and (4) of ICTA. This is facilitated by the use (in clause 228(3)) of the concept of the "unused amount" of a taxed receipt (corresponding to ACSI in ICTA). And providing that, in relation to a taxed receipt, relief under each of clause 228, (corresponding to section 37(2) of ICTA) and clause 231 (corresponding to section 37(4) of ICTA) must not result in that relief (taken with other relief under those, and other, provisions) of more than the taxed receipt. The same change was made for income tax in sections 287 to 292 of ITTOIA (see Change 73 of Annex 1 to ITTOIA).

Clause 235 restricts total relief to the taxed receipt in question. A tenant/assignee (or successor) is entitled to relief only if the taxed receipt in question has an "unused amount". Each relief, in relation to the taxed receipt in question, reduces the unused amount of that taxed receipt and therefore the relief available in future to the tenant/assignee (or successor) by reference to that taxed receipt. Making this explicit is, in principle, favourable to a tenant/assignee and unfavourable to a successor because the tenant/assignee's relief arises before that of the successor.

This change is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 50: Property income: lease premiums etc: rules for determining effective duration of lease: clause 243 and Schedule 1

This change makes some minor adjustments to the rules for determining the effective duration of a lease.

Section 38(1) of ICTA provides:

> In ascertaining the duration of a lease for the purposes of sections 34 to 36-
>
> (a) in any case where-

> (i) any of the terms of the lease (whether relating to forfeiture or any other matter) or any other circumstances render it unlikely that the lease will continue beyond a date falling before the expiry of the term of the lease, and
>
> (ii) the premium was not substantially greater than it would have been, on the assumptions required by subsections (3) and (4) below, had the term been one expiring on that date,
>
> the lease shall not be treated as having been granted for a term longer than one ending on that date.

Rule 1 in section 303(1) of ITTOIA is in similar terms.

Section 38(1)(a) of ICTA and rule 1 in section 303(1) of ITTOIA do not prevent the lease being treated as expiring before the date on which it is thought likely that the lease will in fact end. But it is difficult to see what justification there could be for treating a lease as ending before that date.

Accordingly, rule 1 in clause 243(1) requires the lease to be treated as ending on the date beyond which it is unlikely that the lease will continue. It will no longer be possible to contend that the lease should be treated as ending before that date. Schedule 1 amends rule 1 in section 303(1) of ITTOIA in line with rule 1 in clause 243(1).

Section 38(1)(a) of ICTA and rule 1 in section 303(1) of ITTOIA will give a date falling before the expiry of the lease in question only if:

> the premium was not substantially greater than it would have been … had the term been one expiring on that date.

Section 34(2), (4) and (5) of ICTA deems, in certain cases, amounts to be premiums for the purposes of section 34 of ICTA.

Section 278 of ITTOIA deems, in certain circumstances, an amount to be a premium for the purposes of section 277 of ITTOIA. Sections 279 to 281 of ITTOIA provide, in certain cases, for amounts to be taken into account in a way that is similar to section 277 of ITTOIA's treatment of premiums (but without deeming those amounts to be premiums).

It has been HMRC practice to treat sums deemed to be premiums in section 34 of ICTA as if they were also premiums for the purposes of considering under section 38(1)(a)(ii) of ICTA whether the premium was not substantially greater than it would have been had the term been one expiring on the date in question.

Clause 243(3) reflects this practice by providing that "premium" in rule 1 includes such deemed sums. Schedule 1 inserts section 303(2A) of ITTOIA containing a corresponding definition of "premium" for the purposes of rule 1 in section 303(1) of ITTOIA.

This makes rule 1 in clause 243(1) and in section 303(1) of ITTOIA less likely to apply because the (larger) premium is less likely to be "not substantially greater" than the premium expected had the term been one expiring on the date in question.

In some cases the question of whether or not there is a property business receipt and, if so, how much depends on the effective duration of the lease. If, as a result of this change, the effective duration of a lease is made longer, a landlord may have a smaller property business receipt than would otherwise have been the case and a tenant may correspondingly be entitled to less relief.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 51: Property income: furnished holiday accommodation: permitted longer-term occupation: clause 267

This change alters the period during which, in order to qualify for the special tax treatment of the commercial letting of furnished holiday accommodation, the accommodation must not be occupied for more than 31 days at a time.

It brings the income and corporation tax codes back into line.

Section 504(3) of ICTA provides:

> (3) Accommodation shall not be treated as holiday accommodation for the purposes of this section unless–
>
> (a) it is available for commercial letting to the public generally as holiday accommodation for periods which amount, in the aggregate, to not less than 140 days;
>
> (b) the periods for which it is so let amount in the aggregate to at least 70 days; and
>
> (c) for a period comprising at least seven months (which need not be continuous but includes any months in which it is let as mentioned in paragraph (b) above) it is not normally in the same occupation for a continuous period exceeding 31 days.

It is not clear whether a "month" for the purposes of paragraph (c) means a calendar month (in the sense of January, February, etc) or any period of one month. It is also not clear whether any breaks in the period of at least seven months can fall at any time or must divide the period into periods of whole months. The better view seems to be that any period of a month during which the accommodation is commercially let to members of the public as holiday accommodation must not overlap with any period during which it is continuously in the same occupation for more than 31 days.

A further uncertainty is whether, for the purposes of paragraph (c), the time that the accommodation is "let as mentioned in paragraph (b)" is 70 days or (which is the better view) all the time that it is commercially let to the public generally as holiday accommodation.

On the latter reading, section 504(3)(c) of ICTA secures that accommodation is not let as holiday accommodation if it is let for more than 31 days continuously (otherwise than because of circumstances that are not normal). Clause 267(4) gives effect to this reading.

This reading also reduces to less than five months the total periods during which the accommodation can be in the same occupation for more than 31 days. This can operate capriciously to extend the period of "at least seven months" where the holiday lettings are spaced out throughout the relevant period (see clause 266) and not concentrated in a few months.

In clause 267(5), the requirement in section 504(3)(c) of ICTA is relaxed so that the periods for which the accommodation is continuously in the same occupation for more than 31 days must not amount to more than 155 days (the aggregate length of the five longest months) during the relevant period. This means that the period during which any occupation of the accommodation must be on a short-term basis:

- need not be composed of whole months but can be made up of non-consecutive days; and

- is never extended beyond 155 days.

So, where two or three days of a holiday letting fall in a particular month, the requirement in clause 267(5) of this Bill (unlike section 504(3)(c) of ICTA) does not restrict what can be done with the accommodation during the rest of the month (provided that the condition is satisfied over the relevant period as a whole).

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 52: Property income: furnished holiday accommodation: period over which lettings are averaged: clause 268

This change alters the period during which lettings are averaged for the purpose of treating infrequently let property as qualifying holiday accommodation from the accounting period to the relevant period (as defined in clause 266).

It brings the income and corporation tax codes back into line.

Subsections (6) to (8) of section 504 of ICTA allow averaging where a taxpayer lets both furnished holiday accommodation and accommodation that would be holiday accommodation if the test in section 504(3)(b) of ICTA were satisfied in relation to it ("under-used accommodation"). The requirement in section 504(3)(b) of ICTA is that the accommodation must be commercially let to members of the public for at least 70 days. Section 504(5) of ICTA says that that requirement, for a particular accounting period must be determined by reference to a twelve month period (called the "relevant period" in clause 268). That twelve month period will often coincide with the accounting period. But it may not, an example being when the accommodation is first let as furnished accommodation. Then the relevant period begins on the first day in the accounting period that it is so let.

If the company elects for averaging, however, section 504(7) of ICTA treats the under-used accommodation specified in the election as qualifying holiday accommodation if the average of the number of days during the *accounting period* for which the furnished holiday accommodation and the under-used accommodation was let, is at least 70.

If the relevant period for particular accommodation does not coincide with the accounting period, the accommodation may have been let for more than 70 days during the relevant period but not for more than 70 days during the accounting period. But because the figures averaged in section 504(7) of ICTA are the numbers of days let during the accounting period, specifying the accommodation in an election could not raise the average number of days of letting during that period above 70.

In rewriting section 504(7) of ICTA, clause 268(4) provides that the average is to be taken by reference to days during the "relevant period".

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 53: Property income: rent receivable in connection with a section 39(4) concern where the rent is paid in kind: clause 270 and Schedule 1
This change concerns repealing section 119(2) of ICTA without rewriting it.

It brings the income tax and corporation tax codes back into line.

Section 119 of ICTA makes provision about rent payable in respect of any land or easement "used, occupied or enjoyed in connection with any of the concerns specified in section 55(2)". Section 55 of ICTA includes mines, quarries, certain industrial concerns, canals, docks, markets, bridges, ferries and railways.

Section 119(1) of ICTA provides for the rent from such easements to be charged under Schedule D but it does not specify under which Case of Schedule D the rent is to be charged.

Section 119(2) of ICTA provides for the rent to be taxed under Schedule D Case III if the rent is paid in produce of the concern. If section 119(2) does not apply, the rent is charged under a provision in the table in section 834A of ICTA. The table in section 834A is inserted by Part 1 of Schedule 1 to this Bill, and is a list of places where some of the Schedule D Case VI charges are rewritten.

When section 119 of ICTA was introduced as section 34 of FA 1934 the lessee was required to deduct income tax when paying rent to the lessor. This was achieved by treating the rent as a royalty paid in respect of the user of a patent. But it would be impractical to deduct income tax if the rent were paid in kind. So what is now section 119(2) charged rent paid in kind under Schedule D Case III. This avoided the requirement to deduct income tax because these rents are not a category of income from which tax is deducted. Since the requirement to deduct income tax from rents taxable under section 119 of ICTA was repealed a separate charge on rents paid in kind is no longer required.

Section 119 of ICTA is rewritten in Chapter 7 of Part 4 of this Bill. The charge under Chapter 7 does not distinguish rents that are paid in produce. This represents a change from the position under ICTA. The rewrite of the charge under Schedule D Case III has been absorbed into the rewrite of the charge under Schedule D Case VI (see the table in section 834A of ICTA).

There is no difference between Schedule D Cases III and VI in the basis of assessment.

There may be a minor difference in the deductions that are allowed in calculating the income. Section 70(1) of ICTA provides that:

> income shall be computed under Cases I to VI of Schedule D on the full amount of the profits or gains or income arising in the period … without any other deduction than is authorised by the Corporation Tax Acts

No deduction is allowed under Schedule D Case III. Although Schedule D Case VI does not specify that any deductions may be allowed the word “profits” implies a calculation under which expenses are deducted from the income.

In practice it is likely that most income to which section 119(2) of ICTA applies is covered by section 121 of ICTA (rewritten as clause 272 in this Bill). That section provides for specific deductions to be made in taxing mineral rents and royalties. In the event that rewriting the charge under Schedule D Case III according to the rules of Schedule D Case VI allows any taxpayer to claim any deduction that would not otherwise be allowable the amounts involved are likely to be small.

A further minor difference is that the income charged under Chapter 7 of Part 4 of this Bill is subject to the loss regime in section 396 of ICTA. In the unlikely event that the deductions allowable exceed the rent charged under Chapter 7 the loss can be set against other income charged under a provision in the table in section 834A of ICTA.

The more likely case is that losses on other income taxed under such a provision by the current law can be set against this income. But losses under those provisions are uncommon, as are rents paid in kind.

This change allows the deduction of amounts that are not deductible under the source legislation.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 54: Property income: deduction of management expenses of owner of mineral rights: omission of condition that expenses are "necessarily" incurred: clause 272

This change concerns the omission of the requirement that the allowable expenses of managing mineral rights are incurred "necessarily".

It brings the income tax and corporation tax codes back into line.

Section 121(3) of ICTA makes provision for expenses of management and supervision to be deducted from amounts chargeable to corporation tax in respect of mineral rents and royalties. The section requires that the expenses are disbursed "wholly, exclusively and necessarily".

Section 121(3) of ICTA is rewritten as clause 272. That clause does not reproduce the condition that the expenses must be "necessarily" incurred. There is no evidence as to how this test is applied in practice but it is not obvious how it could be enforced. The extensive body of case law on the meaning of expenses being incurred "necessarily" applies to income formerly taxed under Schedule E (now taxed as employment income under ITEPA). That case law establishes that each and every holder of the office or employment would have to incur the expense.

That is not a test that could be sensibly applied to income taxed under Schedule D Case VI. It is not a test that could be sensibly applied to income taxed under Part 4 of this Bill. It is most unlikely that the "necessarily" restriction can be applied in practice and this clause recognises this by omitting "necessarily".

This change removes a potential obstacle to a successful claim for relief.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 55: Property income etc: priority of the charge on trade profits: the "Crown Option": clauses 287 and 982 and Schedule 1

This change gives priority to the charge on trade profits if an item of income is both a trade receipt and potentially within the receipts of an overseas property business in Part 4 or within a charge to tax in Part 10 of this Bill.

In the source legislation taxable income is allocated to different Schedules. The charges under these Schedules are mutually exclusive.

In addition, a small number of charges (non-schedular charges) are imposed outside the schedular system.

The scope of Schedule D is set out in section 18 of ICTA. The effect of that section (and the relevant case law) is that Schedule D is the residual Schedule. If income meets the conditions to be taxed under Schedule D and the conditions to be taxed under ITEPA or another Schedule of ICTA it is taxed under the alternative and not under Schedule D.

But there is no order of priority between Cases I, III and V of Schedule D. In the event of income falling within more than one of those cases it has long been accepted that HMRC have the option to choose under which case the income should be taxed.

The "Crown Option" was recognised for corporation tax in paragraph 84 of Schedule 18 to FA 1998. This was done, not so much to provide explicit statutory authority for the option, but to explain how it should operate under Self Assessment. That paragraph refers to the case where an amount may fall within Case I or within Case III or V of Schedule D. In such a case, an officer of the Board may determine which case shall apply as the basis of charge for an accounting period. But the paragraph does not set out on what basis the officer's determination is made.

HMRC's guidelines for making the determination are published in paragraph 14035 of the Business Income Manual. The income is taxed under Schedule D Case I and not under Schedule D Case III or V.

This Bill deals with the Crown Option by providing for an order of priority between the Parts if income is capable of being taxed under more than one Part.

Clause 287 provides that if income is capable of being taxed under Part 4 of this Bill as profits of an overseas property business and under Chapter 2 of Part 3 of this Bill as trade profits it is taxed under Part 3. ICTA taxes the profits arising from an overseas property business under Schedule D Case V so clause 287 gives effect to the Crown Option for trades carried on wholly or partly in the United Kingdom (and to section 70A(1) of ICTA for trades carried on wholly abroad).

Clause 982(1) gives priority to Chapter 2 of Part 3 of this Bill if income falls within both Chapter 2 of Part 3 and Chapter 2, 5 or 6 of Part 10 of this Bill. This gives effect to the Crown Option for income within Part 10 of this Bill that is taxed in ICTA under Schedule D Cases III or V. It applies the same approach to trades carried on wholly abroad as is applied to trades carried on wholly or partly in the United Kingdom. This is consistent with the law (see sections 21A and 70A of ICTA) that the profits of both types of trade should be calculated on the same basis.

Chapters 7 (annual payments not otherwise charged) and 8 (income not otherwise charged) of Part 10 of this Bill include income charged under Schedule D Case III or V. But in both cases the income within these Chapters is income that cannot be taxed under another provision. So a specific rule ceding priority to Part 3 of this Bill is not needed.

Schedule 1 to this Bill repeals sections 12AE and 31(3) of TMA and paragraph 84 of Schedule 18 to FA 1998.

In principle, this change is favourable to some taxpayers and adverse to others because it allocates income to a specific head of charge. That head of charge may produce a different amount of income to be brought into charge or may facilitate the claiming or relieving of losses or other reliefs that are not available under the other charge. The rules applicable to income within Part 3 are generally regarded as more flexible and favourable than those applying to the heads of charge which would have applied but for this change.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 56: Loan relationships: references to connections between a company and another person to be rewritten as applying to connections between two companies: clauses 348, 361, 468, 469 and 470.

This change rewrites references to a company connected with a person so as to refer to a connection between two companies.

Section 87 of FA 1996

Section 87 of FA 1996 provides for the amortised cost basis to be used when bringing into account credits and debits on loan relationships when there is a connection between the creditor company and *a person* standing in the position of the debtor or between a debtor company and *a person* standing in the position of a creditor.

Section 87(3) explains what is meant by a connection between a company and another person for the purposes of section 87. The definition is only in terms of the person being a second company. This was not always the case. Section 87(3)(c) originally included the case of a participator of the debtor or creditor company or an associate of the participator until that paragraph was repealed by FA 2002. The definition of "participator" in section 417 of ICTA can include an individual.

The most likely interpretation is therefore that "person" in section 87(1) and (3) of FA 1996 means "company". Section 87 is rewritten accordingly. The far less likely interpretation is that section 87(3) only provides the definition where the other person is a company and that it is up to the courts to interpret what is meant by connection in section 87(1) where the person is an individual. Section 839 of ICTA, which provides a definition of "connected persons" including connected persons who are not companies, only applies where the section itself is applied (see section 839(1)). It is not applied by section 87 of FA 1996 although it is so applied elsewhere in the loan relationship provisions.

Section 88 of FA 1996

Section 88 of FA 1996 provides exceptions to the connection provision in section 87 of FA 1996.

Section 88(1) provides that a connection between a creditor company and the *person* standing in the position of debtor in the exempt circumstances set out in section 88 is disregarded for the connection provisions of section 87. Although section 88(5) provides a refinement of that rule for the debtor company *if* the person standing in the position of a debtor is also a company, it is not clear how the person in subsection (1) who is the debtor could be other than a company, since section 87, as explained above, now only provides connection rules between companies. Section 88(1) and (5) is therefore rewritten as applying to debtor companies only.

Section 88(2) excludes cases where, broadly, loan relationships are treated as trading assets. But paragraphs (e) and (f) of that subsection do not allow the exclusion where the asset representing the loan relationship has, under certain conditions, been in the beneficial ownership of "connected persons".

Section 88(4)(b) explains what is meant by a connected person having the beneficial ownership of assets by applying the meaning of a connection given by section 87 of FA 1996. "Connected person" here is therefore also rewritten as referring to a connected company.

Paragraph 4A of Schedule 9 to FA 1996

Paragraph 4A of Schedule 9 to FA 1996 provides for the deemed release of a loan (and hence a charge on the debtor company) where the creditor company acquires the loan from a second person for an amount less than the carrying value in the accounts of the debtor company. Under sub-paragraph (2)(d) this provision does not apply where there is a connection between the new creditor company and the *person* from whom it acquired that debt. Sub-paragraph (8) provides the meaning for the purposes of the paragraph of connection between a company and another person. In both instances the other person is a company.

It seems probable therefore that "person" in paragraph 4A(2)(d) refers to a company only. Indeed, the effect of paragraph 4A is that no charge arises from a released debt where a loan is passed between group companies.

The far less likely interpretation is that paragraph 4A(8) of Schedule 9 to FA 1996 only provides the definition where the other person is a company and that it is up to the courts to interpret what is meant by connection in paragraph 4A(2)(d) where the person is an individual. Paragraph 4A(2)(d) is therefore rewritten as being only of relevance where the person is a company.

If the courts decided that "connected persons" in sections 87 and 88 of FA 1996 included individuals the rewrite of those sections would extend the circumstances where the amortised cost basis was compulsory. This could be favourable or unfavourable to the taxpayer depending on the effects of applying that particular basis of accounting. If it were held that "person" in paragraph 4A of Schedule 9 to FA 1996 included an individual this would reduce the circumstances when there was a deemed release by the creditor company of its rights under the loan relationship which one would expect to be taxpayer favourable.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with current practice.

Change 57: Loan relationships etc: amortised cost basis and connected companies: fair value to apply in the case of reset bonds and shares with guaranteed returns: clauses 349 and 534

This change gives precedence to fair value accounting where a reset bond or a share which is an interest-like investment would normally attract the amortised cost basis of accounting as a result of the connected companies provisions.

Section 87(2) of FA 1996 requires debits and credits on a loan relationship to be accounted for on an amortised costs basis where there is a connection between the creditor and debtor company. This is rewritten in clause 349.

Sections 88A(4) of FA 1996 requires debits and credits on a loan relationship where the rate of interest is reset to be determined on the basis of fair value accounting (rewritten in clause 454). Sections 91A(3) and 91B(3) of FA 1996 (rewritten in clause 534) also require credits to be determined on the basis of fair value accounting where shares with interest-like returns are treated as loan relationships.

This change gives precedence to the fair value basis where a conflict between the two methods of accounting arises, the more specific rule taking precedence over the more general rule.

The tax effect will depend on the circumstances of the taxpayer and the effects of fair value accounting on the loan relationship or deemed loan relationship.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 58: Loan relationships: deficits on loan relationships referable to basic life assurance and general annuity business: change in basic rule so that deficit set off against income and gains of deficit period instead of being carried forward: clause 388

This changes the default rule for setting off deficits on loan relationships referable to basic life assurance and general annuity business so that such deficits are set off against income and gains of the deficit period instead of being carried forward and treated as expenses in later accounting periods.

Under paragraph 4(4) of Schedule 11 to FA 1996, if a claim is not made under either paragraph 4(2) to set off the deficit against income and gains in the deficit period, or paragraph 4(3) to carry the deficit back and set it off against eligible profits in earlier accounting periods, then the deficit is carried forward to the next accounting period. No claim is required to carry the deficit forward.

This change secures that no claim is required to set off the deficit against income and gains within the deficit period. If a deficit remains after setting off the deficit against eligible income in the deficit period, the excess is carried forward without a claim unless a claim is made to carry it back. (A claim is still required if the company wants to carry the deficit back to earlier accounting periods.)

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 59: Loan relationships: funding bonds: charge to tax as interest: clauses 299 and 413

This change replaces a theoretical but unlikely charge to tax under Schedule D Case VI with a charge under the loan relationships legislation where funding bonds are issued and it is impractical to retain any bonds on account of income tax.

This change reproduces Change 82 in ITTOIA and so brings the income tax and corporation tax codes back into line.

Section 582(1) of ICTA generally treats the issue of funding bonds as a payment of interest and they are taxed accordingly. But there is one situation where funding bonds are charged to tax under Schedule D Case VI, rather than as interest. Section 582(2)(b) and (2A) of ICTA provides that where it is “impracticable” to retain bonds the recipient is instead chargeable to tax under Schedule D Case VI.

It would, however, be extremely unusual for a Case VI charge to arise on a company. Under section 930(1), 933 and 934 of ITA a company or authority is not obliged to deduct tax where the company beneficially entitled to the income is resident in the United Kingdom or, if not resident, the payment is within the charge to corporation tax under section 11 of ICTA. The only likely instance of a Case VI charge arising on a company liable to corporation tax (and hence the loan relationships regime) under section 582 is where tax is deductible on interest because it is paid other than by a company or authority. The only obvious example is a payment of a United Kingdom public revenue dividend under section 892 of ITA and public revenue dividends are unlikely to give rise to funding bonds.

Section 582(3A) of ICTA provides that the provisions of section 582 override the provisions of Chapter 2 of Part 4 of FA 1996 and thus the rules in section 582 apply where that treatment differs from treatment under the loan relationships regime.

As section 582(1) of ICTA treats funding bonds as a payment of interest for all purposes of the Corporation Taxes Acts, applying a different charge under Schedule D Case VI in just one situation has no particular logic and adds an unnecessary complication. As explained above, a Case VI charge is extremely unlikely to arise in the first place. So the separate Case VI charge is not reproduced. Clause 413(2) ensures that all issues of funding bonds are charged to tax as interest, irrespective of the circumstances in which they are issued.

Loss relief against this income for losses previously arising under Schedule D Case VI has not been preserved given the unlikelihood of a Case VI charge. The exemption from tax for income charged under Schedule D Case III and which is applied for charitable purposes (section 505(1)(c)(ii) of ICTA) applies as a result of this change.

A tax disadvantage would arise if the taxpaying company had what would have been in the source legislation a Schedule D Case VI loss to bring forward or carry sideways and which could not be otherwise relieved. But since the likelihood of the Case VI charge arising under section 582 is so remote this can be virtually discounted.

A tax advantage could arise in the case of a charity where income, previously charged under Schedule D Case VI in the source legislation and therefore excluded from exemption, is not under the rewritten provision so excluded. But the likelihood of this occurring is equally remote. A tax advantage might also arise in that non-trading deficits on a loan relationship are available for set off against income within the rewritten provision and which was previously charged under Case VI income and against which such deficits could not be set.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with current practice.

Change 60: Relationships treated as loan relationships etc: meaning of offshore funds for qualifying investments test: clauses 489 and 587

This change clarifies the meaning of “offshore fund” in paragraphs 4 and 8 of Schedule 10 to FA 1996 for the purposes of the “non-qualifying investments test” (known as the "qualifying investments test" in Part 6 of this Bill (relationships treated as loan relationships etc)).

Paragraph 4 of Schedule 10 to FA 1996 provides for a company's "relevant interests in an offshore fund" to be treated as a right under a creditor relationship where the fund fails to satisfy the non-qualifying investments test: broadly where more than 60% of the holdings of the fund by value represent investments that would be loan relationships if held directly by the company.

"Offshore fund" is not directly defined for the purposes of paragraph 4 of Schedule 10 to FA 1996, but the meaning of "relevant interest in an offshore fund" for the purposes of paragraph 4 is given by paragraph 7 of the same Schedule. It is defined as a material interest in an offshore fund for the purposes of Chapter 5 of Part 17 of ICTA *or an interest which would be such an interest on the assumption that the unit trust schemes and arrangements referred to in section 756A(1)(b) and (c) of ICTA were not limited to collective investment schemes*. Section 756A(1) of ICTA (which is subject to sections 756B and 756C of that Act), gives the meaning of "offshore fund" for the purposes of Chapter 5 of Part 17 of ICTA and requires that offshore funds should be collective investment schemes. But the definition of "relevant interest in an offshore fund" in paragraph 7 extends that meaning.

The "non-qualifying investments test" referred to in paragraph 4(1) is in paragraph 8 of Schedule 10 to FA 1996. Paragraph 8(7F) requires "offshore fund", for the purpose of the test, to have the same meaning as in Chapter 5 of Part 17 of ICTA, but it does not mention the assumption in paragraph 7(1)(b) of Schedule 10 that unit trust schemes and arrangements referred to in section 756A(1)(b) and (c) of ICTA need not be limited to collective investment schemes. So it is unclear if that extension to non-collective investment schemes applies.

The definition in paragraph 8(7F) applies to offshore funds held by the investing company, that is, the same offshore fund and the same company as are referred to in paragraph 4(1) (to which the definition in paragraph 7 refers) since the definition in paragraph 8(7F) also applies for the interpretation of "assets of an offshore fund". That expression occurs in paragraph 8(5)(b), which in turn gives the meaning of "investments of an offshore fund" for the purposes of paragraph 8(1) ("investments of the … fund"). This is the same offshore fund referred to in paragraph 4(1).

Paragraph 7(1)(b) and (2) of Schedule 10 provides that for the purposes of paragraph 4 of Schedule 10 an interest is a "relevant interest in an offshore fund" (and therefore falls within paragraph 4(1)(a)) if it would be a "material interest in an offshore fund" assuming the arrangements in section 756A(1)(b) and (c) of ICTA were not limited to collective investment schemes. Therefore it appears that the clear legislative intent is that such interests are subject to paragraph 4 if the fund "fails to satisfy the non-qualifying investments test" in paragraph 4(1)(b), so that the debits and credits brought into account for the purposes of corporation tax as respects the company's interest in the fund are determined on the basis of fair value accounting.

If, when FA 2004 added paragraph 8(7F) to Schedule 10, the intention had been that the narrow definition in paragraph 8(7F) was to apply without the extension implied by paragraph 7(1)(b) and (2) and so that extension was to be ineffective, FA 2004 would have repealed paragraph 7(1)(b) and (2), and there would have been mention of this intention in the commentary to the Finance Bill 2004. So it appears that the better interpretation is that the wider definition of an offshore fund given by the application of the assumption in paragraph 7(2) was meant to apply throughout and therefore it is applied by clause 489 for the whole of Chapter 3 of Part 6 of this Bill and the definition of assets of an offshore fund in clause 493 is glossed accordingly.

Clause 587 in Part 7 of this Bill (derivative contracts) refers also to a holding that is "a material interest in an offshore fund" and applies the meaning of that phrase in clause 489. This change therefore applies also for the purposes of that clause.

This is a minor change in the law as it will prevent the taxpayer from arguing the contrary view that the assumption in paragraph 7(2) does not apply.

Adopting the wider definition of what is an offshore fund potentially brings more investments within the possibility of being qualifying investments and therefore makes it more probable that holdings in the unit trust or offshore fund with the investments are subject to the loan relationship provisions. Whether being subject to the loan relationship provisions is adverse or beneficial depends on the circumstances of the taxpayer.

This change is in principle adverse to some taxpayers and favourable to others. But it is in line with the original legislation before amendment and with the intention of the amended legislation.

Change 61: Relationships treated as loan relationships etc: power to change investments that are qualifying investments: clause 497

This change extends the power in paragraph 8(8) of Schedule 10 to FA 1996 for the Treasury to amend paragraph 8 of that Schedule to extend or restrict the investments of a unit trust scheme or offshore fund that are qualifying investments, so that it also covers investments of open-ended investment companies ("OEICs").

Paragraph 4 of Schedule 10 to FA 1996 treats a company's holdings in unit trust schemes or offshore funds as rights under a loan relationship of the company if the schemes or funds fail the test set out in paragraph 8 of that Schedule. The test is failed when the market value of the scheme's or fund's "qualifying investments" exceeds 60% of the market value of all its investments. Paragraphs 4 and 8 of Schedule 10 are modified by regulation 95 of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) so that they apply similarly to holdings in OEICs.

However, paragraph 8(8) of Schedule 10 gives power for paragraph 8 to be amended by order so as to extend or restrict the investments only of unit trust schemes or offshore funds that are qualifying investments and not those of OEICs. A similar effect might be achieved using the regulation-making power in section 17(3) of F(No.2)A 2005 to modify paragraph 8 in relation to OEICs.

Chapter 3 of Part 6 of this Bill rewrites Schedule 10, incorporating the modifications relating to OEICs. In rewriting paragraph 8(8) in clause 497 of this Bill, the opportunity has been taken to extend the power in that paragraph to cover investments of OEICs, as well as unit trust funds and offshore funds, so that a single instrument can be used to extend or restrict the qualifying investments of all three investment vehicles.

Extending or restricting the investments of OEICs that are qualifying investments could be beneficial or adverse to a company with holdings in OEICs. But since the same effect could be obtained by making regulations under section 17(3) of F(No 2)A 2005, the change does not extend the overall scope of the Treasury's powers.

This change has no implications for the amount of tax paid, who pays it or when. It affects only administrative matters.

Change 62: Relationships treated as loan relationships etc: Industrial and provident society payments treated as interest under loan relationship: clause 499

This change provides that share interest and loan interest of a registered industrial and provident society and share interest of an agricultural co-operative society are treated as trading income where the company is a party to the respective shares or loan for the purposes of a trade.

In the source legislation income from loan relationships is charged under Schedule D Case I if the relationship is used for the purposes of a trade (see section 80(2) of FA 1996) and otherwise under Schedule D Case III (see section 80(3) of that Act).

Section 486(1) of ICTA provides that, notwithstanding anything in the Tax Acts, share or loan interest payable by a registered industrial and provident society is to be treated as interest under a loan relationship of the society. Section 486(4) of ICTA requires any share or loan interest paid by such a society to be chargeable under Schedule D Case III.

"Share interest" is defined in section 486(12) of ICTA to include dividends or other sums payable to a shareholder by reference to shareholding in the society. "Loan interest", which is also defined in that section, would fall within the loan relationships provisions (Chapter 2 of Part 4 of FA 1996) regardless of section 486 of ICTA. However, section 486(4) of ICTA arguably has the effect of charging such interest under Case III only, but the matter is unclear as the words "Notwithstanding anything in the Tax Acts" only occur in section 486(1) of ICTA and the point arises as to whether section 486(4) is overridden by section 80 of FA 1996, which would give Chapter 2 of Part 4 of FA 1996 precedence.

Section 81(4) of FA 1996 excludes share capital from being treated as a debt and hence from being a loan relationship. It seems that the wording of section 486(1) of ICTA does not require the shareholding itself to be treated as a loan relationship. For that to be the case the definition of "share" in section 103 of FA 1996 would need amendment in the same way that it is amended to exclude building society shares which, as a result, are treated as loan relationships. (Section 477A(3) of ICTA, which is not unlike section 486(1), merely requires building society dividends to be treated as liabilities arising under a loan relationship but does not extend the deeming provision to the shareholding.)

Section 486(9) of ICTA requires section 486(1) (but not subsection (4)) to have effect as if references to an industrial and provident society include a reference to an agricultural co-operative society, which complicates the matter still further.

The resulting situation appears to be as follows.

IPSs other than agricultural cooperative societies

All interest which, regardless of section 486 of ICTA, would fall to be brought into account under Chapter 2 of Part 4 of FA 1996 ("natural interest"), other than interest in respect of loan relationships of a co-operative society is chargeable under that Chapter but (arguably) solely as Schedule D Case III income.

All dividends etc which are only treated as income under a loan relationship by virtue of section 486(1) of ICTA are chargeable under Chapter 2 of Part 4 of FA 1996 but solely as Schedule D Case III income. Regardless of whether section 486(4) of ICTA applies to such income or not, there is no underlying loan relationship to fall within section 80(2) of FA 1996 and the income is chargeable under Case III by virtue of section 80(3) of FA 1996. Crown Option cannot apply in this case since the charge can only be to Schedule D Case III. (Crown Option is the right given by paragraph 84 of Schedule 18 to FA 1998 to an officer of Revenue and Customs to choose between different cases of Schedule D.)

Agricultural co-operative societies

All natural interest paid by an agricultural co-operative society is chargeable under Chapter 2 of Part 4 of FA 1996 as a payment under a loan relationship. The interest is chargeable under Schedule D Case III by virtue of section 80(3) of FA 1996 unless the underlying loan relationship is held for the purposes of a trade, in which case the income is chargeable under Case I of that Schedule by virtue of sections 80(2) and 82(2) of FA 1996. The interest does not fall within section 486(4) so there is no obligatory Case III charge under that section.

All dividends paid by an agricultural co-operative society are chargeable under Chapter 2 of Part 4 of FA 1996 as payments under a loan relationship. The dividends do not fall within section 486(4) of ICTA so there is no obligatory Case III charge under that section. But, since there is no underlying loan relationship to fall within section 80(2) of FA 1996, the income is chargeable under Case III by virtue of section 80(3) FA 1996.

The effect of clause 499 is that the Schedule D Case III charge in section 486(4) of ICTA is ignored and the existence of an underlying loan relationship that may be held for the purposes of a trade is assumed.

Whether a company pays more or less tax as a result of this change will depend on a number of factors, for example whether it has trading losses brought forward to reduce what will, as a result of this change, be a trading credit. In most cases the change is not expected to result in any tax difference.

This change is in principle adverse to some taxpayers and favourable to others but is expected to be favourable in most cases.

Change 63: Derivative contracts: amendment of references to a "relevant holding" in a collective investment scheme in relation to certain relevant contracts treated as derivative contracts: clauses 587 and 601

This change clarifies the meaning of references to a "relevant holding" in unit trust schemes, open-ended investment companies and offshore funds in determining whether a relevant contract is a derivative contract.

Paragraph 36 of Schedule 26 to FA 2002 treats as a derivative contract a relevant contract to which a company is a party in an accounting period, that is not otherwise a derivative contract for the purposes of that Schedule, if its "underlying subject matter consists wholly or partly of a holding which is, in that period, a relevant holding". The paragraph does not directly define "relevant holding" for the purposes of this rule. Instead, paragraph 36(3) of that Schedule provides that "for the purposes of this paragraph a person holds a relevant holding in an accounting period if, at any time in that period, he holds…" and there follows a list of what such a holding may comprise. The reference here to a "person" is at odds with the reference in paragraph 36(1)(b) of that Schedule to a holding of which the underlying subject matter of a relevant contract consists.

The source legislation was modelled on a similar provision for loan relationships (see paragraph 4(1) of Schedule 10 to FA 1996). The reference there is to a holding held by a company. In adopting the model in paragraph 4 of Schedule 10 to FA 1996, the reference to a holding of a legal person was retained in error.

Clause 587(3), which rewrites paragraph 36(3) of Schedule 26 to FA 2002, gives a meaning of "relevant holding", for the purposes of subsection (1) of that clause, that brings matters back into alignment. It defines the case where "the underlying subject matter of a contract consists wholly or partly of a relevant holding in an accounting period". That wording matches the phrase "its underlying subject matter consists wholly or partly of a relevant holding in that period" in subsection (1).

This change also applies to clause 601, which determines the accounting basis to be used in determining the credits and debits to be brought into account in relation to a relevant holding mentioned in clause 587.

This change provides a clarification of the law which is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 64: Derivative contracts: amendment of a condition to be satisfied to determine whether the underlying subject matter of a relevant contract is "excluded property" for the purposes of Part 7: clause 591

This change adds acquiring a plain vanilla contract to the circumstances that are relevant to the contract satisfying condition A in clause 591. The circumstances in question are those in which a company carrying on life assurance business becomes a party to such a contract.

Paragraph 3 of Schedule 26 to FA 2002 sets out conditions to be satisfied if a relevant contract is to be a derivative contract for the purposes of that Schedule. ("Relevant contract" is defined in paragraph 2(2) of that Schedule as an option, a future or a contract for differences.) But paragraph 4 of Schedule 26 to FA 2002 excludes a relevant contract from contracts that are derivative contracts for the purposes of that Schedule if, although the relevant contract meets the conditions in paragraph 3 of that Schedule, its underlying subject matter consists wholly of property within specified excluded types of property. One such type is certain shares in a company or rights of a unit holder under a unit trust scheme, if the relevant contract satisfies a condition in paragraph 4(2A), (2B), (2C), (2CA) or (2D) of Schedule 26 to FA 2002.

The condition in paragraph 4(2A) of Schedule 26 to FA 2002 includes that the relevant contract is a plain vanilla contract "entered into" by a company carrying on life assurance business. (A "plain vanilla contract" is defined in paragraph 2(2B) of Schedule 26 to FA 2002 as a relevant contract other than one to which the company is treated as being a party by virtue of a provision mentioned in paragraph 2(2A) of that Schedule.) But the conditions in paragraph 4(2B), (2C) and (2CA) of Schedule 26 to FA 2002 refer to the circumstance in which the relevant contract is "entered into or acquired". That is, the condition can be met in circumstances where the company in question was not a party to the contract when it was made but became a party to the contract at a later point, say by the assignment to it of the assignor's rights and liabilities under the contract.

There is no reason in relation to the condition in paragraph 4(2A) of Schedule 26 to FA 2002 to distinguish between a case in which a company enters into a contract and one in which it acquires the contract. It is not HMRC's practice to make any such distinction. Clause 591(2), which rewrites paragraph 4(2A) of Schedule 26 to FA 2002, therefore refers to a plain vanilla contract "entered into or acquired" by a company carrying on life assurance business. This brings it into line with the conditions in paragraph 4(2B), (2C) and (2CA) of Schedule 26 to FA 2002 that are also rewritten in clause 591.

Because of this change some relevant contracts may cease to be derivative contracts for the purposes of this Part, in which case profits and losses from the contract are not charged by virtue of this Part and may be subject to a more favourable regime (say, the charge on chargeable gains).

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 65: Derivative contracts: credits and debits in respect of capital expenditure: debits not to be brought into account: clause 604

This change clarifies the rule that prevents certain debits in respect of a derivative contract taken to profit and loss being brought into account under Part 7 of this Bill. The rule applies if a related debit has already been brought into account under that Part notwithstanding that it was treated as capital expenditure under generally accepted accounting practice.

Paragraph 17A of Schedule 26 to FA 2002 sets out the general rule that the amounts to be brought into account by a company for the purposes of that Schedule are those that, in accordance with generally accepted accounting practice, are recognised in determining the company's profit or loss for the accounting period in question. Paragraph 17B of that Schedule provides that amounts so "recognised" are those recognised for accounting purposes in certain accounts or statements of the company.

Paragraph 25 of Schedule 26 to FA 2002 varies the general rule for a credit or debit that is treated in the company's accounts as an amount brought into account in determining the value of a fixed capital asset or project. A credit or debit so treated falls outside the meaning of amounts recognised in determining the company's profit or loss for the period. Paragraph 25 of Schedule 26 to FA 2002 provides that, notwithstanding the accounting treatment, the credit or debit is brought into account in the same way as a credit or debit to which paragraph 17A of Schedule 26 to FA 2002 refers. (There is an exception for certain debits taken into account under Schedule 29 to FA 2002 (intangible fixed assets)).

If a company decides to write down the value of the asset to which a debit within this paragraph has been added, or to create a reserve for the amortisation or depreciation of that asset, a debit will be taken to profit and loss. Such a debit would, but for the prohibition in paragraph 25(4) of Schedule 26 to FA 2002, be brought into account in the same way as credits and debits to which paragraph 17A of Schedule 26 to FA 2002 refers.

Paragraph 25 of Schedule 26 to FA 2002 matches paragraph 14 of Schedule 9 to FA 1996. Paragraph 25(4) and paragraph 14(4) were inserted in identical terms by Schedule 10 to FA 2004 (see paragraphs 56 and 33 respectively of that Schedule). A debit in respect of the writing down of the asset, or the creation of an amortisation or depreciation reserve, is not brought into account under Schedule 26 to FA 2002 (or Chapter 2 of Part 4 of FA 1996 in the case of a loan relationship) if attributable to the debit that is brought into account by the main rule in paragraph 25 of Schedule 26 to FA 2002 (paragraph 14 of Schedule 9 to FA 1996 in the case of a loan relationship). But the wording of paragraph 25(4)(b), in so far as it refers to "the interest component of the asset", has no application to the regime for derivative contracts. Such interest is only taken into account under the regime for loan relationships in Chapter 2 of Part 4 of FA 1996. The change dispenses with the redundant words to leave the rule in terms appropriate to derivative contracts.

This change amends the scope of a rule prohibiting a deduction. Whether that amendment results in further disallowance or an easing of disallowance (or any difference) depends largely on how the company in question interpreted the provision in assessing its liabilities. In practice, it is likely to have no tax effect.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

Change 66: Derivative contracts: priority of provisions when a company ceases to be UK resident and ceases to be a member of a group: clauses 609 and 610

This change deals with the deemed assignment and reacquisition of rights and liabilities under a derivative contract on a company ceasing to be UK resident, or the rights and liabilities in question ceasing to be held for the purposes of a permanent establishment in the United Kingdom of a non-UK resident company. The deeming does not apply if such a deemed assignment and reacquisition would otherwise occur at the same time as the company leaves a group after replacing another group member as a party to the contract. It corrects a mismatch between the rules for derivative contracts and those for loan relationships as they deal with the same circumstances.

Paragraph 22A of Schedule 26 to FA 2002 applies if a company ceases to be resident in the United Kingdom or rights and liabilities under a derivative contract of a non-UK resident company cease to be held or owed for the purposes of a United Kingdom permanent establishment. In either case, the company is deemed to have assigned the rights and liabilities under its derivative contracts (or those no longer so held or owed) for a consideration equal to the fair value of the rights and liabilities, and to have reacquired them for the same amount. Paragraph 22A of Schedule 26 to FA 2002 is rewritten in clauses 609 and 610 of this Bill.

Paragraph 30A of Schedule 26 to FA 2002 deems the same assignment and reacquisition to occur, in respect of a derivative contract, if either of two circumstances applies after one member of a group has replaced another as a party to that contract, as a result of a transaction or series of transactions within paragraph 28(2)(a) or (b) of Schedule 26 to FA 2002, so as to trigger paragraph 28(3) of that Schedule. The circumstances are that the transferee company ceases to be a member of that group of companies either, firstly, solely because of an "exempt distribution", that is, a distribution that is exempt by virtue of section 213(2) of ICTA (demergers), or, second, for any other reason. In the first case, the deemed assignment and reacquisition is triggered by and at the time of a "chargeable payment" within the meaning of section 214(2) of ICTA within five years of the company leaving the group. In the second case, the deemed assignment and reacquisition occur when the company leaves the group. Paragraph 30A of Schedule 26 to FA 2002 is rewritten in clauses 630 to 632 of this Bill.

Paragraph 10A of Schedule 9 to FA 1996, rewritten in clauses 333 and 334 of this Bill, is the equivalent for loan relationships of paragraph 22A of Schedule 26 to FA 2002. Paragraph 12A of Schedule 9 to FA 1996, rewritten in clauses 344 to 346 of this Bill, is the equivalent for loan relationships of paragraph 30A of Schedule 26 to FA 2002.

Both paragraph 22A and paragraph 30A of Schedule 26 to FA 2002 may apply at the same time (for example, a company may cease to be UK resident at the time it ceases to be a member of the group because it moves its residence abroad on being bought by a new parent who is non-UK resident). Paragraph 10A(1A) of Schedule 9 to FA 1996 avoids the same duplication in respect of loan relationships by disapplying that paragraph if paragraph 12A of that Schedule applies and the cessation mentioned in one paragraph occurs at the same time as the cessation mentioned in the other.

There is no reason for the two regimes to apply different rules in these circumstances. Clauses 609 and 610 therefore include the equivalent of paragraph 10A(1A) of Schedule 9 to FA 1996, mirroring the rewrite of that provision in clauses 333 and 334. This change brings the two regimes into line.

This change clarifies the order of priority of the operation of the provisions in question. It may, in cases where clause 631 or 632 applies instead of clause 609 or 610, defer the point at which the deemed assignment and reacquisition, and therefore the resulting incidence of a tax charge, occurs.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 67: Derivative contracts: meaning of "impairment loss" for the purposes of the meaning of "carrying value": clause 702

This change provides a meaning for the term "impairment loss" which is used in providing the meaning of "carrying value" in clause 702 of this Bill.

Paragraph 54(1) of Schedule 26 to FA 2002 provides that "carrying value", where that term is used in that Schedule, is to be construed in accordance with paragraph 50A(3A) and (3B) of that Schedule. Paragraph 50A of Schedule 26 to FA 2002 brings into account under that Schedule an adjustment on a company changing to international accounting standards. Sub-paragraph (3A) provides that, for the purposes of that paragraph, the "carrying value" of a contract includes amounts recognised for accounting purposes in relation to a derivative contract in respect of a number of items, including "impairment losses (including provisions for bad or doubtful debts)".

The term "impairment loss" is not defined in Schedule 26 to FA 2002. It is arguable that the reference in subparagraph (3A) to "amounts recognised for accounting purposes" brings with it the meaning of that term provided by generally accepted accounting practice. For example, paragraph 6 of International Accounting Standard 36 says: "impairment loss is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount." And there are similar but not identical references to impairment losses in other standards. The term could therefore be included in clause 710 of this Bill (other definitions) beside a number of other terms taken from generally accepted accounting practice which have the meaning they have for accounting purposes.

However, section 103(1) of FA 1996 provides a definition of "impairment loss" for the purposes of Chapter 2 of Part 4 of that Act (loan relationships). That Chapter includes Schedule 9 to FA 1996 which has a number of paragraphs dealing specifically with impairment losses (for example, paragraphs 5ZA to 6C). Paragraph 19A of that Schedule deals with the adjustment to be made for the purposes of that Chapter on a change of accounting policy. That paragraph is drafted in very similar terms to paragraph 50A of Schedule 26 to FA 2002. It also includes the equivalent of paragraph 50A(3A) of Schedule 26 to FA 2002, with a mention of impairment losses, so that the definition in section 103(1) of FA 1996 applies.

As the provisions for derivative contracts deal with this matter in an equivalent manner to the provisions for loan relationships, it adds consistency in the construction of such equivalent provisions to adopt the definition of "impairment loss" in section 103(1) of FA 1996 for the purposes of paragraph 50A(3A) of Schedule 26 to FA 2002. That definition (together with the subsidiary definition of "impairment" in section 103(1) of FA 1996) has therefore been rewritten in clause 702(4).

This change provides a clarification of the law which is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 68: Unpaid remuneration of employees: payment made after return submitted but within 9 months of the end of the period of account: clauses 867, 1250 and 1289 and Schedule 1

This change drops the requirement to make a claim for a deduction for remuneration paid after the return is submitted but within nine months of the end of the period of account in which it is charged.

This change brings the income tax and corporation tax codes back into line in rewriting section 43 of FA 1989. And it is adopted for consistency in rewriting parallel rules in section 44 of FA 1989 and paragraph 113 of Schedule 29 to FA 2002.

Sections 43(5) and 44(5) of FA 1989 deal with profit calculations made within nine months of the end of the period of account. Paragraph (a) of each subsection requires the assumption that any remuneration unpaid at the time of the calculation will not be paid by the end of that nine month period. That means the proposed remuneration cannot be deducted in making the calculation. Paragraph (b) of each subsection provides an adjustment procedure that applies when the remuneration is paid after the calculation is made but before the end of the nine month period. If a claim is made within two years of the end of the period of account the calculation may be adjusted.

There is a parallel rule in paragraph 113(5) of Schedule 29 to FA 2002 which applies to the intangible fixed assets regime.

This change brings the adjustment procedure into line with the normal Self Assessment rules and deals with the adjustment as an amendment to a return. Section 42(7) of TMA sets out the rules for making claims. Schedule 1 to this Bill removes the reference to section 43(5) of FA 1989 in paragraph (b) of that subsection and does not replace it.

The change alters the time available for making the adjustment from two years after the end of the period of account in every case to a date that depends on the length of the period of account.

Paragraph 15(4)(a) of Schedule 18 to FA 1998 gives the time limit for making amendments to corporation tax returns. It is 12 months from the filing date for the relevant return.

Corporation tax returns are required for accounting periods. The end of a period of account will always end an accounting period. In the normal case where the company has a 12 month period of account the change makes no difference to the time limit for "claiming" the relief. The filing date is 12 months after the accounting date and the date for amending the return is 12 months after that. This is the same time limit as those in sections 43(5) and 44(5) of FA 1989.

In fact, the time limit for "claiming" the relief is unaffected if the period of account is no longer than 18 months.

Example One

A notice to file for the 12 months ended 31 December 2005 is issued in January 2006. This accounting period is included in a period of account that runs from 1 January 2005 to 30 June 2006. The filing date for the accounting period is 30 June 2007 and the amendment date 30 June 2008. This is two years after the end of the period of account.

The time limit for "claiming" the relief will be reduced only if the period of account is longer than 18 months. The filing date for the first accounting period in such a period of account is 12 months after the 18-month point. The time limit for amending the return is 12 months after that filing date. This will be less than two years after the end of the period of account.

Example Two

A notice to file for the 12 months ended 31 December 2005 is issued in January 2006. This accounting period is included in a period of account that runs from 1 January 2005 to 31 December 2006. The filing date for the accounting period is 30 June 2007 and the amendment date 30 June 2008. This is less than two years after the end of the period of account (31 December 2008).

A company is unlikely to be disadvantaged by the change. In Example Two the company would have to submit its return before 30 June 2007 (the filing date) at a time when the remuneration was unpaid. The remuneration would then have to be paid on or before 30 September 2007. Under the change the company would still have nine months to "claim" the relief (compared with 15 months under section 43(5)(b) or 44(5)(b) of FA 1989).

In practice periods of account longer than 18 months are unusual and nearly all companies affected by the provision claim the deduction in their original return.

This change puts the method of allowing relief on the same basis as that in paragraph 6 of Schedule 24 to FA 2003, rewritten in clause 1295.

Schedule 24 to FA 2003 is a similar provision to section 43 of FA 1989. It denies a deduction for amounts charged in respect of employee benefit contributions unless the benefits are provided within nine months of the end of the period in respect of which they are charged.

Paragraph 6 of Schedule 24 to FA 2003 deals with the case in which the return is made before the end of the nine month period. Unlike section 43(5) of FA 1989 it does not require a claim. It provides merely that the calculation can be adjusted. This is the most appropriate way of dealing with the point under Self Assessment.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 69: Miscellaneous income: beneficiaries' income from estates in administration: set off of excess of allowable estate deductions in the final tax year of the administration period: absolute interests: clause 943
This change provides for any amounts that are allowable against the aggregate income of the estate in calculating the residuary income of the estate in the "final tax year" (the tax year in which the administration period ends), but cannot be so allowed because they exceed that income, to be set off against the amount in respect of which the beneficiary with an absolute interest is taxable or, if there is more than one such beneficiary, for a just and reasonable part to be set off.

It brings the income tax and corporation tax codes back into line.

Section 697(1A) of ICTA provides that where the deductions for any year exceed the aggregate income of the estate, the excess shall be carried forward and treated as an allowable deduction in the following year. Clearly, this is not possible in the tax year in which the administration period ends. In practice, however, excess deductions may be set off against any residuary income of the estate which has not been paid out. (This is often necessary since personal representatives may incur a high proportion of expense on the estate towards the end of the administration period, for example, because of the billing of legal or accountancy fees at the end.)

In rewriting section 697(1A) of ICTA, clause 943(3) reflects that practice by providing for a company's basic amount of estate income for the final accounting period (that is, the company's share of the residuary income of the estate that has not yet been paid out) to be reduced by the excess deductions. If there is more than one absolute interest in the residue of the estate at the end of the administration period a just and reasonable part of the excess is subtracted.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 70: Miscellaneous income: beneficiaries' income from estates in administration: exclusion of income from specific dispositions and income from contingent interests from the aggregate income of the estate: clauses 947 and 949
This change excludes income from specific dispositions and income from contingent interests from the aggregate income of an estate (which is used to compute the residuary income of an estate and hence affects the amount of estate income that is chargeable to tax where a person has an absolute interest in the estate) and from the deductions made in determining the residuary income of the estate.

It brings the income tax and corporation tax codes back into line.

The aggregate income of the estate is defined in section 701(8) of ICTA as:

> the aggregate income from all sources [for the tax year in question] of the personal representatives of the deceased as such, treated as consisting of –

(a) any such income which is chargeable to United Kingdom income tax by deduction or otherwise, such income being computed at the amount on which tax falls to be borne for that year;

(b) any such income which would have been so chargeable if it had arisen in the United Kingdom to a person resident and ordinarily resident there, such income being computed at the full amount thereof actually arising during that year, less such deductions as would have been allowable if it had been charged to United Kingdom income tax;

(c) any amount of income treated as arising to the personal representatives under section 410(4) of ITTOIA 2005 (stock dividends) that would be charged to income tax under Chapter 5 of Part 4 of that Act if income arising to personal representatives were so charged (see section 413 of that Act);

(d) in a case where section 419(2) of that Act applies (release of loans to participator in close company: debts due from personal representatives), the amount that would be charged to income tax under Chapter 6 of Part 4 apart from that section; and

(e) any amount that would have been treated as income of the personal representatives as such under section 466 of that Act if the condition in section 466(2) had been met (gains from contracts for life insurance);

but excluding any income from property devolving on the personal representatives otherwise than as assets for payment of the debts of the deceased.

Property that is the subject of a specific disposition is available for the payment of the deceased's debts and so is not excluded. However, under section 697(1)(b) of ICTA "the amount of any of the aggregate income of the estate for [a tax year] to which a person has on or after assent become entitled by virtue of a specific disposition either for a vested interest during the administration period or for a vested or contingent interest on the completion of the administration" is deductible from the aggregate income of the estate for that year in calculating the amount of the residuary income of an estate for that year. The Scottish version of this provision omits the words "on or after assent" and the words following "specific disposition": see section 702(b) of ICTA. But the inclusion of the words "on or after assent" for the rest of the United Kingdom means that much of the income of the specific disposition will form part of the aggregate income. The result is that the measure of the income taken to be available to residuary beneficiaries is inflated.

In practice, HMRC allow all income from specific dispositions to be deducted from the aggregate income of the estate in calculating the residuary income of the estate for the year of assent and later years. But it is considered simpler for it merely to be excluded from what counts as the aggregate income and not to be deducted from it. Accordingly, the definition of "the aggregate income of the estate" in clause 947 of this Bill contains an exclusion for all income from specific dispositions to which a person is or may become entitled at subsection (5)(a). In consequence, the deduction for this income in section 697(1)(b) of ICTA and its adaptation for Scotland in section 702(b) of ICTA have not been rewritten.

Since income tax is treated as having been paid on this income, any reduction in the income taken to be available to beneficiaries as a result of this change will result in:

- corporate beneficiaries who pay tax at the main corporation tax rate paying less tax; but

- those not liable to corporation tax, or liable to tax at the small companies' rate, not being able to reclaim so much tax.

This change is adverse to some taxpayers and is favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 71: Miscellaneous income: beneficiaries' income from estates in administration: removal of the requirement for interest to be annual and a charge on residue to be deductible in calculating the residuary income of the estate: clause 949

This change removes the requirements for interest to be annual and a charge on residue in order to be deductible from the aggregate income of the estate in calculating the residuary income of the estate.

It brings the income tax and corporation tax codes back into line.

The deductions that are allowable in ascertaining the amount of the residuary income of an estate for an income tax year are set out in section 697(1)(a) and (b) of ICTA. Section 697(1)(a) of ICTA refers to "the amount of any annual interest, annuity or other annual payment [for the year] which is a charge on residue …". There is a definition of "charges on residue" in section 701(6) of ICTA which is adapted for Scotland in section 702(d) of ICTA.

So far as the requirement for the interest to be annual is concerned, historically tax legislation has distinguished between short interest (which was not usually deductible) and annual or yearly interest (which was usually deductible). FA 1969 abolished the general relief for interest paid by taxpayers. However, specific provision was made for relief to continue to be allowed in respect of interest on borrowings for certain purposes. Annual or yearly interest continued to be significant as there was a requirement that tax was deducted from certain payments of yearly interest. But under current law interest, whether short or annual, may be deducted as an expense in computing the profit or loss of a trade for tax purposes if incurred wholly and exclusively for business purposes. (This is subject to certain restrictions on the deduction of annual interest paid to a person not resident in the United Kingdom and there is still a requirement to deduct tax in certain circumstances in relation to annual interest under section 874 of ITA, for example, where the payment is to a person whose usual place of abode is outside the United Kingdom.)

The other requirement in section 697(1)(a) of ICTA is that the payment of annual interest must be a charge on residue. "Charges on residue" are defined in section 701(6) of ICTA as certain specified liabilities properly payable out of the estate, as well as interest payable in respect of them. The definition is wide enough to include all interest ever likely to be paid by personal representatives, so the requirement that the payment is a charge on residue is otiose for interest.

Therefore, clause 949(2)(a) of this Bill, which rewrites section 697(1)(a) of ICTA, omits the requirements for interest to be annual and a charge on residue before it can be deducted from the aggregate income of the estate to calculate the residuary income of the estate. As a consequence, all interest paid by the personal representatives will be deductible, except for interest on unpaid inheritance tax which is expressly disallowed by section 233(3) of IHTA.

Since income tax is treated as having been paid on this income, any reduction in the income taken to be available to beneficiaries as a result of this change will result in:

- corporate beneficiaries who pay tax at the main corporation tax rate paying less tax; but

- those not liable to corporation tax, or liable to tax at the small companies' rate, not being able to reclaim so much tax.

This change is adverse to some taxpayers and is favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 72: Miscellaneous income: beneficiaries' income from estates in administration: amounts grossed up using basic rate: reduction in share of residuary income of estate: clause 951

This change provides that the basic rate of income tax is used to gross up the sums paid before the completion of the administration of an estate (or sums payable on the completion of the administration of the estate) to a beneficiary with an absolute interest in the estate, for the purposes of determining whether the beneficiary has been charged to tax on more income than the beneficiary has enjoyed and adjusting the tax payable by it accordingly.

Section 697(2) of ICTA provides that where:

- the total of a beneficiary's shares of the residuary income of an estate for all years in which the beneficiary held an absolute interest exceeds,

- the total sums paid or payable to that beneficiary during or at the end of the administration period ("benefits received"),

that excess is deducted from the beneficiary's share of the residuary income of the estate in the year the administration is completed. Any excess which cannot be deducted in that year is deducted from the beneficiary's share for the previous year and so on.

To determine the benefits received, section 697(3) of ICTA provides that the sums paid (or payable) are taken to be such amounts as would, after the deduction of income tax for the year of assessment in which they were paid, be equal to those sums. That is, they are grossed up.

When 697(3) of ICTA was rewritten for income tax purposes in section 668(5) of ITTOIA, as a result of section 4(1) of ICTA the amount of income tax was taken to have been deducted at the "basic rate".

Section 4(1) of ICTA provided that any provision requiring, permitting or assuming the deduction of income tax from any amount, or treating income tax as having been deducted from or paid on any amount, should, subject to any provision to the contrary, be construed as referring to deduction or payment of income tax at the basic rate in force for the relevant year of assessment.

Section 4(1) of ICTA was repealed by ITA 2007 and was not rewritten as a general rule.

This change provides that the basic rate is to be used when amounts are grossed up for the purpose of this clause. It brings the income tax and corporation tax codes back into line, and restores the law to the position before section 4(1) of ICTA was repealed.

Current practice is that the benefits received are grossed up at the basic rate and therefore this change will make no difference in practice.

Whether this change is advantageous or not depends on how section 697(3) of ICTA would be interpreted in the absence of section 4(1) of ICTA. The change is advantageous if a grossing up rate of more than the basic rate would be applied, and disadvantageous if a lower rate would be applied or no grossing up could be done.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 73: Miscellaneous income: beneficiaries' income from estates in administration: how reduction in share of residuary income of estate under section 697(2) and (3) of ICTA operates for successive absolute interests: clause 954

This change relates to the reduction in the share of the residuary income of the estate required where the amounts paid during or payable at the end of the administration period in respect of an absolute interest are less than the share of the residuary income for all tax years, and clarifies how the reduction is to be made in cases where the absolute interest has been held successively.

It brings the income tax and corporation tax codes back into line.

Under section 697(2) of ICTA on the completion of the administration of an estate in which a company has an absolute interest, a comparison is made between the aggregate benefits received in respect of that interest and the aggregate for all years of the residuary income of the company having that interest. If the aggregate of the benefits is less than the aggregate of the residuary income, the amount of the shortfall is to be applied in reducing the company's residuary income for the tax year in which the administration is completed. If that does not exhaust the amount of the shortfall, the remainder is used to reduce the previous tax year's residuary income, and so on for earlier tax years. (Section 697(2) of ICTA is rewritten in clause 951.)

Section 697(4) of ICTA provides that if a different person had an absolute interest in the residue at any time in the administration period "the aggregates mentioned in [section 697(2) of ICTA] shall be computed in relation to those interests taken together". This is too vague to indicate how the reduction is to be made under section 697(2) of ICTA where there is more than one person with a share of the residuary income of the estate available to be reduced.

One possibility would be for the reduction to be apportioned in some way between the absolute interest holders. But it is not at all obvious how such an apportionment would work because section 697(2) of ICTA requires the excess for the final tax year of the administration period to be used to reduce the last absolute interest holder's residuary income in the previous tax year. So it is not apparent whether that would have to be done before any other person's reduction was made. The other holder or holders of the interest may have held it several tax years before the final year.

Clause 954(6) and (7) of this Bill provide for the reduction to be made in these circumstances. Clause 954(6) provides that the last absolute interest holder's share of the residuary income should be reduced first. If there is still an excess of residuary income over the gross amount of all sums paid during or payable at the end of the administration period after going through all the years in which the final holder had the interest, the excess is then applied to the residuary income of the previous holder for the last tax year in which that person had the interest and then to earlier tax years (and earlier absolute interest holders as appropriate) working backwards.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 74: Miscellaneous income: beneficiaries' income from estates in administration: requirement for apportionments where the parts of the

residuary estate in which successive interests subsist do not wholly correspond: clause 959

This change introduces a requirement for just and reasonable apportionments to be made in cases involving successive interests in the residuary estate where the part of the residuary estate in which a succeeding interest subsists does not wholly correspond with the part in which the preceding interest subsisted.

It brings the income tax and corporation tax codes back into line.

The taxation of successive interests in the residue of an estate is dealt with in section 698 of ICTA. Section 701(11) of ICTA provides that where different parts of the estate are the subject of different residuary dispositions, Part 16 of ICTA has effect in relation to each of those parts with the substitution for references to the estate of references to that part of the estate. (This is rewritten as a general rule for the interpretation of this Chapter in clause 934(3) of this Bill.) But there is no provision for situations where the residuary estate in which a later holder acquires an interest was not all subject to the interest held by a previous holder or is only a part of the residuary estate in which a previous holder held an interest.

Clause 959 of this Bill provides that in such cases such apportionments as are just and reasonable are to be made. As the apportionment depends on the facts of each case, this change could result in a favourable or adverse outcome for any particular taxpayer.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 75: Investment income: foreign dividend coupons: charge on income treated as arising from foreign holdings: clause 974

This change clarifies two points in rewriting section 18(3B) of ICTA. First, that a "bank in the United Kingdom" means a bank's office in the United Kingdom, whether the bank is resident in the United Kingdom or abroad. Second, that a "dealer in coupons in the United Kingdom" means a coupon dealer carrying on business in the United Kingdom, whether the dealer is resident in the United Kingdom or abroad.

This change reproduces Change 103 in ITTOIA and so brings income tax and corporation tax back into line.

Section 18(3B) of ICTA provides that a charge under Schedule D Case V arises on the sale or other realisation of coupons for foreign dividends by a "…bank in the United Kingdom…" which pays over the proceeds or carries them to an account. This is interpreted by HMRC to mean the office in the United Kingdom of a bank, whether that bank is incorporated in the United Kingdom or abroad. Similarly, a sale of such coupons to a "… dealer in coupons in the United Kingdom …" is taken to mean a coupon dealer carrying on business in the United Kingdom, whether resident in the United Kingdom or abroad.

Clause 974 is based principally on section 18(3) and (3B) of ICTA. It treats income as arising from foreign holdings where the proceeds of sale of a dividend coupon attached to the holding are (a) paid over or otherwise realised by a bank in the United Kingdom, or (b) arise from a sale to a coupon dealer in the United Kingdom by someone other than a bank or coupon dealer. So subsection (3) of the clause refers to "… a bank's office in the United Kingdom…" and subsection (4) refers to a person "… dealing in coupons in the United Kingdom …" in rewriting section 18(3B) of ICTA.

Where section 18(3B) of ICTA does not apply, then section 730 of ICTA may apply to charge the foreign dividends to corporation tax. An alternative interpretation to "in the United Kingdom" may, depending on circumstances, take a sale of coupons out of one of those ICTA provisions and into another. Whether or not more or less tax is paid as a result of being taxed under clause 974 of this Bill or section 730 of ICTA depends on the taxpayer's own circumstances.

This change is adverse to some taxpayers and favourable to others in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 76: Relief for employee share acquisitions: recovery of relief given in respect of approved Share Incentive Plans (SIPs): clauses 986, 990, 992, 993 and 998

This change deals with the withdrawal of relief given in respect of an approved SIP.

Schedule 4AA to ICTA gives relief for the costs of setting up an approved SIP, contributions to a plan trust and the provision of shares awarded to employees under the SIP. It is rewritten in Chapter 1 of Part 11 of this Bill.

Paragraphs 10, 11 and 12 of Schedule 4AA to ICTA withdraw relief in certain circumstances.

If relief is withdrawn, Schedule 4AA to ICTA treats the company as receiving a trading receipt equal to the withdrawn relief. If the business is a property business the effect of section 21A of ICTA is to treat the company as receiving a receipt of the property business equal to the withdrawn relief (because section 85B of ICTA, which provides that Schedule 4AA shall have effect, is in Chapter 5 of Part 4 of ICTA and that Chapter is listed in section 21A(2) of ICTA). If relief is withdrawn under paragraph 11 of Schedule 4AA and the company is carrying on an investment or insurance business, paragraph 13 of Schedule 4AA provides for an amount to be taxed under Schedule D Case VI.

But paragraph 13 of Schedule 4AA to ICTA does not apply to the case where a deduction under paragraph 9 of Schedule 4AA is withdrawn under paragraph 10(1) or 10(8) or paragraph 12 of Schedule 4AA.

The purpose of this change is to clarify and make more consistent the way in which withdrawn relief is treated. This is done in clause 986 of this Bill, which deals with the treatment of amounts treated as received under Chapter 1 of Part 11 of this Bill when relief is withdrawn. The following clauses in this Bill also treat a company as receiving a an amount equal to the withdrawn relief: clauses 990(4) and (5), 992(4) and (6), 993(2) and (4) and 998(3) and (4). This amount is treated as received when the event withdrawing the relief occurs. In the source legislation it is treated as arising in the period of account in which the event occurs.

If the company is carrying on a trade or property business the amount is treated as a receipt of that trade or business, see clause 986(2) of this Bill.

If the company has ceased to carry on the trade or property business the amount is treated as a post-cessation receipt, see clause 986(3). This clarifies the existing law which does not expressly deal with the case of a trading receipt received after the trade has ceased.

If the company is not carrying on, or has not carried on, a trade or property business the amount is one to which the charge to corporation tax on income is applied, see clause 986(4). This includes not only the amount that is taxed under Schedule D Case VI by paragraph 13 of Schedule 4AA to ICTA but also an amount which paragraphs 10 and 12 of Schedule 4AA treat as a trading receipt even though the company is not carrying on a trade.

This change clarifies and standardises the law on the basis of generally accepted practice. To that extent this change removes in principle the right of a taxpayer to assert that the generally accepted practice is unlawful.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 77: Additional relief for research and development: applies for corporation tax only: clauses 1044, 1045, 1063, 1068, 1074, 1087, 1092 and 1149

This change makes clear that the additional relief for expenditure on research and development (including vaccine research) and for expenditure on the remediation of contaminated land applies only for corporation tax.

Research and development

Schedule 20 to FA 2000 and Schedules 12 and 13 to FA 2002 apply only to companies. See the respective paragraphs 1(1) of each Schedule. The source legislation does not say that the relief given by those Schedules is restricted to a company liable to corporation tax. This leaves open the possibility that the reliefs are available to a company liable to income tax. Such a company would carry on a trade in the United Kingdom other than through a permanent establishment in the United Kingdom.

It is most unlikely that such a company would meet the qualifying conditions for relief but there are other more direct indicators that the reliefs are available only to companies liable to corporation tax.

First, the legislation is drafted in terms of "accounting periods" and that is a term that is defined only for corporation tax. See paragraph 1(1) of each Schedule and section 12 of ICTA.

Second, Parts 9A, 9BA and 9C of Schedule 18 to FA 1998 provide that claims to each relief must be made in the company tax return; that is, the company's return of its corporation tax liability. There is no equivalent provision for income tax.

Third, paragraph 19 of Schedule 20 to FA 2000 and paragraph 19 of Schedule 13 to FA 2002 restrict the carrying forward of a loss that has been surrendered in return for the payment of a tax credit. There is no equivalent provision for income tax.

Schedule 20 to FA 2000 and Schedules 12 and 13 to FA 2002 are rewritten in Part 13 of this Bill (additional relief for expenditure on research and development) and repealed by Schedule 1. Clause 1044(1), and other clauses in Part 13, provide that the relief applies only for corporation tax.

Contaminated land

The change that additional relief is available only to companies liable to corporation tax also applies to the additional relief that is available under clause 1149 for expenditure on the remediation of contaminated land.

Paragraph 13 of Schedule 22 to FA 2001 provides that a company may deduct 150% of its qualifying land remediation expenditure from the profits of a Schedule A business or a trade carried on by the company. This paragraph does not limit the relief to corporation tax, but should only apply to corporation tax for the same reasons as those mentioned above for research and development. The change makes it clear that the additional relief applies only for corporation tax.

This change removes the possibility of entitlement to relief for companies subject to income tax.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 78: Additional relief for research and development: R&D threshold: clauses 1050, 1064, 1075 and 1097

This change makes a small adjustment to the calculation of the total qualifying R&D expenditure threshold where a company has an accounting period that is shorter than 12 months.

Schedule 20 to FA 2000 and Schedule 12 to FA 2002 provide relief for companies which have incurred qualifying expenditure on research and development. Schedule 13 to FA 2002 provides relief for companies which have incurred qualifying expenditure on vaccine-related research. These reliefs are rewritten in Chapters 2, 3, 4, 5 and 7 of Part 13 of this Bill.

The source legislation in paragraph 1(1) of Schedule 20 to FA 2000, paragraphs 1(1) and 7(1) of Schedule 12 to FA 2002 and paragraph 1(1) of Schedule 13 to FA 2002 states that a company is entitled to relief for an accounting period if the company's qualifying expenditure for that period is not less than £10,000 or, if the accounting period is less than 12 months, such amount as bears to £10,000 the same proportion as the accounting period bears to 12 months. While the effect of the source legislation is generally understood, it is not explicit how it should be applied to particular circumstances. The legislation requires that the short accounting period be compared arithmetically to a 12 month period (the "normal" length of an accounting period). But not all 12 month periods are the same. What is the correct comparative period of 12 months? What should happen when that 12 month comparative period includes an extra day because it is a leap year?

In the cases affected by this change, the use of an arithmetical formula in which the denominator is based on a standardised number of days in a year removes any uncertainty in this regard. The number of days in the actual accounting period is divided by 365 to obtain the relevant proportion to apply to the threshold amount in order to find the adjusted threshold. So there is no need to consider which is the correct comparison period of 12 months when more than one such period could be appropriate.

In a leap year, the source legislation lowers by £27 the £10,000 threshold in clauses 1050, 1064, 1075 and 1097 of this Bill. Dividing by 365 in all cases, when 366 days might have been the appropriate number for substitution into the denominator, gives a slightly higher R&D threshold for the purposes of these clauses.

This change assists taxpayers because it provides certainty and clarity. But in limited circumstances it will raise slightly the qualification threshold, thereby denying relief where relief might otherwise have been available.

This change is adverse to some taxpayers in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 79: Additional relief for research and development etc: meaning of "staffing costs": clauses 1123 and 1170

This change relates to the rewrite of paragraph 5(1) of Schedule 20 to FA 2000 (relief for expenditure on research and development) and paragraph 5(1) of Schedule 22 to FA 2001 (relief for expenditure on contaminated land). The effect of the change is that the definitions of "staffing costs" in clauses 1123 and 1170 of this Bill apply to money earnings and reimbursed expenses. (Note that "employee costs", which is the expression used in Schedule 22 to FA 2001, is rewritten in clause 1170 as "staffing costs" because the terms of the definition are identical to the terms used in defining "staffing costs" in clause 1123.)

Schedule 20 to FA 2000 allows a small or medium-sized enterprise to claim additional relief for qualifying expenditure on research and development that is related to its trade. "Staffing costs" (as defined in paragraph 5 of Schedule 20 to FA 2000) is one of the categories of qualifying expenditure. The same definition is applied in Schedules 12 and 13 to FA 2002.

In relation to contaminated land, Schedule 22 to FA 2001 allows a company to claim additional relief for qualifying expenditure on the remediation of contaminated land used for the purposes of a trade or UK property business. "Employee costs" (as defined in paragraph 5 of Schedule 22) is one of the categories of qualifying expenditure.

When these Schedules were introduced, paragraph 5(1)(a) of each Schedule defined staffing costs and employee costs respectively as:

> the emoluments paid by the company to directors or employees of the company, including all salaries, wages, perquisites and profits whatsoever other than benefits in kind.

This language drew on the definition of "emoluments" in section 131 of ICTA. The only difference is that section 131 of ICTA omitted the words "other than benefits in kind". Section 131 of ICTA identified the emoluments on which an employee was charged to income tax under the former head of charge, Schedule E.

Schedule E was rewritten in ITEPA. The charge on emoluments became part of the charge on employment income. The word "emoluments" is outdated and was replaced in ITEPA by "earnings". The charge on employment income is made up of a number of different elements and the meaning of "earnings" in ITEPA goes wider than the definition of "emoluments" in section 131 of ICTA.

References to emoluments in legislation not being rewritten in ITEPA were amended by that Act so as to align them with the new definition of earnings. This included the references in paragraph 5(1)(a) of Schedule 20 to FA 2000 and paragraph 5(1)(a) of Schedule 22 to FA 2001. Paragraphs 245 and 258 of Schedule 6 to ITEPA substituted the following:

> (a) The earnings paid by the company to directors or employees of the company

Paragraphs 245 and 258 of Schedule 6 to ITEPA also inserted the following definition of "earnings":

> earnings or amounts treated as earnings which constitute employment income (see section 7(2)(a) or (b) of the Income Tax (Earnings and Pensions) Act 2003)

There were two problems with this amendment.

First, it was unnecessary. The definition in section 131 of ICTA applied in determining the tax charge on the employee receiving the payment. It identified an amount that constituted income in the hands of the employee. Over the years it has been the subject of a significant amount of judicial comment, particularly the meaning of "perquisites and profits whatsoever".

The definitions in paragraph 5(1)(a) of Schedule 20 to FA 2000, and paragraph 5(1)(a) of Schedule 22 to FA 2001, apply to determine the amount of an expense in the hands of the company. Although the language is the same, the definitions were independent of the definition in section 131 of ICTA because that definition was from the standpoint of the employee. None of the supporting structure of Schedule E that influenced the interpretation of the definition applies to Schedule 20 to FA 2000 or Schedule 22 to FA 2001. There was no need to change the definition in Schedule 20 and Schedule 22 to mirror the rewrite of Schedule E.

Second, inadvertently it expanded the definition so that it included benefits in kind. These came in through the reference to amounts treated as earnings in section 7(2)(b) of ITEPA. The definition of those amounts in section 7(5)(b) of ITEPA includes payments under the benefits code.

This error was corrected in paragraph 7 of Schedule 17 to FA 2004. That Schedule made a number of minor amendments to, or connected with, ITEPA. The aim of the Schedule was to restore the pre-ITEPA position with minimal differences. It did this in paragraph 5(1) of Schedule 20 to FA 2000 and paragraph 5(1) of Schedule 22 to FA 2001 by reinstating the original definition.

The difficulty with the original definition is partly that words such as "emoluments" and "perquisites" are outdated and partly that aspects of the definition are not clear. It is not certain that terms defined to regulate the income tax position of an employee have or should have the same meaning where the same term is used to regulate the corporation tax position of an employer company. In particular it is not clear what the phrase "profits whatsoever" means when looked at from the position of the employer making the payment. It is not possible to pay an amount of profit. Profit is a concept that applies to the person who receives the payment.

The reference to emoluments in paragraph 5(1)(a) of Schedule 20 to FA 2000 is rewritten in clause 1123. The reference to emoluments in paragraph 5(1)(a) of Schedule 22 to FA 2001 is rewritten in clause 1170. The exclusion by the source legislation of benefits in kind limits the meaning to amounts paid in money.

Both clauses 1123 and 1170 rewrite the reference to emoluments in two parts:

- earnings paid in money (subsection (2)); and
- reimbursed expenses (subsection (3)).

"Earnings" is not defined so it has its ordinary meaning. It covers salaries, wages, commissions, bonuses and tips. It covers such payments whether paid regularly or otherwise. This covers part of the rewrite of "perquisites and profits whatsoever".

"Reimbursed expenses" covers the balance of the rewrite of "perquisites and profits whatsoever". It applies to cash reimbursements of expenses but not to expenses reimbursed in a non-cash form such as car and fuel benefits. This follows from the exclusion by the source legislation of benefits in kind.

In clauses 1123(2) and (3) and 1170(2) and (3), the phrase "because of … employment" is used instead of the ITEPA phrase "by reason of employment". The intended effect is that interpretations developed in relation to ITEPA, which might not be appropriate in this corporation tax context, cannot simply be read across into this definition. The phrase takes its ordinary meaning. There must be a relevant payment, and on ordinary principles, that payment must have been made because of the fact of employment of that director or employee.

The requirement that the expenses are paid by the director or employee comes because paragraph 5(1)(a) of Schedule 20 to FA 2000 and paragraph 5(1)(a) of Schedule 22 to FA 2001 apply to "profits whatsoever". There is no profit to the director or employee unless he or she has incurred a personal liability that is then relieved by the company. So it would not apply to expenditure incurred by the director or employee using a company credit card (a card linked to the company's bank account) because the cost is borne by the company (the company is liable), not the director or employee.

This change modernises the language of the law without changing the meaning of the law. This change also clarifies the law on the basis of generally accepted practice. To that extent this change removes in principle the right of a taxpayer to assert that the generally accepted practice is unlawful.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 80: Expenses of management: credit unions: clause 1218
This change makes clear that a credit union cannot be the subject of a charge to tax on a FISMA repayment or an industrial development grant under Part 16 of this Bill.

Section 487(4) of ICTA provides that a credit union is not a company with investment business *for the purpose of section 75 of ICTA.* As a result, such a company cannot have expenses of management deducted under section 75. And it follows that there can be no charge on a "reversal amount" under section 75B of ICTA.

But the charge under section 76B of ICTA on a repayment under FISMA is not dependent on there having been a previous deduction under section 75. It is arguable that the rule in section 487(4) of ICTA is not wide enough to remove the possibility of a charge under section 76B.

In the unlikely event that a credit union receives an industrial development grant it is similarly arguable that section 487(4) of ICTA does not remove the charge under section 93(1) of ICTA.

Clause 1218(2) of this Bill takes credit unions completely outside the rules in Part 16. So there can be no charge under the rules in Chapter 5 of that Part.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 81: Expenses of management: clause 1221
This change clarifies the relationship between:

- the rules in section 75(4) of ICTA that an expense must be in respect of the company's investment business and not for an unallowable purpose; and

- other rules that expenses are to be treated as expenses of management.

In the case of expenses that are to be treated as expenses of management, there is a distinction between:

- rules that simply treat expenditure as an expense of management; and

- rules that go to on to say that expenditure is, as a result, *deductible under section 75*.

The rules in the first category leave the expenditure to meet the tests in section 75(4) of ICTA. Clause 1221 of this Bill preserves this position for rules such as that in clause 1244 of this Bill (rewriting section 79 of ICTA).

The rules in the second category apparently override the rules in section 75(4) of ICTA. Clause 1221(2) and (3) of this Bill make this clear.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 82: Expenses of management: cessation of business: clauses 1240 and 1242 and Schedule 1

This change clarifies the deduction timing rule in cases where an investment business ceases.

Before FA 2004 a company claiming management expenses had to be one "whose business consists wholly or mainly in the making of investments" (part of the definition of "investment company" in section 130 of ICTA, used in section 75(1) of ICTA). So it was likely that when the business ceased to be carried on there would be an end of an accounting period in accordance with section 12(3)(e) of ICTA.

The timing rules in sections 90(1)(ii) and 579(3A) of ICTA make the payments referable to the "accounting period ending on the last day on which the … business was carried on". If an accounting period ends on that day, the rule is straightforward.

Since FA 2004 management expenses are available to a company with investment business. Such a company may carry on other activities, such as a trade. So it is not necessarily the case that the cessation of the investment business triggers the end of an accounting period.

These clauses cater for the possibility that an accounting period does not end with the cessation of the investment business: they refer to the accounting period *in which* the investment business ceases. If an accounting period does in fact end with the cessation of the investment business, there is no change in the law.

This change applies also to the corresponding rule for expenses of insurance companies in sections 76ZG and 76ZI of ICTA (inserted by Schedule 1 to this Bill).

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 83: Car or motor cycle hire: clause 1251 and Schedule 1
This change clarifies the operation of section 578A of ICTA in three areas.

Corporation tax: expenses of management
Two rules, which partly overlap, restrict the amount that can be charged to tax when the amount of a deduction for management expenses has been reduced under section 578A(3) of ICTA and a credit reversing the expenses is later brought into account.

If there is a rebate or release of a debt, the "reversal amount" within section 75B(3) of ICTA is "so much of the debit as represents the expenses of management". The amount which "represents the expenses of management" is restricted under section 578A(3) of ICTA. So the amount treated as the "reversal amount" under section 75B(3) cannot exceed that restricted amount (£75 in the example below).

Section 578A(4) seems to duplicate this restriction. It also imposes a stronger restriction in a case where a rebate represents only part of the original deduction (see below). But in the context of management expenses, section 578A(4) applies only in relation to rebates, not releases of debts.

It is not entirely clear how section 578A(4) of ICTA should be reconciled with the competing rule given by section 75B of ICTA.

Clause 1251(4) of this Bill makes clear that the restriction is the same as the one made under clause 1251(2). The clause also makes clear what happens if the rebate or release of a debt represents only part of the original deduction.

Example

Car hire charge	100
Restriction (25%)	25
Allowed	75
Rebate	60

It is clear that the charge on the rebate should be restricted by 25% to 45.

It is similarly uncertain how section 578A of ICTA interacts with section 76 of ICTA (expenses of insurance companies). In section 76ZN of ICTA (inserted by Schedule 1 of this Bill) subsection (3)(a)(ii) caters for the possibility that the release of a debt for car hire may be a "reversal" within section 76(7) of ICTA. In that case, this rule ensures that the reversal is restricted by the appropriate fraction.

Income tax: receipt of a "rebate"
Section 578A(4) of ICTA applies if there is:

- a rebate; or
- a release of a debt,

in connection with an expense that has been restricted under the section. Clause 56(4) of this Bill rewrites the rule for corporation tax. But section 48(4) of ITTOIA seems to apply only to the release of a debt: although the introductory words of subsection (4) refer to a rebate, the main part of the rule refers only to debts released. Schedule 1 to this Bill amends section 48(4) of ITTOIA so that it applies also to rebates (which are brought into account as a receipt of the trade without a special rule).

Income tax: "corresponding provisions"
Section 578A of ICTA applies to:

- a trading deduction;
- a management expense; and
- an expense of an insurance company.

A rebate or release of a debt is restricted under subsection (4) however the original deduction was given. Clauses 56(3) and (5) and 1251(3) and (5) of this Bill make this clear by referring to a "corresponding provision". But section 48(4) of ITTOIA deals only with the case where the original deduction (as a trading expense) was restricted under that section. Schedule 1 of this Bill amends section 48(3) of ITTOIA, and introduces a new subsection (4A), so that it applies also to deductions previously given as a management expense or as an expense of an insurance company.

Summary
The corporation tax change merely clarifies the law. The income tax changes restrict a charge to tax in cases where ITTOIA may not give the restriction.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 84: Partnerships: reinstatement of section 111(10) of ICTA: clause 1258
This change makes clear that the rule in clause 1258 of this Bill (that a firm is not a separate entity for tax purposes) applies to a firm carrying on any business, whether or not that business is a trade.

It brings the income tax and corporation tax codes back into line.

Section 111(1) of ICTA provides that a partnership is not to be treated as an entity separate and distinct from the partners. The subsection refers to a trade or profession carried on in partnership.

Before section 111 was amended by ITTOIA subsection (1) applied to all businesses, not just trades and professions. The extension to all businesses was lost when subsection (10) was repealed by ITTOIA.

But sections 114 and 115 of ICTA set out the rules for calculating the profits of a firm. Those sections apply to all businesses, not just trades and professions. So it is doubtful whether the absence of the rule in section 111(10) has any consequences.

The broadening of the rule brings more companies into it. Whether this is favourable or adverse to those companies depends on the particular circumstances.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 85: Distributions and partnerships: Schedule 1
This change makes it clear that section 114(1)(a) of ICTA does not apply to payments received by companies carrying on a business in partnership.

Section 114(1) of ICTA requires that the profits of a trade etc carried on in partnership should be calculated as if the trade etc were carried on by a company (the “deemed company” in clause 1261). In calculating those profits, section 114(1)(a) provides that “references to distributions shall not apply”.

It is clear from the context that this rule applies to payments made *by* the firm. So there is no question of a payment of, say, interest being treated as a distribution by the firm under section 209 of ICTA and being disallowed in calculating the firm’s profit.

There is a theoretical possibility that the rule in section 114(1)(a) of ICTA also applies to payments *to* the firm. In that case, the rule in section 208 of ICTA (which removes distributions by a United Kingdom resident company from the charge to corporation tax) would not apply and the distributions received would be a receipt of the firm’s trade etc.

This is not how the rule is interpreted in practice. So clause 1260(2) deals only with payments *by* the firm. But there is an indication in the Real Estate Investment Trust rules that section 114(1)(a) of ICTA does apply to payments to a firm: section 121(4) of FA 2006 provides that section 114(1)(a) of ICTA "does not disapply subsection (1)". That subsection charges some distributions to tax as if they were receipts of a property business. HMRC's view is that section 121(4) of FA 2006 is unnecessary because section 114(1)(a) of ICTA does not in any case affect section 121(1) of FA 2006.

Schedule 1 to this Bill repeals section 121(4) of FA 2006.

Treating section 114(1)(a) of ICTA as applying to payments received by a firm would increase the tax liabilities of its partners. So the removal of the possibility of that treatment reduces those liabilities.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 86: Partnerships: allocation of firm's profits between partners: clauses 1263 and 1264

This change legislates the practice in paragraph 72245 of the HMRC Business Income Manual.

It brings the income tax and corporation tax codes back into line.

Section 114(2) of ICTA provides that a partner's share of the profits or losses of a trade carried on in partnership is to be determined "according to the interests of the partners". It offers no guidance on how this is to be done.

Some partnership agreements provide for an initial allocation of profits (often in the form of a salary or interest on capital) to some partners before the balance is allocated on the basis of a percentage share in the profits.

For instance, three partners may agree to allocate profits of 250,000 as follows:

Partner	**A**	**B**	**C**	**Total**
Salary	50,000	50,000		100,000
Balance (30/30/40)	45,000	45,000	60,000	150,000
Total	95,000	95,000	60,000	250,000

But, if the profits were only 90,000, the position would be:

Partner	**A**	**B**	**C**	**Total**
Salary	50,000	50,000		100,000
Balance (30/30/40)	(3,000)	(3,000)	(4,000)	(10,000)

Total	47,000	47,000	(4,000)	90,000

Section 114(2) of ICTA deals in this case with an allocation of the trade *profits*. So the answer for partner C cannot be a loss. HMRC practice, supported by decisions by the Special Commissioners, is to re-allocate C's "loss" to the other partners, so that in the example both A and B are allocated 45,000 of the trade profits. C's share is nil.

A similar position can arise if the result for the firm is a loss. A share of that loss under section 114(2) of ICTA cannot be a profit.

Clause 1263 of this Bill sets out how a profit is to be allocated between partners, so that no partner's share is a loss. Clause 1264 of this Bill sets out the corresponding rule for the case where the overall result is a loss.

Whether the new statutory rules for apportioning profits result in an adverse or favourable result for particular partners depends upon the particular circumstances.

This change is in principle adverse to some taxpayers and favourable to others but it is expected to have no practical effect as it is in line with generally accepted practice.

Change 87: Partnerships: resident partners and double taxation agreements: clause 1266 and Schedule 1

This gives statutory effect to the HMRC practice of giving a narrow interpretation to the word "affect" in section 115(5A) of ICTA.

It brings the income tax and corporation tax codes back into line.

The business profits article of the United Kingdom/Jersey double taxation agreement exempts the profits of a Jersey firm from United Kingdom tax. In the case of Padmore v CIR (1989), 62 TC 352 CA[2], the Court of Appeal decided that the exemption covered the share of the profits arising to a United Kingdom resident partner. The rules in section 115(5) to (5B) of ICTA were enacted in 1987 to remove the exemption.

It was intended that the 1987 legislation should do no more than remove the exemption claimed in the Padmore case. The words used in section 115(5A) of ICTA are "do not affect any liability to corporation tax". On the face of it, these words could deny the partner any relief, including tax credit relief, under a double taxation treaty.

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Subsection (2) of clause 1266 of this Bill makes it clear that it is only the partner's chargeability to tax that is preserved, overriding any provision to the contrary in a double taxation treaty. No other effect of the treaty is overridden.

The amendment of section 59 of TCGA in of Schedule 1 to this Bill makes a similar clarification in relation to relief under double taxation arrangements for capital gains tax and for corporation tax on chargeable gains.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with generally accepted practice.

Change 88: Partnerships: change of basis: Schedule 1

This change concerns the charge on a change of basis by a firm carrying on a property business.

ICTA and FA 2002

The change of basis rules in section 64 of, and Schedule 22 to, FA 2002 apply to property businesses because the rules are specifically applied by section 21B of ICTA. In the case of a property business carried on in partnership section 111(10) of ICTA (before it was repealed by ITTOIA) and section 114(1) of ICTA (for corporation tax) set out how each partner's share of the income from a property business is determined.

In addition paragraph 13 of Schedule 22 to FA 2002 sets out how to calculate each partner's share of an adjustment charge.

ITTOIA

Section 860 of ITTOIA rewrites paragraph 13 of Schedule 22 to FA 2002 for income tax. It is expressed to apply to trades. The extension of the rules in the partnership Part of ITTOIA to non-trade businesses (see section 847(2) of that Act) does not apply to section 860. So for income tax there is no explicit rule about how to deal with the partners' share of adjustment income in a property business.

This Bill

Clause 1267 of this Bill applies explicitly to property businesses and rewrites the FA 2002 rules (as applied by section 21B of ICTA). Schedule 1 to the Bill amends section 860 of ITTOIA to fill the gap left by ITTOIA and to bring the income tax and corporation tax codes back into line.

The change does not affect the total amount charged to income tax on a change of basis. It makes more certain what each partner's share of that amount is. If a partner was able to take advantage of any uncertainty in ITTOIA and argue that the partner's share should be less than that previously prescribed by ICTA and FA 2002, the change in this Bill is adverse to that partner. But in that case the change is necessarily favourable to the other partners.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

Change 89: Partnerships: sale of patent rights: clauses 1271 and 1272 and Schedule 1

This change explains how section 558 of CAA applies if there is a change of membership of a firm.

Under section 524(1) of ICTA an amount of tax is charged on the seller in instalments over a number of accounting periods. Section 525(3) of ICTA applies "where … a charge falls to be made on two or more persons jointly as being the persons for the time being carrying on a trade …".

It is clear from section 558 of CAA that the intention is that the present partners should step into the shoes of the seller of the patent rights. But it is not clear how this should work in practice. In particular, it is not clear:

- how such a charge is to be converted into a charge that falls on the persons for the time being carrying on the business;

- by what mechanism the corporation tax charged under section 524 of ICTA is to be replaced by the charges (to income tax or corporation tax) that are appropriate to the persons for the time being carrying on the business; or

- how the spreading of the charge should work given that individuals may become liable for tax that was originally charged by reference to accounting periods and companies may become liable for tax that was originally charged by reference to tax years.

The change clarifies the effect of the legislation by filling in these gaps.

The same clarification is made by amendments to sections 861 and 862 of ITTOIA (see Schedule 1 to this Bill).

Whether this particular basis is adverse or favourable to any particular taxpayer in comparison with any other theoretical basis will depend upon the specific circumstances.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 90: Unremittable income: conditions for granting relief: clause 1274
This change broadens one condition and removes another condition for claims for relief in respect of unremittable income under section 584 of ICTA. The corresponding change was made for income tax by section 841 of ITTOIA (see Change 135 in Annex 1 to the explanatory notes for that Act).

This change brings the income tax and corporation tax codes back into line.

Section 584 of ICTA provides for relief for companies taxed on income arising outside the United Kingdom, where the income cannot be remitted to the United Kingdom and certain conditions are met. Section 584(1)(a) and (2)(b) of ICTA refers to income which cannot be remitted to the United Kingdom because of the laws of the overseas territory, any executive action of its government or the impossibility of the company obtaining foreign currency in the overseas territory "notwithstanding any reasonable endeavours on its part".

(A) It could be argued that there cannot be an inability to transfer due to the impossibility of obtaining foreign currency in that territory if foreign currency is in fact obtainable there (regardless of whether it may be transferred to the United Kingdom). Clause 1274(3)(c) of this Bill removes the possibility of that narrow interpretation being taken. It requires an inability to transfer because of the impossibility of obtaining in the territory currency "that could be transferred to the United Kingdom". The reference to that currency being foreign has been dropped as misleading. If local currency can be obtained that cannot be transferred to the United Kingdom, the case is likely to fall within clause 1274(3)(a) or (b), but there is no point in excluding it from paragraph (c).

(B) The condition about "reasonable endeavours" in section 584(2) of ICTA has not been rewritten in this Bill. It is regarded as adding little to the requirements of section 584(1)(a) ICTA. If, by reasonable endeavours, the taxpayer company could transfer the income to the United Kingdom, the test in section 584(1)(a) of ICTA of its being prevented from transferring it must not be met, and there would then be no inability to transfer *because of* local law, government action or the impossibility of obtaining foreign currency as required under section 584(1)(a) of ICTA.

This change increases the range of income in respect of which relief for unremittable income may be available.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 91: Unremittable income: withdrawal of relief: ECGD payments received: clause 1276
This change involves the withdrawal of relief in respect of unremittable income on the making of an Export Credit Guarantee Scheme payment in respect of the income. The

corresponding change was made for income tax by section 843 of ITTOIA (see Change 141 in Annex 1 to the explanatory notes for that Act).

This change brings the income tax and corporation tax codes back into line.

Section 584 of ICTA provides a relief from income tax where a company's income arising outside the United Kingdom is charged on the basis of the income arising in the accounting period, but that income cannot be transferred to the United Kingdom because of circumstances outside the company's control ("unremittable income"). Section 584(2) of ICTA provides that if such a company makes a claim in respect of overseas income which:

- is unremittable; and
- it will continue to be prevented from transferring to the United Kingdom, notwithstanding any reasonable endeavours on its part,

the amount of the income is to be left out of account in charging income from that source.

However, under section 584(2A) of ICTA, if on any date "paragraph (a) or (b) of subsection (2) above ceases to apply" the income is treated as arising on the date of the change and is charged to tax for the accounting period in which that date falls.

Section 584(5) of ICTA modifies the operation of the relief where a payment is made under the Export Credit Guarantee Scheme in respect of the unremittable income. Section 584(5) of ICTA provides that "…to the extent of the payment, the income shall be treated as income to which paragraphs (a) and (b) of subsection (2) above do not apply (and accordingly cannot cease to apply)". This makes it clear that no claim can be made, but not whether relief already given may be withdrawn or, if it may, whether the charge to withdraw the relief is to be made for the accounting period in which the income first arose, or the accounting period in which the Export Credits Guarantee Department payment ("ECGD payment") is made.

This lack of clarity appears to be an unintentional result of amendments made by paragraph 33 of Schedule 20 to FA 1996, which substituted the present subsections (2) and (2A) of section 584 of ICTA for the original subsection (2) and amended subsection (5) in consequence. Those amendments, which were part of the changes made to facilitate Self Assessment for income tax, built on the changes already made by F(No 2)A 1987 for the introduction of "Pay and File" for corporation tax. (Prior to ITTOIA, section 584 of ICTA applied for both income tax and corporation tax.)

Before the FA 1996 changes section 584(2) of ICTA provided not only that account would not be taken of the income to the extent that the claimant showed "to the satisfaction of the Board that conditions [corresponding to those in paragraphs (a) and

(b) in the present subsection (2)]" were satisfied with respect to it, but also that "on the Board ceasing to be satisfied that those conditions are satisfied" such assessments etc were to be made as were necessary to take account of the income and of any tax payable in the overseas territory in respect of it "according to their value at the date when in the opinion of the Board those conditions cease to be satisfied with respect to it".

The original section 584(5) of ICTA provided that, to the extent of the Export Credit Guarantee Scheme payment, the income should be treated as income "with respect to which the conditions mentioned in subsection (2) above are not satisfied (and accordingly cannot cease to be satisfied)". So it plainly had the effect that not only could no claim be made, but the Board would be bound to be satisfied that the income had ceased to be unremittable – or perhaps had never been unremittable – and so it could be assessed. It was never very clear what date was to be used for the value of the income and the foreign tax. But presumably the only date that could be used was the date when the Board had to cease to be satisfied, that is the date of the payment.

There is no good reason for the treatment of income which is no longer unremittable to vary according to whether circumstances have changed or an ECGD payment has been made. So the apparent change in the effect of section 584(5) of ICTA introduced by FA 1996 appears to have been completely unintentional. In practice, the income is taxed in the accounting period in which the ECGD payment is made. Therefore clause 1276(4) and (5) of this Bill, which rewrites section 584(5) of ICTA, provides for the income to be taxed in that accounting period, and accordingly for the income and any tax payable in respect of it in the place where it arises to be taken into account for corporation tax purposes at that date.

This change withdraws or prohibits relief by reference to the payment of an Export Credit Guarantee Scheme payment in addition to, rather than solely by virtue of, the income becoming remittable.

This change is adverse to some taxpayers in principle. But it is in line with the original legislation before amendment and with the intention of the amended legislation. And it is expected to have no practical effect as it is in line with current practice.

Change 92: General exemptions: savings certificates: unauthorised purchases involving multiple certificates: clauses 1281 and 1282

This change enables multiple savings certificates to be regarded as authorised in part where an unauthorised number of certificates have been purchased, and so confers exemption on the income from the part that is so regarded.

The Treasury limit the number of savings certificates of any particular issue that a person is permitted to purchase. The limits are stated in the prospectus for each issue.

The income from savings certificates is exempt from corporation tax under section 46 of ICTA. However, the exemption only applies to certificates purchased within the permitted limits. Section 46(3) of ICTA provides that the exemption does not apply to savings "... certificates ... purchased ... in excess of *the amount* which a person is for the time being authorised to purchase ...". It is not entirely clear how this would work in the case of multiple certificates. (These are certificates which represent a number of individual unit certificates.)

For example, if the maximum number of certificates permitted is 100, X holds 80, and then purchases a multiple certificate of 50, section 46(3) of ICTA appears to prevent the exemption from applying to the second multiple certificate. However, in practice, the second certificate is treated as 50 individual certificates, so that 20 would be treated as authorised and 30 as unauthorised.

Clauses 1281(2) and 1282(4) of this Bill reflect this practice by providing that certificates are authorised "so far as" their acquisition was not prohibited by regulations made by the Treasury limiting a person's holding or, in the case of Ulster Savings Certificates, such regulations made by the Department of Finance and Personnel.

The change provides an exemption where it could otherwise be argued that no exemption is due.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 93: General calculation rules: exceptions from the disallowance of expenditure on business entertainment and gifts in calculating the profits of non-trade and non-property businesses: clauses 1298 to 1300

This change extends an exception made in calculating profits of a business which is a trade or property business to non-trade and non-property businesses.

It brings the income tax and corporation tax codes back into line.

Section 577 of ICTA (business entertaining expenses) prohibits the deduction of business entertaining expenditure in calculating profits chargeable to tax under Schedule D. Profits chargeable to tax under Schedule D include not only profits of a trade, profession or vocation, whether chargeable under Case I, II or V of that Schedule, but also profits chargeable under other Cases of that Schedule. Section 21A(2) of ICTA applies section 577 of ICTA to the computation of income under Schedule A.

Section 577(8) of ICTA extends the restriction of expenses to those incurred in the provision of gifts.

There are a number of exceptions from the restriction under section 577(1) or (8) of ICTA. Subsection (9) makes an exception for "expenditure incurred in making a gift to a body of persons or trust established for charitable purposes only" and two named bodies are treated as such a body of persons for this purpose. This exception applies only in "computing profits under Case I or II of Schedule D".

So the exception provided by section 577(9) of ICTA does not apply to businesses other than trades, professions and vocations or property businesses.

It is not HMRC policy, despite the words of section 577(9) of ICTA, to make a distinction in the application of the exception between trades and property businesses and other businesses. Clauses 1298 to 1300 of this Bill extend the benefit of the exception in principle to those other businesses.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 94: General calculation rules: exceptions to the rule restricting deductions for business gifts: clause 1300

This change provides for the monetary limit on the cost of gifts excluded from the general rule prohibiting a deduction for such expenses (see clause 1298 of this Bill) to be increased by Treasury order.

It brings the income tax and corporation tax codes back into line.

Clause 1300(3) of this Bill is based on section 577(8)(b) of ICTA. The £50 limit in section 577(8)(b) of ICTA (previously £10) was inserted with effect in relation to accounting periods beginning on or after 1 April 2001 by section 73 of FA 2001 in line with an increase in the corresponding VAT provision made by Treasury order.

Section 577(8)(b) of ICTA was rewritten as it applied to employees by section 358(3)(b) of ITEPA. Section 716(2) of ITEPA provides that the Treasury may by order increase, or further increase, the sum specified in various provisions in ITEPA including the £50 limit in section 358(3)(b) of ITEPA.

Section 577(8)(b) of ICTA was rewritten as it applied to income tax on trades, professions and vocations by section 47 of ITTOIA. (Section 47 of ITTOIA is applied to other businesses for income tax purposes by sections 272 and 867 of ITTOIA.) Section 47 of ITTOIA provides that the Treasury may by order increase, or further increase, the £50 limit in section 47(3)(b) of ITTOIA.

Clause 1300 of this Bill brings the mechanism for changing the limit for corporation tax purposes into line with ITEPA, ITTOIA and the VAT provisions.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 95: General calculation rules: apportionment etc of miscellaneous profits and losses to accounting period: clause 1307

This change modifies the application of section 72 of ICTA so that it applies to certain income within Schedule D Case V as well as Case VI. The corresponding change was made by for income tax by section 871 of ITTOIA (see Change 147 in Annex 1 to the explanatory notes for that Act).

This change brings the income tax and corporation tax codes back into line.

Section 72(1) of ICTA permits the apportionment of profits or losses for the purposes of Schedule D Cases I, II or VI if accounts have been made up for a period which is not coterminous with the accounting period. Section 72 of ICTA is applied by section 21A of ICTA for the purpose of calculating the profits of a Schedule A business.

Although section 72 of ICTA is expressed to apply in the case of profits or gains chargeable under Schedule D Cases I, II and VI only, it applies also to income from a trade chargeable to tax under Schedule D Case V. Section 70(2) of ICTA applies the rules applicable to Schedule D Case I in computing such Schedule D Case V income. Clause 52 of this Bill (apportionment etc. of profits and losses to accounting period) applies the rule in section 72 of ICTA to all trades, whether income from the trade falls within Schedule D Case I or Case V.

Clause 1307 of this Bill applies the rule in section 72 of ICTA for the purpose of calculating income charged under provisions listed in section 834A of ICTA (inserted by Schedule 1 to this Bill). Subsection (2) of clause 1307 disapplies section 834A(3) of ICTA, which excludes income chargeable under Chapter 8 of Part 10 of this Bill from the tables in that section so far as the income arises from a source outside the United Kingdom. This ensures that clause 1307 extends to income within Schedule D Case V as well as income within Case VI.

This change increases the range of income to which the apportionment provisions may apply.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 96: Other general provisions: definition of "caravan": clause 1314

This change provides a single definition of "caravan" and is based on section 29(1) of the Caravan Sites and Control of Development Act 1960 and section 13(1) of the Caravan Sites Act 1968.

It brings the income and corporation tax codes back into line.

The change is relevant to clauses 43, 207, and 248.

For the purposes of paragraph 3 of Schedule A (see section 15(1) of ICTA) "caravan" has the meaning given by section 29(1) of the 1960 Act. Paragraph 3 is re-written in clause 207. The same definition is attracted by paragraph 4 of Schedule A (re-written in clause 248).

Subsection (1) of clause 1314 of this Bill reproduces the effect of section 29(1) of the 1960 Act; and subsection (2) reproduces the effect of section 13(1) of the 1968 Act. The section does not, however, reproduce the effect of section 13(2) of the 1968 Act (which provides that a structure mentioned in section 13(1) (a twin-unit caravan) is not a caravan if its dimensions exceed specified limits). Neither the 1960 Act nor the 1968 Act extend to Northern Ireland. However, the Caravans Act (Northern Ireland) 1963 contains the same definition for Northern Ireland as is contained in section 29(1) of the 1960 Act.

It is not clear whether the 1968 Act modifications apply for the purposes of paragraphs 3 and 4 of Schedule A in ICTA. First, it is likely that Parliament intended that only one definition of "caravan" was to apply throughout the United Kingdom. But the 1968 Act does not extend to Northern Ireland. As the substance of the definitions in the 1960 Act (which applies to Great Britain) and in the Northern Ireland Act of 1963 are the same, a reference to the definition in the 1960 Act would be enough to secure a uniform definition.

Second, paragraph 3(2) of Schedule A in ICTA provides that "caravan" has the meaning "given by" section 29(1) of the 1960 Act. Section 13 of the 1968 Act modifies the operation of Part 1 of the 1960 Act (rather than the section 29(1) definition). Because the definitions in section 29(1) apply "in" Part 1 of the 1960 Act it is therefore not certain whether the modifications made by the 1968 Act have been attracted.

Clause 1314 resolves these doubts by reproducing only section 13(1) of the 1968 Act. Consequently it does not matter whether a twin-unit caravan can be lawfully moved on a highway when assembled. For the purposes of Schedule A (rewritten as property income in this Bill) it is also immaterial if the twin-unit caravan exceeds the dimensions specified in section 13(2) of the 1968 Act: property income treatment seems more appropriate the bigger the structure.

This change extends the meaning of "caravan" which may result in a more beneficial tax treatment.

The changes are in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 97: Repeal of section 74(1)(k) of ICTA: disallowance of deduction for average loss: Schedule 1

This change omits the prohibition of a deduction for "any average loss beyond the actual amount of loss after adjustment" in section 74(1)(k) of ICTA.

It brings the income tax and corporation tax codes back into line.

The rule in section 74(1)(k) of ICTA applies to the practice in shipping and aviation of sharing between all parties with a financial interest in a vessel and its cargo the financial loss incurred where *part* of a vessel or its cargo is jettisoned, lost or damaged in an attempt to save the vessel, the crew and passengers or the rest of the cargo.

The term "average loss" refers to the share of the loss allocated to each party. The term "actual amount of loss after adjustment" reflects the possibility that loss adjusters will be involved in determining the actual loss for insurance purposes.

The loss after adjustment may not be known for some years after the loss has occurred. Under section 74(1)(k) of ICTA, the tax position for the accounting period in which the loss occurred should strictly be kept open until the adjusted figure is known.

Generally accepted accountancy practice in such cases is to make a provision in the accounts for the period in which the loss occurs and review the provision in later years so that over time the total deduction matches the loss suffered. Dispensing with section 74(1)(k) allows the taxpayer to follow generally accepted accountancy practice by bringing the timing of the deduction into line with the accounts.

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to circumstances. Any overall tax effect is likely to be negligible.

Change 98: Unremittable income: appeals to the Special Commissioners: Schedules 1 and 2

This change involves the omission from this Bill of any provision rewriting the requirement under section 584(9) of ICTA that appeals concerning questions about relief for unremittable income should be heard by the Special Commissioners. The corresponding change was made for income tax by paragraph 153 of Schedule 2 to ITTOIA (see Change 142 in Annex 1 to the explanatory notes for that Act).

This change brings the income tax and corporation tax codes back into line.

Section 584(9) of ICTA provides that appeals involving any question as to the operation of that section (relief for unremittable overseas income) must be made to the Special Commissioners and not to the General Commissioners. This is a departure from the normal rules in sections 31B to 31D of TMA under which in most cases a taxpayer may have an appeal heard by the General Commissioners or make an election under section 31D of TMA for the appeal to be heard by the Special Commissioners.

This Bill omits any requirement about appeals that involve any question as to the operation of Part 18 of the Bill. So the normal rules in sections 31B to 31D of TMA will apply to such appeals without restriction. The paragraph headed "tribunal reform" in Part 21 of Schedule 2 (transitionals and savings etc) to the Bill preserves the requirement under section 584(9) of ICTA where a claim to relief under Part 18 involves income that arose in an accounting period ending before 31 March 2009.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 99: Repeal of sections 586 and 587 of ICTA: Schedule 1
This change concerns the repeal of sections 586 and 587 of ICTA.

Section 586 of ICTA was enacted in 1940 and denies relief for payments made in connection with certain war damage indemnity schemes. Section 587 of ICTA was enacted in 1941 and denies relief for certain payments in respect of war injuries of employees.

Both sections apply only if the United Kingdom is in a declared state of war and were a response to the particular circumstances of the Second World War. Because of the very high rates of taxation during the war (seen most clearly in the case of Excess Profits Tax at 100%) these payments could often be made entirely at the Exchequer's expense. The likelihood of the sections becoming operative and accurately reflecting policy at that time is remote. Sections 586 and 587 are for all practical purposes obsolete.

Both sections apply only for corporation tax. They were effectively repealed for income tax by the consequential amendments made by paragraphs 247 and 248 of Schedule 1 to ITTOIA.

This change completes the repeal of a prohibition on relief for all tax purposes.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect.

Change 100: Repeal of section 695(6) of ICTA: Schedule 1
This change relates to the omission of section 695(6) of ICTA, which requires that where relief is given to a company with a limited or discretionary interest in a foreign estate for United Kingdom income tax borne by the income of the estate, the company's income should include an amount corresponding to the relief.

It brings the income tax and corporation tax codes back into line.

Section 695(5) of ICTA enables a beneficiary of a foreign estate who is entitled to a limited interest in the residue of the estate and is charged to tax for an accounting period in respect of income from the estate to claim relief if any of the aggregate income of the estate has borne United Kingdom income tax for a relevant year of assessment. Section 698(3)(b) of ICTA applies this also to beneficiaries who are charged in respect of income paid from the estate under a discretion.

Section 695(6) of ICTA (which is also applied by section 698(3)(b) of ICTA) provides that where the relief is given "such part of the amount in respect of which [the beneficiary] has been charged to corporation tax as corresponds to the proportion mentioned in [section 695(5) of ICTA] shall be deemed to represent income of such amount as would after deduction of income tax be equal to that part of the amount charged". (The proportion referred to is the proportion that the amount of the beneficiary's income that has borne United Kingdom income tax, less the tax, bears to the amount of the aggregate income of the estate, less United Kingdom income tax.) The meaning of this provision, which originated while surtax was still charged, is now obscure, and it is particularly difficult to see how it could operate in the context of Self Assessment for corporation tax. Consequently, in practice it tends to be ignored. Therefore it is not being rewritten in this Bill.

This change is beneficial to the taxpayer because the amount of the relief given under section 695(5) of ICTA to a beneficiary does not count as the beneficiary's income and so the beneficiary's income is reduced.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 101: Repeal of section 817 of ICTA: Schedule 1
This change concerns the repeal of section 817 of ICTA.

Section 817 of ICTA can trace its origins back almost unchanged to the 1803 Income Tax Act. The general clarifications it provides may have served some useful purpose in the early years of income tax. But they are no longer required.

The section is a profit calculation rule. It applies in “arriving at the amount of profits or gains”. It does not apply to deductions made after those profits have been calculated. The scope of the word “profits” is not clear. Section 817 of ICTA is not included in the definition of “profits” in section 6 of ICTA. Given the restrictions in section 38 of TCGA, section 817 of ICTA could have no application to the calculation of chargeable gains even if it were thought capable of applying to that element of the corporation tax profit.

Section 817 of ICTA appears to apply to the calculation of the income element only of corporation tax profits.

The primary purpose of the section is set out in subsection (1)(a). This provides that no deduction is allowed in calculating the profits unless the deduction is “expressly enumerated in the Corporation Tax Acts”. This Bill and those parts of the corporation tax code that are not yet rewritten set out what deductions are to be allowed in calculating the various types of profit. There is no need for a general rule that says no other deductions are to be allowed.

Subsection (1)(b) denies a deduction for an annuity or other annual payment from which income tax is deducted and which is paid out of the profits. A payment made out of the profits pre-supposes that the profits have been calculated. Such a rule can have no application in calculating the amount of the profits.

Subsection (2) denies a deduction for a loss of capital or a loss in a trade or office or profession. In this Bill the treatment of capital is dealt with in the rules that set out how to calculate profits from different sources. There is no method of calculation that would allow a deduction for a trade loss in calculating the profit from another trade or source. It is not clear what is meant by a loss in an office. If it means an excess of expenses over income again there is no method of calculation that would allow a deduction for this negative amount in calculating the profit from another source.

Section 817 was repealed for income tax by the amendments made by paragraph 327 of Schedule 1 to ITTOIA.

This change completes for all tax purposes the repeal of a rule restricting deductions.

This change is in taxpayers’ favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 102: Repeal of paragraph 5 of Schedule 30 to ICTA: Schedule 1
This change concerns the repeal of paragraph 5 of Schedule 30 to ICTA.

Paragraph 5 of Schedule 30 to ICTA is a transitional measure that relates to the pre-1963 version of Schedule A. Under that version of Schedule A, a company which owned the property from which it carried on a trade was allowed a Schedule D Case I deduction equal to the amount of the Schedule A charge on the property. The right to the deduction was removed when Schedule A moved from a charge on the annual value of the property to a charge on the rent received.

At that time companies were liable to income tax not corporation tax. Timing differences between Schedule D Case I and Schedule A could result in a loss of relief if the company ceased to occupy the property for the purposes of the trade in a period in which it did not also cease to carry on the trade. FA 1963 introduced a deduction to compensate for this loss of relief. It is based on the relief that would have been given for the years 1963-64 and 1964-65 and is allowed in calculating the trade profits for the accounting period in which the company ceases to carry on the trade.

In theory it is still possible to claim the relief but given the passage of 45 years and the effects of inflation it is unlikely any new claims will be made on or after 1 April 2009. For this reason paragraph 5 of Schedule 30 to ICTA is redundant and can be repealed.

Paragraph 5 was repealed for income tax by the amendments made by paragraph 352 of Schedule 1 to ITTOIA.

This change completes the repeal for all tax purposes of a relieving provision.

This change is adverse to some taxpayers in principle. But it is expected to have no practical effect.

Change 103: Repeal of section 63 of FA 1999: treatment of transfer fees under pre-1999 contracts: Schedule 1
This change concerns the repeal of section 63 of FA 1999.

Section 63 of FA 1999 provides for transitional relief for football and other sports clubs on the introduction of new accounting standards for intangible assets in 1997 and 1998.

Before introduction of the new accounting standards transfer fees etc were charged to the club's profit and loss account in the year in which they were due. Under the new accounting standards sums paid for players are spread over the life of the player's contract.

Without section 63 of FA 1999 the value of the unexpired part of an existing contract at the date the new accounting standard is adopted would be transferred to the balance sheet and charged to tax as income. Relief for that amount would then be spread over the remaining life of the contract.

Section 63 of FA 1999 gives transitional relief by providing that for tax purposes the requirements of the new accounting standards can be ignored for any contracts entered into before the beginning of the first accounting period in which the club adopted the new accounting standard.

The new accounting standards are effective for accounting periods ending on or after 23 December 1998. So section 63 of FA 1999 applies only to contracts entered into before 1999.

In most cases a footballer's contract will last three or four years. Contracts may be shorter in the case of a veteran player or longer in the case of a promising young player. But it is unlikely that any contracts to which section 63 of FA 1999 could apply will still be in force when this Bill comes into effect on 6 April 2009. For this reason, section 63 FA 1999 is redundant and can be repealed.

This change has no implications for the amount of income liable to tax or who is liable for tax on it. It affects (in principle but not in practice) only when tax is paid.

Change 104: Amendments of CAA: Schedule 1

The consequential amendments made by this Bill have brought to light some minor errors in the corresponding consequential amendments made by ITTOIA.

This Bill is drafted on the basis of a company starting or ceasing to carry on a trade etc, rather than on the basis of a trade etc commencing or being discontinued. So sections 114(1)(c) (partnership changes) and 337(1)(a) (successions) of ICTA are not specially rewritten. Instead the effects of partnership changes and successions are set out in the main rules where they are relevant.

Some rules that are not rewritten by this Bill rely on section 114 or 337 of ICTA. So they are consequentially amended. A similar exercise was undertaken in ITTOIA. In amending the following rules in CAA it has come to light that the amendments made by ITTOIA may not have preserved the law as it was before ITTOIA.

Sections 108, 112 and 115 of CAA

Before ITTOIA section 108(1)(b) of CAA said "the disposal is not an occasion on which the qualifying activity is treated as continuing under any of the relevant provisions of ICTA". That condition can be satisfied if there is a disposal of the plant and machinery without a change in the persons carrying on the qualifying activity.

The condition in section 108(1)(b)(i), as substituted by ITTOIA, can only be satisfied if there is a change in the persons carrying on the qualifying activity.

The amendments of section 108 made by this Bill, so far as relating to income tax, aim to reverse the inadvertent change in the law that resulted from the amendment made by ITTOIA.

There is also a need to reverse changes of a similar nature, again so far as relating to income tax, that resulted from the amendments by ITTOIA of sections 112 and 115 of CAA.

Section 263 of CAA

In subsection (1A)(b) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Bill removes the reference.

The conditions in subsection (1A) are expressed as alternatives but they are intended to operate independently: paragraph (a) in the case of income tax; and paragraph (b) in the case of corporation tax. The replacement subsections (1)(c), (1A) and (1B) clarify the way the rules work.

Before amendment by ITTOIA the income tax rule did not apply to businesses (such as "special leasing") which are neither a trade nor a property business. The new subsection (1B) preserves the position for corporation tax. The replacement subsection (1A) reverses a change made by ITTOIA.

Section 265 of CAA

In subsection (1A)(b) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Bill removes the reference.

The conditions in subsection (1A) are expressed as alternatives but they are intended to operate independently: paragraph (a) in the case of income tax; and paragraph (b) in the case of corporation tax. The replacement subsections (1)(b), (1A) and (1B) clarify the way the rules work.

Before amendment by ITTOIA the income tax rule did not apply to businesses (such as "special leasing") which are neither a trade nor a property business. The new subsection (1B) preserves the position for corporation tax. The replacement subsection (1A) reverses a change made by ITTOIA.

Section 558 of CAA

In subsection (1)(c)(ii) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Bill makes the necessary correction.

Section 559 of CAA

In subsection (1A)(b) the reference to section 18 or 362 of ITTOIA was wrongly inserted by ITTOIA. This Bill removes the reference.

The conditions in subsection (1A) are expressed as alternatives but they are intended to operate independently: sub-paragraph (a) in the case of income tax; and sub-paragraph (b) in the case of corporation tax. The replacement subsections (1)(b), (1A) and (1B) clarify the way the rules work.

Section 577 of CAA

Following the repeal of sections 114(1) and 337(1) of ICTA (and the corresponding income tax rule in section 113(1) of ICTA) there is no longer any rule that *treats* an event as the equivalent of the setting up, commencement or discontinuance of a trade etc. The new subsections (2A) to (2C) set out how the rules work. Subsection (2B) sets out the income tax rule that should have been inserted by ITTOIA.

It is difficult to predict how the courts would interpret these provisions for income tax following the ITTOIA amendments. In general, treating an event as a cessation of a trade etc changes the tax liabilities of those carrying on the trade etc before and after the event: a reduction for one is balanced by an increase for the other.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

Change 105: Qualifying hire car or motor cycle: section 49(2)(b) of ITTOIA: Schedule 1

This change concerns the definition of "qualifying hire car or motor cycle" for the purposes of section 48 of ITTOIA in section 49(2)(b) of ITTOIA. It corrects a minor error in ITTOIA.

It brings the income and corporation tax codes back into line.

Section 48 of ITTOIA restricts the amount which can be deducted in calculating the profits of a trade for income tax purposes in respect of the cost of the hire of a car or motor cycle with a retail price (when new) of more than £12,000 *other than* "a qualifying hire car or motor cycle".

Section 49 of ITTOIA defines various terms used in section 48 of ITTOIA.

Section 49(2)(b) of ITTOIA defines "a qualifying hire car or motor cycle" as a car or motor cycle which:

> (b) is hired under a hire-purchase agreement under which there is an option to purchase exercisable on the payment of a sum equal to not more than 1% of the retail price of the car when new.

The income tax rule in section 48 of ITTOIA was formerly in section 578A of ICTA. The definition of "qualifying hire car" in section 49(2)(b) of ITTOIA was formerly in section 578B(2)(a) of ICTA.

Section 578B(2)(a) of ICTA, as it applied for income tax, referred to "an option to purchase exercisable on the payment of a sum equal to not more than 1% of the retail price of the car when new". But because section 578B(1) of ICTA provided that "references to a car … include a motor cycle", the option to purchase in the case of a motor cycle had to be exercisable for a sum equal to 1% of the retail price *of the motor cycle*.

Instead of defining "car" so as to include motor cycle, sections 48 and 49 of ITTOIA refer to "a car or motor cycle" where appropriate. But the reference to the retail price of the motor cycle when new was omitted in error from the definition of "qualifying hire car" in section 49(2) of ITTOIA.

This change corrects that error. It removes any doubt as to the amount for which an option to purchase must be exercisable for a motor cycle to qualify for exemption from the restriction in section 48 of ITTOIA.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.

Change 106: Derivative contracts: contracts which became derivative contracts on 16 March 2005: assumption in respect of consideration on deemed disposal: Schedule 2

This change clarifies what accounting period is relevant to the calculation of the deferred capital gain to be brought into account when a company ceases to be a party to a contract that became a derivative contract as from 3.00pm on 16 March 2005.

Paragraph 4A of Schedule 26 to FA 2002 provides for a chargeable gain or allowable loss to be brought into account when a company ceases to be a party to a relevant contract (an option, future or contract for differences) that became a derivative contract on 16 March 2005 but was a chargeable asset immediately before then. "Chargeable asset" is defined in paragraph 4A(4) of that Schedule as one where a gain on its disposal would be a chargeable gain for the purposes of TCGA.

A contract to which paragraph 4A applies became a derivative contract on 16 March 2005 as a result of amendments to the definition of a derivative contract in Part 2 of Schedule 26 to FA 2002 introduced by the Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2005 (SI 2005/646).

The assumed consideration, for the purposes of the calculation of the gain or loss to be brought into account under paragraph 4A of Schedule 26 to FA 2002, is an amount "equal to the value (if any) given to the contract in the accounts of the company at the end of the company's accounting period immediately before *its first new period*". Neither in paragraph 4A nor anywhere else in Schedule 26 to FA 2002 is there any guidance as to what a company's "first new period" is. The term occurs, in connection with provisions applying to derivative contracts, only in Schedule 28 to FA 2002 (transitional provisions on the implementation of Schedule 26 to that Act). It is defined for that purpose in paragraph 7 of Schedule 28 to FA 2002 as “its first accounting period to begin on or after” 1 October 2002, that is, the day that Schedule 26 to FA 2002 came into force.

The amendments made by the Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2005 (SI 2005/646) have effect in relation to periods of account beginning on or after 1 January 2005 and ending on or after 16 March 2005. If a company makes up its accounts to, say, 31 December, its accounting period ended 31 December 2005 will be the first accounting period to which paragraph 4A of Schedule 26 to FA 2002 can apply. Logically, the chargeable gain (or allowable loss) to be brought into account under the paragraph should therefore be that which had accrued immediately before that period began, that is, at the end of the accounting period ended 31 December 2004. The consideration used in the calculation of the gain (or loss) will therefore be the value of the contract in the company’s accounts at 31 December 2004, even though the deemed disposal date is 16 March 2005. If a company makes up its accounts to, say, 30 September, the first accounting period to which the paragraph applies is that beginning on 1 October 2005. The accrued chargeable gain (or allowable loss) to be brought into account will therefore be calculated by reference to the value shown in the accounts at 30 September 2005 (but again the deemed disposal date is 16 March 2005). If the company made up accounts for a period of a few weeks early in 2005, the second leg of the commencement rule for the amendments made by the Order, that the first period to which the amendments apply must end on or after 16 March 2005, ensures that the amendments do not have effect in relation to an accounting period ending before they came into effect. “First new period” means in effect the first accounting period to which the amendments made by the Order apply.

This change repairs an omission in the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2005 (SI 2005/646). It gives certainty for the calculation of the chargeable gain or allowable loss to be brought into account under paragraph 4A of Schedule 26 to FA 2002. The application of Schedule 26 to FA 2002 to accounting periods of the company in respect of the contract in question begins with the period immediately following that identified for the purposes of finding the consideration relevant to the calculation under paragraph 4A of Schedule 26 to FA 2002.

In principle, this change is favourable to some and adverse to other taxpayers as it may identify an amount of consideration for the calculation of the deferred chargeable gain or allowable loss that differs from the amount an alternative reading of “first new period” would identify. But it is unlikely to affect significantly the aggregate profits chargeable to tax in respect of the relevant contract, whether as a chargeable gain or as credits and debits arising on a derivative contract, as regards any company to which it applies.

This change is in principle and in practice adverse to some taxpayers and favourable to others. But the numbers affected and the amounts involved are likely to be small.

ANNEX 2: EXTRA-STATUTORY CONCESSIONS, CASE LAW AND LIST OF REDUNDANT MATERIAL NOT REWRITTEN

This Annex is in three parts:

Table 1: a list of ESCs (and one Statement of Practice) that are rewritten in the draft Bill;

Table 2: a list of clauses which involve enacting case law principles; and

Table 3: a list of provisions that are redundant in whole or in part and are omitted by the draft Bill.

TABLE 1

The following ESCs and Statement of Practice are rewritten in the draft Bill.

ESC etc	Description	See Annex 1
C34	Tax concessions on overseas debts	Change 40
C36	Treatment of income from caravan sites where there is both trading and associated letting income	Change 4
SP11/81	Redundancy payments: cessation of part of a trade	Change 17

TABLE 2

The following table sets out the clauses which involve giving statutory effect to principles derived, wholly or mainly, from case law.

Topic	Clause
UK company distributions: Strand Options and Futures Ltd v Vojak, 76 TC 220 CA[3]	1285

TABLE 3

The omission of provisions which are redundant in whole or in part is an integral part of the rewrite process.

[3] STC [2004] 64

But, for ease of reference, those omissions worthy of specific explanation are listed in the table below. The table also sets out where those explanations can be found.

Redundant provision	Topic	See commentary on clause etc
TMA s.19(2)	Lease premiums etc — information on Case VI charges	Schedule 1
TMA ss.12AE and 31(3)	Legislating the "Crown Option"	Schedule 1
TMA s.90(1)(b) and (2)	Interest on unpaid corporation tax	1303
ICTA s9(2A) and (6)	Computation of income: application of income tax principles	969
ICTA s.11(2)(part)	Permanent establishments	19
ICTA s.12(2)(a)(part)	Accounting periods	9
ICTA s.12(8)	Accounting periods	Overview of Chapter 2 of Part 2
ICTA s.18(3A): Schedule D Case III(b)(i)(part),(ii)	Annual payments	977
ICTA s.18(3B) to (3E)(part)	Sale of coupons	Overview of Chapter 6 of Part 10
ICTA s.24(6)(a)	Definition of "lease"	256
ICTA s.40(1),(2),(3)(part), (4), (4A)	Apportionment of sale proceeds	259
ICTA s.70(1)	Basis of assessment	8
ICTA s.74(1)(c)	Private expenses – rent	54
ICTA s.74(1)(d)(part)	Trade tools	68
ICTA s.74(1)(da)	CAA: integral features	60 and 263
ICTA s.74(1)(f)(part)	Interest	Schedule 1
ICTA s.74(1)(g)	Improvements	53
ICTA s.74(1)(h)	Notional interest	Schedule 1
ICTA s.74(1)(m)	Annuities	Schedule 1
ICTA s.85	Approved profit sharing schemes	1000
ICTA s.86(5)(d)	Seconded employees	Schedule 1
ICTA s.92	Regional development grants	Schedule 1
ICTA s.93(2)(a)(part), (b)	Industrial development grants	102
ICTA s.95(1C)	Dealers in securities	130
ICTA s.101	Valuation of work in progress	Schedule 1
ICTA s.104(3)	Post-cessation receipts	Overview of Chapter 15 of Part 3
ICTA s.105(1)(part), (3)(part)	Post-cessation receipts – capital allowances	197
ICTA s.110(3),(4),(5)	Post-cessation receipts	Overview of Chapter 15 of Part 3

Redundant provision	**Topic**	**See commentary on clause etc**
ICTA s.116(5)	Transfer of relief	1260
ICTA s.337A(2)(b)	Computation of income: intangible fixed assets	Schedule 1
ICTA s.399(1B)	Dealings in commodity futures etc: withdrawal of loss relief	Schedule 1
ICTA s.491(9),(11)(part)	Mutual concerns – examples dropped	101
ICTA s.695(6)	Beneficiaries income from estates in administration	961
ICTA s.698(1)(part)	Aggregate income of an estate	947
ICTA s.699A(1)(b)	Untaxed sums in income of an estate	963
ICTA s.700(5)(part)	Statements relating to estate income	967
ICTA s.701(6), (7)	Charges on residue	947
ICTA s.826(5A)	Interest payable	Schedule 1
ICTA Sch.5 para.3(4)(b)	Herd basis – replacement of animals	114
ICTA Sch.5 para.7(part)	Herd basis – working animal rule	110
ICTA Sch.5 para.9(part)	Herd basis – working animal rule	110
FA 1988 Sch.7(part)	Company residence	15
FA 1988 Sch.12(part)	Building societies	Schedule 1
TCGA s. 158(part)	Meaning of “trade” etc	Schedule 1
TCGA s. 201(2)	Mineral leases: royalties	Overview of Chapter 7 of Part 4
FA 1995 s.126(7A)(part)	Non-residents	Schedule 1
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CORPORATION TAX BILL

EXPLANATORY NOTES

[VOLUME IV]

These notes refer to the Corporation Tax Bill as introduced in the House of Commons on 4 December 2008 [Bill 1]

Ordered, by The House of Commons,
to be Printed, 4 *December* 2008.

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LONDON - THE STATIONERY OFFICE
Printed in the United Kingdom by
The Stationery Office Limited

£x.00

[Bill 1–EN (IV)] 54/4