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 III]

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 3
(SECTIONS 907 TO 1330 AND SCHEDULES)

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Part 9: Intellectual property: know-how and patents

Overview

2289. This Part rewrites some special provisions in Chapter 1 of Part 13 of ICTA which charge to corporation tax certain receipts from intellectual property. The corresponding rules for income tax are in Chapter 2 of Part 5 of ITTOIA.

2290. This Part applies to capital sums arising from the disposal of know-how in certain circumstances and capital sums from the sale of patent rights.

2291. This Part does not rewrite those parts of the provisions in Chapter 1 of Part 13 of ICTA which apply to trades (such as section 531(1) to (3) of ICTA). Such parts of the source provisions are rewritten in Chapter 13 of Part 3 of this Bill.

2292. This Part does not apply to amounts arising from intangible fixed assets within Part 8 of this Bill. The rules in Chapter 16 of Part 8 define which assets and amounts come within Part 8. If an asset is within Part 8 that Part gives all the tax rules that apply.

2293. The rules in this Part largely mirror the corresponding rules for income tax and bring the corporation tax provisions back into line with their income tax counterparts. Where there are differences between the two they derive mainly from the way in which the two taxes are charged and the possibility that accounting periods, unlike tax years, will not be of 12 months duration.

Chapter 1: Introduction

Clause 907: Overview of Part

2294. This clause introduces the charges applied by the Part. It is new.

2295. *Subsections (4)* and *(5)* alert readers to the primacy of the intangible fixed assets rules in Part 8 of the Bill. Very broadly, the rules in Part 8 apply only to intangible fixed assets that were created or acquired on or after 1 April 2002. Otherwise the rules in this Part continue to apply.

2296. Royalties from intellectual property are an exception to this as they automatically fall within Part 8 if they are recognised for accounting purposes on or after 1 April 2002. Most income from intellectual property is in the form of royalties. So specific rules in the source legislation applying to royalties are obsolete in a way that rules applying to other (mainly capital) amounts are not. To the extent that, exceptionally, other income receipts from intellectual property not within Part 8 may arise (such as casual profits from the exploitation of intellectual property charged in the source legislation under Case V or VI of Schedule D) those receipts will be subject to the “sweep–up” charge in clause 979 of this Bill.

2297. For this reason there is no need, in the corporation tax context, for rules equivalent to those in sections 579 to 582 of ITTOIA (which apply to royalties and other income from intellectual property).

Chapter 2: Disposals of know-how
Clause 908: Charge to tax on profits from disposals of know-how
2298. The clauses in Chapter 2 deal with consideration received for the disposal of know-how. This clause applies the charge to corporation tax on income to the proceeds of certain disposals of know-how. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 583 of ITTOIA.

2299. Under the source legislation, income from disposals of know-how is charged to tax under Schedule D Case VI of ICTA.

2300. *Subsection (1)* applies the charge to corporation tax on income. Subsection (1)(b) is based on section 531(8) of ICTA but the words “whether absolute or qualified” are omitted since they are superfluous.

2301. *Subsection (5)* restores a definition of “mineral deposits” that applied before CAA was enacted. This change reproduces Change 51 in ITTOIA and so brings the income and corporation tax codes back into line. See *Change 41* in Annex 1.

Clause 909: Exceptions to charge under section 908
2302. This clause sets out the exceptions to the charge under clause 908. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 584 of ITTOIA.

Clause 910: Profits charged under section 908
2303. This clause sets out the amount charged to tax under clause 908. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 585 of ITTOIA.

2304. *Subsection (3)* is new and gives a signpost to the clause which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 531 of ICTA as if it were contained in CAA.

Chapter 3: Sales of Patent Rights
Clause 911: Overview of Chapter
2305. This clause introduces the rules in this Chapter about the sales of patent rights. It is new.

Clause 912: Charge to tax on profits from sales of patent rights
2306. This clause applies the charge to corporation tax on income to capital sums from the sale of patent rights. It is based on sections 524 and 533 of ICTA. The corresponding rule for income tax is in section 587 of ITTOIA.

2307. Section 524(5) of ICTA is not rewritten because it does not appear to add anything to the proposition set out in clause 5(3) of this Bill (which defines the scope of the charge to corporation tax on a non-UK resident company trading in the UK through a permanent establishment in the UK). Any non-capital proceeds of the sale of patent rights will be amounts of income forming part of a non-UK resident company's chargeable profits by virtue of clause 19(3)(b) of this Bill (which defines the chargeable profits of a non-UK resident company). So the company will be within the charge to corporation tax in respect of such amounts.

Clause 913: Profits charged under section 912

2308. This clause sets out the amount charged to tax under clause 912. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 588 of ITTOIA.

2309. This clause is subject to the spreading rules in clauses 914 to 917.

2310. *Subsection (2)* defines deductible costs as the capital cost of the rights sold plus any incidental expenses of sale. This makes it explicit that such expenses may be deducted. The types of expenses which may be allowed under this clause are not listed. Incidental expenses which relate to both capital sale proceeds and other sums not chargeable to tax under clause 912 are effectively apportioned under the rules about net proceeds of sale in clause 929.

2311. *Subsection (5)* is new and includes a signpost to clause 926 which deals with contributions to expenditure. This signpost is necessary because section 532 of ICTA treats section 524 of ICTA as if it were contained in CAA.

Clause 914: UK resident companies: proceeds of sale not received in instalments

2312. This clause sets out the spreading rules if the company chargeable by virtue of clause 912 is UK resident and does not receive the proceeds of sale in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 590(1) to (3) and (6) of ITTOIA.

2313. The approach in this clause differs from that in section 590 of ITTOIA. The latter also deals with the case where the taxpayer is UK resident and receives the proceeds of sale in instalments but in this Part that case is dealt with in a separate clause (see clause 915).

2314. *Subsection (5)* states the time limit for elections under *subsection (4)*. Unlike the source legislation this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

Clause 915: UK resident companies: proceeds of sale received in instalments

2315. This clause sets out the spreading rules if the company chargeable by virtue of clause 912 is UK resident and receives the proceeds of sale in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 590(1) and (4) to (6) of ITTOIA.

2316. *Subsection (5)* states the time limit for elections under *subsection (4)*. Unlike the source legislation this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA.

Clause 916: Non-UK resident companies: proceeds of sale not received in instalments

2317. This clause sets out how non-UK resident companies are taxed on capital sums from the sale of patent rights if the sale proceeds are not received in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 591 of ITTOIA.

2318. *Subsection (4)* states the time limit for making an election under *subsection (3)*. The reference in section 524(6) of ICTA to "the Board" has not been reproduced and this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to an "officer of Revenue and Customs" in accordance with Schedule 1A to TMA. This change reproduces Change 149 in ITTOIA and so brings the income and corporation tax codes back into line. See *Change 1* in Annex 1.

2319. A non-UK resident company is within the charge to corporation tax in respect of sales of patent rights only if it is carrying on a trade in the UK through a UK permanent establishment and the patent is held for that trade (see clause 19). *Subsection (5)* of this clause (and of clause 917) is relevant if such a company, having elected for spreading under *subsection (3)* of this clause (or of clause 917) ceases within the maximum allowed spreading period of six years to be within the charge to corporation tax in respect of the trade it was carrying on through its UK permanent establishment. If (for example) in year four the company ceased to carry on the trade through a UK permanent establishment then the capital sum would be spread rateably over four years and any earlier spreading based on a presumption that it would continue to carry on the trade in the UK through a UK permanent establishment for the whole six years would be revised in accordance with *subsection (6)* of this clause (or of clause 917).

Clause 917: Non-UK resident companies: proceeds of sale received in instalments

2320. This clause sets out how non-UK resident companies are taxed on capital sums from the sale of patent rights if the sale proceeds are received in instalments. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 592 of ITTOIA.

2321. *Subsection (2)* makes explicit what is implicit in the source legislation.

2322. *Subsection (4)* states the time limit for elections under *subsection (3)*. The reference in section 524(6) of ICTA to "the Board" has not been reproduced and this clause does not specify to whom the election must be made. But the general rules about claims and elections in Schedule 18 to FA 1998 require elections to be made in a return or, if that is not possible, to "an officer of Revenue and Customs" in accordance with Schedule 1A to TMA. So Change 149 in ITTOIA is reproduced to bring the income and corporation tax codes back into line. See *Change 1* in Annex 1.

2323. The note on clause 916(5) is also relevant to *subsection (5*) of this clause.

2324. Section 524(10) of ICTA is not rewritten. Section 524 of ICTA prescribes particular tax treatments with alternatives available by election. Section 524(10) of ICTA requires claims for relief under section 524 to be made to the Board. The claim relates to the spreading over six years of capital sums received from the sale of patent rights for the purposes of charging the sum to tax. As spreading is automatic for UK resident companies, the claim can be relevant only to non-UK resident companies. However, section 524(6) of ICTA, which deals with spreading rules for non-UK resident companies, refers to an election the rules for which are fully stated in that subsection and rewritten in clauses 916 and 917. Section 524(10) of ICTA is, therefore, superfluous.

Clause 918: Winding up of a body corporate

2325. This clause deals with a body corporate which is chargeable to corporation tax under clause 912 if it commences to be wound up. It is based on section 525 of ICTA. The corresponding rule for income tax is in section 594 of ITTOIA.

Clause 919: Deduction of tax from payments to non-UK resident companies

2326. This clause provides rules relating to the deduction of tax from payments to non-UK resident companies which are liable for tax under clause 912 on profits from the sale of the whole or part of any patent rights. It is based on section 524 of ICTA. The corresponding rules for income tax are in section 595 of ITTOIA.

Clause 920: Adjustments where tax has been deducted

2327. This clause provides a rule relating to adjustments which may be necessary if tax is deducted from payments to a non-UK resident company under clause 919. It is based on section 524 of ICTA. The corresponding rule for income tax is in section 596 of ITTOIA.

Clause 921: Licences connected with patents

2328. This clause provides that certain matters relating to the acquisition or grant of a licence in respect of patent rights are treated for the purposes of the Chapter as a purchase or (as the case may be) sale of patent rights. The clause is based on section 533 of ICTA. The corresponding rule for income tax is in section 597 of ITTOIA.

Clause 922: Rights to acquire future patent rights

2329. This clause brings rights to acquire future patent rights within the patent rights rules in this Chapter. It is based on section 533 of ICTA. The corresponding rule for income tax is in section 598 of ITTOIA.

Clause 923: Sums paid for Crown use etc treated as paid under licence

2330. This clause provides that sums paid for Crown use, or by a government of a country outside the United Kingdom are, in certain circumstances, to be treated as paid under a licence. It is based on section 533 of ICTA. The corresponding rule for income tax is in section 599 of ITTOIA.

2331. The reference in section 533(4) of ICTA to “sections 46 to 49 of the Patents Act 1949” has not been reproduced in this section. This is because patents granted under these provisions have ceased to have effect so it is unnecessary to reproduce this reference. The removal of this unnecessary material follows the line adopted in section 482 of CAA and mirrors what was done in section 599 of ITTOIA.

2332. The words “used” and “use” in this clause (which correspond with the relieving legislation in section 482 of CAA) are intended to be read widely and cover “make” and “sell”.

Chapter 4: Relief from corporation tax on patent income

Clause 924: Relief for expenses: patent income

2333. This clause provides relief for certain expenses in connection with patents. It is based on sections 526 and 528 of ICTA. The corresponding rule for income tax is in section 600 of ITTOIA.

2334. The relief is on the basis of expenses incurred. This relaxes any requirement in the source legislation that fees have to be paid before a deduction can be made.

2335. *Subsection (2)* defines “patent application and maintenance expenses” for the purposes of this clause. Relief for such expenses is excluded from the scope of this clause if the expenditure is incurred for the purposes of a trade carried on by the payer. This is because there is a similar provision for trading expenses connected with patents (in clause 89 of the Bill).

2336. *Subsection (4)* gives a signpost to clause 926 which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 526 and 528 of ICTA as if those provisions were contained in CAA.

Clause 925: How relief is given under section 924

2337. This clause sets out how relief is given when a claim is made under clause 924 for patent expenses to be set against patent income. It is based on sections 526, 528 and 533 of ICTA. The corresponding rule for income tax is in section 601 of ITTOIA.

2338. *Subsection (2)* allows relief for expenditure against patent income in the accounting period in which the expenditure is incurred. However, if the expenses exceed the patent income in the accounting period, the surplus expenses cannot be used to create a loss under this clause. Any such surplus is dealt with in accordance with *subsection (3)*.

Chapter 5: Supplementary

Clause 926: Contributions to expenditure

2339. This clause restricts expenditure allowable under clause 910, clause 913 and clause 924 to the extent that the expenditure is met by a public body or someone other than the company. It is based on section 532 of ICTA and section 532 of CAA. The corresponding rule for income tax is in section 603 of ITTOIA.

2340. *Subsection (3)* is new and excludes the application of this clause to incidental expenses incurred by the seller of patent rights (see clause 913(2)(b)). This is because section 524 of ICTA only bites in the first place on the net proceeds of a sale.

Clause 927: Contributions not made by public bodies nor eligible for tax relief

2341. This clause qualifies the general rule in clause 926 by providing that contributions not made by public bodies may still be eligible as deductible expenditure in certain circumstances. The clause is based on section 532 of ICTA and section 536 of CAA. The corresponding rule for income tax is in section 604 of ITTOIA.

Clause 928: Exchanges

2342. This clause extends the definition of a sale of property to include exchanges of property for the purposes of this Part. It is based on section 532 of ICTA and sections 453 and 572 of CAA. The corresponding rule for income tax is in section 605 of ITTOIA.

Clause 929: Apportionment where property sold together

2343. This clause provides for the apportionment of sale proceeds and expenditure on a just and reasonable basis if property within the scope of this Part is sold with other property. It is based on section 532 of ICTA and sections 453 and 562 of CAA. The corresponding rule for income tax is in section 606 of ITTOIA.

Clause 930: Questions about apportionments affecting two or more persons

2344. This clause provides for questions relating to apportionment under clause 929 that affect two or more persons to be determined by the body prescribed by section 563 of CAA. It is based on section 532 of ICTA and section 563 of CAA. The corresponding rule for income tax is in section 607 of ITTOIA.

Clause 931: Meaning of "capital sums" etc

2345. This clause applies section 4 of CAA (which defines "capital expenditure" and "capital sums") for the purposes of the Part. It is based on section 532 of ICTA. The corresponding rule for income tax is in section 608 of ITTOIA.

Part 10: Miscellaneous income

Chapter 1: Introduction

Clause 932: Overview of Part

2346. This clause describes the function and contents of the Part. It is new.

Chapter 2: Dividends from non-UK resident companies

Clause 933: Charge to tax on dividends of non-UK resident companies

2347. This clause sets out the charge to corporation tax on dividends from a company that is not resident in the UK. It is based on sections 9, 18 and 70 of ICTA. The corresponding income tax provision is section 402 of ITTOIA.

2348. The approach adopted in ICTA is to compute income for corporation tax from each type of source in the same way as for income tax, and then apply any specific corporation tax rules. Following the enactment of ITTOIA, which set up a different scheme for income tax, sources of income for corporation tax have continued to be computed under the rules of the separate Schedules and Cases. Dividends paid by a non-UK resident company were charged under Schedule D Case V.

2349. The clause mirrors section 402 of ITTOIA by explicitly excluding capital dividends – the Schedule D Case V charge was a charge on income and the wording of the clause reflects this.

Chapter 3: Beneficiaries' income from estates in administration

Overview

2350. This Chapter charges to corporation tax income paid or payable by personal representatives to residuary beneficiaries from estates in administration. The Chapter rewrites sections 695 to 702 of ICTA. The corresponding rules for income tax are in Chapter 6 of Part 5 of ITTOIA.

2351. Personal representatives are taxable at the basic rate or the dividend ordinary rate on any income they receive during the administration period. When the income which arises to the personal representatives is paid to the residuary beneficiaries, it is treated as having borne income tax at those rates.

Clause 934: Charge to tax on estate income

2352. This clause applies the charge to corporation tax on income to estate income. It is based on sections 695(2) to (4), 696(3) and (6), 698(3) and 701(11) of ICTA. The corresponding rule for income tax is in section 649 of ITTOIA.

2353. The approach of Part 16 of ICTA is to deem sums to have been paid as income for all tax purposes. In the case of both UK and foreign estates, the income is not charged under a particular Schedule or Case and it is implicit that tax is charged on those sums. This clause applies to both UK and foreign estates. And it has now been made explicit that the charge to tax applies to all estate income which is treated as arising under the Chapter from a deceased person's estate.

Clause 935: Absolute, limited and discretionary interests

2354. This clause defines the three types of interest in the whole or part of the residue of an estate. It is based on sections 698(1) and (3) and 701(2) and (3) of ICTA. The corresponding rule for income tax is in section 650 of ITTOIA.

2355. *Subsections (1)(b)* and *2(b)* reflect the fact that the amount of any residue, and the income from it, can only be an estimate until the residue has been ascertained.

2356. *Subsection (4)* covers the following four situations:

- where income/capital is properly payable directly to the person with the interest;
- where income/capital is properly payable to the person with the interest indirectly through a trustee or other person;
- where income/capital is properly payable for the benefit of the person with the interest, to another person, and that income/capital is paid directly to that other person; and
- where income/capital is properly payable to a person where that person is a personal representative and *subsection (5)* applies.

2357. Subsection (5) deals with the situation where personal representatives would have an absolute or limited interest in the residue of another deceased person's estate if a right they have as personal representatives were vested in them for their own benefit. In these circumstances they are treated as having that interest. The term "personal representatives" is defined in clause 968. The definition corresponds with that in section 989 of ITA.

Clause 936: Meaning of "UK estate" and "foreign estate"

2358. This clause defines "UK estate" and "foreign estate" for the purposes of this Chapter. It is based on sections 699A(1B) and 701(9), (10) and (10A) of ICTA. The definitions in this clause underpin the whole of this Chapter. The corresponding rule for income tax is in section 651 of ITTOIA.

Clause 937: Absolute interests in residue

2359. This clause sets out the basis on which estate income is treated as arising in an accounting period in the case of absolute interests in residue. It is based on section 696(3) and (5) of ICTA. The corresponding rule for income tax is in section 652 of ITTOIA.

2360. *Subsections (2)* and *(3)* set out the relevant conditions. A payment need not be made in the "final accounting period" because the net amount of estate income in that period is always equal to the assumed income entitlement for that period. Under section 696(5) of ICTA, taxing a company with an absolute interest in a residuary estate depends on whether the company receives payments and, in the final year of administration, on a fictional payment under that section. The same effect is achieved in this clause by determining the liability by considering the assumed income entitlement in all accounting periods. Assumed income entitlement is dealt with in clause 948.

Clause 938: Meaning of "the administration period", "the final accounting period" and "the final tax year"

2361. This clause defines "the administration period", "the final accounting period" and "the final tax year". It is based on sections 695(1), 701(13) and 702 of ICTA. The corresponding rule for income tax is in section 653 of ITTOIA.

2362. *Subsection (2)* defines when the administration of the estate is completed for Scotland. A full definition for Scotland is required because the completion of the administration of an estate would otherwise have no meaning under Scottish law (although the definition has been updated by replacing the archaic expression "for behoof of"). In contrast, there are cases under English law which have established that the administration is complete when the residue of the estate is ascertained and is ready for distribution. Case law explains what this means in particular circumstances (see, for example, R v Special Commissioners ex parte Dr Barnardo's Homes (1921), 7 TC 646 HL, Daw v CIR (1928), 14 TC 58 HC and CIR v Sir Aubrey Smith (1930), 15 TC 661 CA).

Clause 939: Limited interests in residue

2363. This clause deals with estate income relating to limited interests. It is based on section 695(2) and (3) of ICTA. The corresponding rule for income tax is in section 654 of ITTOIA.

2364. The clause sets out the basis on which estate income is treated as arising in an accounting period for limited interests in residue. The clause reflects the need to deal with accounting periods before the final accounting period. Also, a limited interest might cease in an accounting period before the final accounting period and sums might be paid in respect of that interest in a later accounting period; so that situation has to be provided for.

Clause 940: Discretionary interests in residue

2365. This clause deals with estate income relating to discretionary interests in residue. It is based on section 698(3) of ICTA. The corresponding rule for income tax is in section 655 of ITTOIA.

Clause 941: UK estates

2366. This clause sets out the amount charged to tax under clause 934 for income from UK estates. It is based on sections 695(2) to (4), 696(3) and (4) and 698(3) of ICTA. The corresponding rule for income tax is in section 656 of ITTOIA.

2367. As there are fundamental differences between the basis of charge for income from UK and foreign estates, the rules for foreign estates have been dealt with in a separate clause (clause 942).

2368. *Subsection (2)* provides that income from a UK estate is charged on the gross amount of the estate income arising for the accounting period. This is the basic amount of the income grossed up at the applicable rate. "Basic amount" is a new term. This avoids confusion with the term "net amount" since it is the "net amount" which is actually charged to tax in the case of a foreign estate (except where clause 963 (income treated as bearing income tax) applies).

Clause 942: Foreign estates

2369. This clause sets out the amount charged to tax under clause 934 for income from foreign estates. It is based on sections 695(4), 696(6) and 698(3) of ICTA. The corresponding rule for income tax is in section 657 of ITTOIA.

2370. *Subsection (5)* provides that, so far as the income is not within clause 963, the charge is on the basic amount of that income. Where the income is within clause 963, the charge is on the gross amount of the income calculated in accordance with clause 946.

Clause 943: Absolute interests

2371. This clause explains how to calculate the basic amount of estate income for absolute interests. It is based on section 696(3) to (5) of ICTA. The corresponding rule for income tax is in section 660 of ITTOIA.

2372. This section removes all the deeming of amounts to have been paid in Part 16 of ICTA. Instead, it looks at either amounts actually paid or the assumed income entitlement. It then catches all previously untaxed income due to the absolute interest holder by taxing the assumed income entitlement in the final accounting period. This avoids the two stage process inherent in section 696(5) of ICTA.

2373. *Subsection (3)* introduces a new rule allowing excess estate deductions in the final year to be set off against the basic amount of estate income for the final accounting period. See *Change 69* in Annex 1.

Clause 944: Limited interests

2374. This clause explains how to calculate the basic amount of estate income for limited interests. It is based on section 695(2) to (4) of ICTA. The corresponding rule for income tax is in section 661 of ITTOIA.

Clause 945: Discretionary interests

2375. This clause identifies the basic amount of estate income relating to discretionary interests. It is based on sections 695(4) and 698(3) of ICTA. The corresponding rule for income tax is in section 662 of ITTOIA.

Clause 946: Applicable rate for grossing up basic amounts of estate income

2376. This clause provides for basic amounts of estate income to be grossed up, as appropriate, for the purposes of the clauses charging income (clause 941 for UK estates and clause 942 for foreign estates) by reference to the rate at which tax is borne by the aggregate income of the estate. It is based on sections 699A and 701(3A) of ICTA. The aggregate income of the estate is defined in clause 947. The corresponding rule for income tax is in section 663 of ITTOIA.

2377. *Subsection (5)* explains the interaction between "the relevant tax year" and "accounting period" for the purposes of this Chapter.

Clause 947: Aggregate income of the estate

2378. This clause explains what is meant by the "aggregate income of the estate" for a tax year. It is an important definition of general application. It is based on sections 701(5) and (8) and 702 of ICTA. The corresponding rule for income tax is in section 664 of ITTOIA.

2379. *Subsection (2)* defines the income and amounts within the aggregate income of the estate. Subsection (2)(b) brings in foreign source income and *subsection (4)* provides that such income takes account of any deductions which would have been available if it had been subject to United Kingdom income tax. So subsection (4) brings foreign source income into line with United Kingdom source income.

2380. *Subsection (5)* provides that two types of income are excluded from the aggregate income of the estate. The exclusion detailed in subsection (5)(a) concerning income to which any person may become entitled under a specific disposition is new to the definition of the aggregate income of the estate although it is similar to section 697(1)(b) of ICTA which deals with amounts which are deductible from the aggregate income in calculating the residuary income of the estate.

2381. It is not considered appropriate for income from specific dispositions or income from contingent interests to be treated as part of the aggregate income of the estate. See *Change 70* in Annex 1.

2382. Section 698(1) of ICTA in part deals with the position where the deceased person ("A"), whose estate is being administered by personal representatives, had an absolute or limited interest in the residue of the estate of another deceased person ("B"). Section 698(1) of ICTA deems the personal representatives to have the same interest as "A" "notwithstanding that that right is not vested in them for their own benefit". The substance of this is rewritten in clause 935(5). Section 698(1) of ICTA also deems any income in respect of such an interest to be part of the aggregate income of A's estate. This part of the source legislation is not rewritten because such income will fall within the definition of the aggregate income of the estate anyway, once the personal representatives are deemed to have the interest, because it will be the income of the deceased's personal representatives as such. It is immaterial for this purpose that that right in relation to the estate of another deceased person "is not vested in them for their own benefit".

2383. It is not necessary to expand on the two types of excluded income mentioned in subsection (5) of this clause (with the exception of *subsection (6)* of this clause) since it will be clear when such income arises. Consequently, section 701(6) and (7) of ICTA (which provide the meaning for "charges on residue") are not rewritten.

Clause 948: Assumed income entitlement

2384. This clause explains the new concept of the "assumed income entitlement". It is based on section 696(3A), (3B) and (5) of ICTA. The corresponding rule for income tax is in section 665 of ITTOIA.

2385. The concept of "assumed income entitlement" has been introduced as a tool for calculating the basic amount of estate income for absolute interests. It is similar to the "aggregated income entitlement" in section 696(3B) of ICTA but applies in a more straightforward way.

2386. Step 4 in *subsection (1)* deals also with situations where a beneficiary liable to corporation tax was, at some earlier point during the administration period, chargeable to income tax. It also deals with other situations where a non-UK resident beneficiary becomes UK resident, when the estate is a foreign estate.

Clause 949: Residuary income of the estate

2387. This clause explains how the residuary income of the estate is calculated. It is based on section 697(1) and (1A) of ICTA. The corresponding rule for income tax is in section 666 of ITTOIA.

2388. Beneficiaries with absolute interests need to know the residuary income of the estate for a tax year in order to work out their assumed income entitlement.

2389. *Subsection (2)* lists the "allowable estate deductions". This is a new label for the items which may be deducted from the aggregate income of the estate. Subsection (2)(a) refers to "all interest paid in that year by the personal representatives …". Section 697(1)(a) of ICTA refers to "the amount of any annual interest, annuity or other annual payment for that year which is a charge on residue …". The requirements that interest must be annual and also a charge on residue have not been reproduced. See *Change 71* in Annex 1.

2390. In practice, HMRC allow income from specific dispositions to be deducted from the aggregate income of the estate in calculating the residuary income of the estate in the year of assent and later years. But it is considered simpler for it merely to be excluded from what counts as the aggregate income and not be deducted from it. See *Change 70* in Annex 1.

2391. Subsection (2)(b) deals with annual payments. Because of the restricted meaning given to annual payments, much of the wide definition in sections 701(6) and 702(d) of ICTA is otiose. Any liabilities which are annual payments will now have to meet only the requirement that they are properly payable out of residue and this is also a requirement of section 701(6) of ICTA. Omitting the remainder of the definition removes unnecessary material. As a consequence of the change, section 701(7) of ICTA, which limits the meaning of “charges on residue” in relation to specific dispositions, does not need to be rewritten either.

2392. The clause does not contain an ordering rule for allocating allowable estate deductions against different categories of income. It is implicit in this clause that the taxpayer may choose whichever allocation is most advantageous.

Clause 950: Shares of residuary income of estate

2393. This clause explains the rules for determining the share of residuary income treated as arising from a company’s absolute interest in the whole or part of the residue of an estate. It is based on section 696(2) and (8) of ICTA. The corresponding rule for income tax is in section 667 of ITTOIA.

Clause 951: Reduction in share of residuary income of estate

2394. This clause provides that the share of the residuary income of the estate of a company with an absolute interest is reduced at the end of the administration period in certain circumstances. It is based on section 697(2) and (3) of ICTA. The corresponding rule for income tax is in section 668 of ITTOIA.

2395. Until it was repealed by ITA 2007, section 4(1) of ICTA provided that sums paid during (or on completion of) the administration period were to be grossed up by reference to the basic rate for the tax year in which it was paid in the case of UK estates. *Subsection (5)* provides that, for the purposes of subsection (1)(b) the basic rate is used when grossing up these sums. See *Change 72* in Annex 1.

Clause 952: Applicable rate for determining assumed income entitlement (UK estates)

2396. This clause sets out the calculation of the applicable rate for the purposes of calculating income tax to be deducted from the residuary income at step 2 of clause 948(1). The clause is based on section 701(3A) of ICTA. The corresponding rule for income tax is in section 670 of ITTOIA.

Clause 953: Introduction

2397. This clause introduces the clauses dealing with successive interests where two or more interests in the whole or part of the residue of an estate are held successively during the administration period by different persons. It is based on section 698(4) to (6) of ICTA. The income tax rules corresponding to *subsections (2)* and *(3)* are rewritten in section 671(7) and (8) of ITTOIA.

2398. Subsection (3) ensures that where a previous holder is not a company within the charge to corporation tax, that person's accounting periods (for the purposes of this clause) correspond with tax years.

Clause 954: Successive absolute interests

2399. This clause explains the position where two or more absolute interests in the residue of an estate are held successively by different persons. It is based on sections 697(4) and (5), and 698(2) of ICTA. The corresponding rule for income tax is in section 671 of ITTOIA.

2400. *Subsection (3)* contains an ordering rule to ensure that all determinations under subsection (2) or clause 955(2) are made in relation to the person with the earlier interest before the person with the later interest. This subsection has been inserted to make explicit what is already implicit in the source legislation.

2401. *Subsection (4)* provides a special rule where there are two or more absolute interests in the final accounting period. It is intended to ensure that it is the last absolute interest which is charged to tax on the assumed income entitlement, which will comprise all the residuary income, in the final accounting period. This is because the last absolute interest holder will receive the capital of the residue (and also all outstanding income in respect of it).

2402. *Subsections (5)* and *(6)* contain special rules where clause 951 (reduction in share of residuary income of estate) applies and there are successive absolute interests. These subsections provide that the calculation under clause 951(1)(a) and (b) is to be made by reference to all the absolute interests taken together. Then, after applying the reduction to the last absolute interest under clause 951(2) and (3), any remaining excess is applied to the previous absolute interest holders working backwards from the beginning of the last interest. See *Change 73* in Annex 1.

Clause 955: Assumed income entitlement of holder of absolute interest following limited interest

2403. This clause and clause 956 explain the position of the absolute interest holder where successive limited and absolute interests in the residue of an estate are held by different persons. It is based on section 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 672 of ITTOIA.

2404. The clause applies only where the later interests arise or are created on the cessation of the previous interest otherwise than by death. The position of limited interests which cease on the death of the holder before the final tax year are dealt with in section 654 of ITTOIA and clause 939 of this Bill. All sums paid or remaining payable in respect of that interest after the tax year of death are treated as estate income arising in the tax year of death.

2405. Examples of situations, in relation to limited interests, that are covered by the clause include:

- the disclaiming of a life interest which accelerates an existing interest under the will; and

- an interest which is only held until marriage or attaining a certain age.

2406. *Subsections (3)* and *(4)* contain the two rules introduced by *subsection (2).* They deal with the limited interest which ceases otherwise than on death. They also explain how such an interest is brought into the calculation of whether the person with the absolute interest has an assumed income entitlement and, if so, its amount. The assumed income entitlement works on a cumulative basis, so the share of the residuary income of the absolute interest holder and the basic amounts of previous accounting periods are taken into account.

Clause 956: Payments in respect of limited interests followed by absolute interests

2407. This clause covers the position where the absolute interest holder is entitled to receive payments in respect of a preceding limited interest which has ceased otherwise than on death. It is based on section 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 673 of ITTOIA.

2408. *Subsection (2)* deals with such payments while the absolute interest holder still has the absolute interest. It provides that a payment made to the absolute interest holder in respect of the limited interest is treated as paid in respect of the absolute interest (and not the limited interest). Thus, such payments may form part of the basic amount of estate income in accounting periods before the final accounting period.

2409. *Subsection (3)* deals with the position where the holder's absolute interest has itself ceased (but the administration period continues). The approach here is to treat any such sum paid in these circumstances as a payment in respect of the earlier limited interest. The result is that such payments are treated as estate income under the limited interests provisions. But *subsection (6)* provides that the payments are treated as paid or payable in respect of the absolute interest for the purposes of clause 951 (reduction in share of residuary income of estate).

2410. The taxation of successive interests in the residue of an estate is dealt with in section 698(1A) to (2) of ICTA. Section 698(1B) of ICTA deals with the case where there were successive interests in an estate which ceased otherwise than on death and the earliest or one of the earlier interests was a limited interest (see section 698(1A) of ICTA).

2411. Section 698(1B)(a) of ICTA provides that Part 16 of ICTA applies as if all the interests were the same interest ("the deemed single interest"), so that none of them is to be treated as having ceased on being succeeded by any of the others.

Section 698(1B)(b) of ICTA then determines who had the deemed single interest. It is either the person in respect of whose interest or previous interest the payment was made (section 698(1B)(b)(i) of ICTA) or a person who has or had an interest and is entitled to receive the payment (section 698(1B)(b)(ii) of ICTA). So a beneficiary who does not give up his or her entitlement to income which is unpaid at the time the interest ceases is taxable on the payment, rather than the person holding the successive interest at the time when the payment is made. However, section 698(1B)(b) of ICTA is made subject to section 698(1B)(c) of ICTA. Section 698(1B)(c)(i) of ICTA provides that, so far as a later interest is an absolute interest, it is to be treated as having always existed and the earlier interest or interests as having never existed for the purposes of the provisions dealing with absolute interests in section 696(3A) to (5) of ICTA.

2412. In rare circumstances the later absolute interest may itself have ceased at the time the payment is made. For example, A has a limited interest which is succeeded by absolute interests held first by B and then by C, and a payment is received by B in respect of A's earlier limited interest after B's own interest has ceased but before the end of the administration period. As a result of section 698(1B)(b)(ii) of ICTA, Part 16 of ICTA applies to the payment as if B had the deemed single interest. So section 696(3) of ICTA deems the sum to be paid to B as income in the accounting period in which it is actually paid. That is an accounting period in which C had the absolute interest. Under section 698(1B)(c)(i) of ICTA for the purposes of section 696(3A) to (5) of ICTA, Part 16 of ICTA is to apply as if the later interest of C had always existed and the earlier interests had never existed. Section 698(1B)(c)(ii) and (iii) of ICTA then provides that sums paid as income in respect of the earlier interests are deemed to be sums paid in respect of the later interest of C.

2413. The relationship between these particular provisions, where the later interest has itself ceased at the time the payment is made but the administration period continues, is difficult to work out. It would seem that the payment in the above example should be taxed on B because of section 696(3) of ICTA. The payment is then brought into account when the payments made in respect of C's interest are compared to its aggregated income entitlement (in making the final year calculation under section 696(5) of ICTA in respect of C's interest to determine whether any amount should be treated as having been paid to C immediately before the end of the administration period). So although section 698(1A) and (1B) of ICTA operate in a very convoluted way in the above circumstances, the end result appears to be that B, the person with the absolute interest who receives the payment, is taxed on it, but it does not affect B's aggregated income entitlement.

2414. In order to spell out how a payment made in these circumstances should be treated, subsections (3) and (4) of this clause provide that where such a payment is made, this Chapter applies as if the earlier limited interest had continued to subsist while the later absolute interest subsisted and had been held by the holder of the later absolute interest. The result is that payments to that holder are treated as estate income under the provisions about limited interests.

2415. Sums to which that holder is entitled that remain payable at the end of the administration period are treated in the same way. They will be basic amounts arising from the limited interest in the accounting period in which the absolute interest ceases and are dealt with by clauses 939 and 944. The effect of this on later absolute interests is then determined by the successive absolute interests provisions in clause 954. Under subsection (6) of this clause, however, these sums are to be treated as paid or payable in respect of the absolute interest for the purposes of the provisions about the reduction in shares of residuary income under clause 951.

Clause 957: Holders of limited interests

2416. This clause explains the position of a limited interest holder where successive interests in the residue of an estate are held by different persons and the earlier, or if there are more than two, the earliest of the interests is a limited interest. It is based on sections 695(2) and (3) and 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 674 of ITTOIA.

2417. The clause only applies where the later interests arise or are created on the cessation of the previous interest otherwise than by death.

2418. *Subsections (3)* to *(5)* cover three sets of circumstances described as "cases" where the estate income in respect of successive limited interests is treated as arising. The cases are the equivalent for successive limited interests of the three cases for single limited interests in clause 939. But the clause recognises that there may be more than one limited interest in the chain of succession, so references are made to "one of the interests" and subsection (5) refers to "the last of the successive interests".

2419. There is also an additional sub-paragraph in each case providing that a limited holder (as defined) is entitled to receive the payment. This reflects the fact that the person who receives the payment in these circumstances is not always the person in respect of whose interest the payment is made. For example, on disclaiming a life interest, a beneficiary may also disclaim any entitlement to income accrued in respect of that interest but not yet paid.

2420. The clause does not make it explicit that a new chain of succession begins with the first limited interest (and a previous absolute interest is ignored) for the purposes of this provision. Nor does the clause make it explicit that two limited interests which are preceded by a limited interest which ceased on the death of the beneficiary are covered by the clause. These conclusions are implicit in this clause.

Clause 958: Basic amount of estate income: successive limited interests

2421. This clause explains how to calculate the net amount of estate income for successive limited interests. It is based on sections 695(2) to (4) and 698(1A) and (1B) of ICTA. The corresponding rule for income tax is in section 675 of ITTOIA.

2422. The clause is the equivalent provision to clause 944 for limited interests that are not successive.

Clause 959: Apportionments

2423. This clause applies where successive interests apply to only part of the residue. In other words, the residuary estate is divided up and one or more of the successive interests provisions apply to a part or parts of that estate. It also applies where one of the interests covers the whole estate and the other interest covers part of it. It is new. The corresponding rule for income tax is in section 676 of ITTOIA. See *Change 74* in Annex 1.

2424. In such circumstances, it is possible that a subsequent interest may not cover exactly the same part of the residuary estate as the interest which preceded it. For example, limited interest holders may give up half their interest, thus accelerating the interest of the absolute interest holder. Only half the share of the residuary income and half the net amounts of the limited interest holder would be needed for the calculation of whether the absolute interest holder has an assumed income entitlement in accordance with clause 955(2). The clause provides for just and reasonable apportionments to be made in these circumstances.

Clause 960: Relief in respect of tax relating to absolute interests

2425. This clause provides for relief if income, which has borne United Kingdom tax, arises to a company with an absolute interest in the residue of a foreign estate. It is based on section 696(7) of ICTA. The corresponding rule for income tax is in section 677 of ITTOIA.

2426. *Subsection (2)* contains the formula for calculating the relief where a claim is made. The labels in section 696(7)(a) and (b) of ICTA – “the deemed income” and “the aggregate income” respectively – were added as explanatory aids in the course of the ICTA consolidation. These labels are not retained.

Clause 961: Relief in respect of tax relating to limited or discretionary interests

2427. This clause provides for relief if income, which has borne United Kingdom tax, arises to a company with a limited or discretionary interest in the residue of a foreign estate. The clause is based on sections 695(5) and 698(3) of ICTA. The corresponding rule for income tax is in section 678 of ITTOIA.

2428. *Subsection (2)* provides for a reduction to be made from the tax charged on the company following a claim for relief. The tax is to be reduced by an amount equal to the appropriate fraction of that tax. The fraction here (based on section 695(5) of ICTA) is slightly different from the fraction used for absolute interests (based on section 696(7) of ICTA). The labels in section 695(5)(a) and (b) of ICTA – “the deemed income” and “the aggregate income” respectively – were added as explanatory aids in the course of the 1988 consolidation. These labels are not retained.

2429. Section 695(6) of ICTA is not rewritten. The meaning of this provision, which was introduced when surtax was still charged, is now obscure and it is difficult to see how it could operate in the context of Self Assessment for companies. See *Change 100* in Annex 1.

Clause 962: Income from which basic amounts are treated as paid

2430. This clause sets out the rules for determining from which part of the aggregate income of the estate a basic amount is treated as paid. It is based on sections 699A(2) and 701(3A) of ICTA. The corresponding rule for income tax is in section 679 of ITTOIA.

2431. Personal representatives may receive such income from a number of sources, and different rates of tax apply to different types of income. Some of the income is taxed in the hands of the personal representatives at "the applicable rate" (the basic rate or the dividend ordinary rate. See clause 963).

2432. The basic amounts of estate income do not always correlate precisely to the income received by the personal representatives. It is therefore necessary to attribute payments out of the residuary estate in the form of basic amounts to particular types of income received by the personal representatives.

Clause 963: Income treated as bearing income tax

2433. This clause deals with income which is treated as bearing income tax. It is based on section 699A of ICTA. The corresponding rule for income tax is in section 680 of ITTOIA.

2434. Where such income forms part of the aggregate income of the estate (as a result of clause 947(2)), this clause treats the income as having borne tax at either the dividend ordinary rate or the basic rate (as appropriate) for certain provisions within the Chapter.

2435. Section 699A(1)(b) of ICTA is not rewritten in this Bill. This provision provides that the sums to which section 699A(1)(a) of ICTA applies must be sums in respect of which the personal representatives are not directly assessable to United Kingdom income tax. Of the income referred to in section 699A(1)(a) of ICTA to which section 699A(1)(b) of ICTA applies, none appears to be directly assessable. So section 699A(1)(b) of ICTA serves no useful purpose.

Clause 964: Transfers of assets etc treated as payments

2436. This clause is concerned with the appropriation of assets by personal representatives to themselves, any other transfer of assets and the set off or release of a debt. The clause is based on section 701(12) of ICTA. The corresponding rule for income tax is in section 681 of ITTOIA.

Clause 965: Assessments, adjustments and claims after the administration period
2437. This clause deals with adjustments after the end of the administration period. It is based on section 700(1) to (3) of ICTA. The corresponding rule for income tax is in section 682 of ITTOIA.

Clause 966: Power to obtain information from personal representatives and beneficiaries
2438. This clause enables HMRC to obtain information for the purpose of this Chapter. It is based on section 700(4) of ICTA.

Clause 967: Statements relating to estate income
2439. This clause enables a company to request statements relating to a deceased person's estate. It is based on section 700(5) and (6) of ICTA.

2440. The last part of section 700(5) of ICTA that requires the statement to set out the matters in section 700(5)(a) to (b) separately for each part of estate income, in cases where different applicable rates apply, has not been rewritten. This requirement is considered unnecessary because the requirement to show amounts separately must occur in order for subsection 967(1)(b) of this clause to be satisfied.

Clause 968: Meaning of "personal representatives"
2441. This clause provides the meaning of "personal representatives". It is based on section 701(4) of ICTA.

Chapter 4: Income from holding an office
Overview
2442. Section 9 of ICTA applies income tax law and practice to the charge and calculation of corporation tax and has been amended by ITEPA, ITTOIA and ITA in the course of the separation of corporation tax from income tax. (See the commentary on Chapter 1 of Part 2.)

2443. After this Bill is enacted the only context in which the principle underlying section 9 of ICTA will continue to be relevant is the charge to corporation tax on income from the holding of an office: this corporation tax charge still operates by reference to income tax.

Clause 969: Charge to tax on income from holding an office
2444. This clause applies "the charge to corporation tax on income" to income from an office. It is based on section 9 of ICTA. The charge on income is explained in clause 2.

2445. Section 9(3)(b) of ICTA was amended by ITEPA and refers to employment, pension and social security income. Previously section 9(3) referred to "the like Schedules and Cases". As a company cannot be an employee and cannot receive pension and social security income, these aspects of section 9(3)(b) have not been rewritten. Employment income however includes income from holding an office. A company can hold an office - a common example is as a company secretary - so this clause rewrites that aspect of the source legislation.

2446. Under *subsection (2)* the amount of income from an office charged to tax is determined in accordance with income tax law and practice and under *subsection (4)* the provisions of ITEPA govern the calculation of the income from this source. The clause uses “calculated” for “computed”.

2447. *Subsection (3)* provides that subsection (2) is subject to provisions of the Corporation Tax Acts. The Corporation Tax Acts are defined in section 831(1)(a) of ICTA as “enactments relating to the taxation of the income and chargeable gains of companies and of company distributions (including provisions relating also to income tax)”. In section 9(1) of ICTA the reference is to “the Tax Acts”. The reference has been narrowed since the qualifications to subsection (2) of this clause only occur in corporation tax enactments.

2448. Section 9(2A) of ICTA which provided that for corporation tax purposes no income shall be computed under ITTOIA will be spent when this Bill is enacted and is repealed.

2449. Section 9(4) of ICTA expands upon section 9(1). The part of this subsection that applies an exemption in an Income Tax Act (other than ITTOIA and ITA) has been rewritten in *subsection (4)(b)*, since it is not absolutely certain that exemptions are covered by subsections (1) to (3) of this clause.

2450. The other part of section 9(4) that provides for any provision of the Income Tax Acts (again other than ITTOIA and ITA) which charges any amount to income tax to have like effect for corporation tax has not been rewritten since the determination of the charge is covered by subsections (1) to (2) of this clause (and in the context of employment income in ITEPA free standing charges are not believed to be an issue).

2451. Section 9(5) of ICTA applies “where, by virtue of this section or otherwise” any enactment applies both to corporation tax and income tax. This provision is amended by this Bill but is not repealed since it could have an application to an enactment that is not being rewritten.

2452. Section 9(6) of ICTA is repealed since it no longer serves a useful purpose.

2453. The interpretation of “office” in *subsection (6)* is based on section 5(3) of ITEPA. The ITEPA provision derives from the cases of Great Western Railway Company v Bater (1922), 8 TC 231 and Edwards v Clinch (1981), 56 TC 367. This accords with the application of income tax principles in subsection (2) based on section 9(1) of ICTA.

Clause 970: Rule restricting deductions for bad debts

2454. This clause deals with bad debts arising from the holding of an office. It is based on section 88D of ICTA.

2455. The corresponding rule about trade debts is in clause 55.

2456. This clause is needed because section 88D(4) of ICTA imports the extended meaning of "trade" in section 6(4) of ICTA. So the ICTA rule applies to a vocation and also to an office or employment. In this Bill, for corporation tax purposes a company cannot carry on a vocation or be employed.

2457. *Subsection (1)* excludes from the rule any debts that are dealt with by the loan relationship rules in Parts 5 and 6 of the Bill. Section 88D(1) of ICTA also excludes debts that are dealt with by the rules for derivative contracts and intangible fixed assets. Those rules are not relevant to an office-holder and so are not mentioned in the clause.

Chapter 5: Distributions from unauthorised unit trusts

Overview

2458. This Chapter applies the charge to corporation tax on income to payments to companies from unauthorised unit trusts. It is based on section 469 of ICTA. The corresponding income tax provisions are in Chapter 10 of Part 4 of ITTOIA.

Clause 971: Overview of Chapter

2459. This clause sets out how relevant amounts are calculated and charged to corporation tax. It also points to particular provisions of ITA and of ICTA which deal with the position of a unit holder. It is new.

Clause 972: Charge to tax under this Chapter

2460. This clause applies the charge to corporation tax on income to amounts shown in the unit trust scheme's accounts as income available for payment to unit holders or for investment in the scheme. It is based on sections 9, 18 and 469 of ICTA. The corresponding charge for income tax is in section 547 of ITTOIA.

Clause 973: Amount of income treated as received

2461. This clause sets out the amount of income treated as received by a unit holder from an unauthorised unit trust scheme under clause 972(2). It is based on section 469 of ICTA. The corresponding rule for income tax is in section 548 of ITTOIA.

2462. *Subsection (2)* contains a method statement setting out the steps to be taken to calculate the gross amount of income on which the unit holder is charged to tax.

Chapter 6: Sales of foreign dividend coupons

Overview

2463. This Chapter rewrites the charge to tax in section 18(3B) to (3E) of ICTA on the proceeds of the sale of coupons attached to foreign shares, where the sale is made through a bank in the United Kingdom or to a dealer in coupons in the United Kingdom.

2464. Although these provisions include coupons on both securities and shares, for corporation tax purposes the charge applies in effect to the sale of coupons on shares only.

2465. Chapter 2 of Part 4 of FA 1996 charges to tax all profits and gains arising to a company from its loan relationships. Profits and gains include (section 81(5) and 84(1) of that Act) payments payable in pursuance of any rights under a loan relationship. The sale of a coupon on a security is charged to tax in the same way as any sale in pursuance of a right under a loan relationship. Section 18(3B) of ICTA as it applies to coupons on securities is therefore unnecessary for corporation tax purposes and section 80(5) of FA 1996 applies to give the loan relationship provisions precedence in any event.

2466. Section 18(3B) of ICTA requires Schedule D Case IV in section 18(3) to be read as including proceeds of the sales of coupons for foreign dividends. Subsection (3B) does not explain how the charge is allocated between Schedule D Case IV and Case V. The obvious assumption is that where the coupon is issued in respect of a security out of the United Kingdom it falls within Case IV (which charges income from overseas securities) and otherwise within Case V (which charges income from possessions outside the United Kingdom).

2467. Section 18(3A) of ICTA requires “Case III” as set out in that subsection to be substituted for “Case IV” in section 18(3) of ICTA. The effect of this is to bring the extended meaning of Case IV required by section 18(3B) of ICTA into a Case III charge which incorporates a charge under the loan relationships provisions which, as explained above, *already* charges to tax the sale of coupons in respect of securities.

2468. Whether or not it was intentional that a Case IV charge for corporation tax should remain within section 18(3B) to (3E) of ICTA to be brought within Case III by section 18(3A) of ICTA is unclear. Subsections (3B) to (3E) were introduced in FA 1996, the same Finance Act that introduced section 18(3A) of ICTA. Either way the effect of section 18(3B) to (3E) of ICTA is simply to bring within the loan relationships provisions the sale of coupons on securities even though they are already within the provisions on first principles.

2469. For these reasons section 18(3B) to (3E) of ICTA has been rewritten to exclude the sales of coupons on foreign securities.

Clause 974: Charge to tax under this Chapter
2470. This clause applies the charge to corporation tax to income which is treated as arising from foreign holdings where a dividend coupon attached to the holding is (a) sold or otherwise realised by a bank in the United Kingdom or (b) sold to a coupon dealer in the United Kingdom by someone other than a bank or a coupon dealer. It is based on section 18(3), (3B) and (3E) of ICTA. The corresponding rule for income tax is in section 570 of ITTOIA.

2471. *Subsection (3)* applies where the coupon is sold by the bank on behalf of another. See *Change 75* in Annex 1.

2472. *Subsection (4)* applies where a person who is neither a bank nor another coupon dealer sells the dividend coupons to a coupon dealer in the United Kingdom. Section 18(3B)(b) of ICTA refers to a dealer in coupons in the United Kingdom. See *Change 75* in Annex 1.

Clause 975: Meaning of "foreign holdings" etc
2473. This clause gives the meaning of "foreign holdings" and "dividend coupons". It is based on section 18(3B), (3C), (3D) and (3E) of ICTA. The corresponding rule for income tax is in section 571 of ITTOIA.

2474. For reasons given above the extended definition of "dividends" to include interest or other annual payments has been omitted as part of the exclusion of coupons in respect of securities. It is considered that "dividends" alone in section 18(3D) of ICTA is sufficient to refer to any income from shares.

2475. The definition in s*ubsection (1)* of "foreign holdings" as shares outside the United Kingdom which are issued by or on behalf of a non-UK resident body of persons reflects the wording of section 18(3C) of ICTA. Section 18(3B) states that the references in Schedule D Cases IV and V to income arising from securities or possessions out of the UK are to be taken *in the case of relevant foreign holdings* as including the various categories of proceeds detailed under paragraphs (a) and (b). This is construed as meaning that where the securities or possessions are out of the United Kingdom *and* are relevant foreign holdings references to income from them include the proceeds under those paragraphs (but not in other cases). In other words there is no assumption of a complete overlap between securities or possessions out of the United Kingdom *and* relevant foreign holdings. Whether a security or possession is within Cases IV and V as a security or possession out of the United Kingdom may depend on a number of factors (see <u>Westminster Bank Executor and Trustee Co (Channel Islands) Ltd v National Bank of Greece SA</u> (1970), 46 TC 472 HL).

Chapter 7: Annual payments not otherwise charged
Overview
2476. The Chapter sets out the charge to corporation tax on income on any annual payments that are not charged to tax by any other provision of this Bill or any other legislation. It is based on the part of section 18 Schedule D Case III (b) of ICTA

which deals with annual payments and the part of section 18 Schedule D Case V of ICTA which deals with foreign annual payments. The corresponding rules for income tax are in Chapter 7 of Part 5 of ITTOIA.

2477. Annuity payments made under purchased life annuities and distributions from unauthorised unit trusts (which in the source legislation are treated as annual payments) are generally regarded as investment income. A company which is the recipient of a payment under a purchased life annuity contract is deemed to be a party to a creditor relationship (see clauses 561 and 562 of this Bill). The application of the charge to corporation tax on income for distributions from unauthorised unit trusts is in clause 972 of this Bill. As the application of the charge to corporation tax on income for annual payments in this Chapter takes effect only if an amount is not otherwise charged to corporation tax, there is no overlap between the various provisions.

2478. The phrase "annual payment" is retained but is not defined in the Bill or in the source legislation. Instead it derives its meaning from an extensive body of case law. That case law illustrates that the phrase has a meaning for tax purposes far different from its natural one. Replacing that phrase would risk breaking the link to case law without making the law any clearer or easier to understand.

Clause 976: Overview of Chapter

2479. This clause provides an overview of the Chapter and signposts other relevant provisions. It is new.

Clause 977: Charge to tax on annual payments not otherwise charged

2480. This clause applies the charge to corporation tax on income to annual payments not charged elsewhere. It is based on sections 9 and 18 of ICTA. The corresponding rule for income tax is in section 683 of ITTOIA.

2481. *Subsection (1)* applies the charge to corporation tax on income to residual annual payments. The charge to tax in the source legislation is in respect of "any annuity or other annual payment". The reference to "any annuity or other" is omitted because most annuities are charged to tax not under this Chapter but under Part 5 (loan relationships). Including a reference to annuities might therefore be misleading.

2482. The words "whether inside or outside the United Kingdom" in Schedule D Case III (b) are also omitted. The place of payment is only one of a number of factors derived from case law which may be taken into account in determining the source of annual payments.

2483. The source legislation excludes "any payment chargeable under Schedule A". It is not necessary to rewrite this as clauses 209, 270, 277 and 280 apply the charge to corporation tax on income to property income.

2484. *Subsection (2)* ensures that any exemption resulting from the application of the charge to corporation tax on income to other income is not reversed by the application of that charge under this Chapter.

2485. *Subsection (3)* rewrites “or whether annually or at shorter or longer intervals”.

Clause 978: Exemption for payments by persons liable to pool betting duty

2486. This clause gives an exemption from corporation tax for annual payments made by persons liable to pool betting duty. It is based on section 126 of FA 1990 and section 121 of FA 1991. The corresponding rule for income tax is in section 748 of ITTOIA.

2487. The exemption applies to payments made in consequence of a reduction in pool betting duty, whenever that reduction is made (see *subsection (2)*). Subsection (2) combines the conditions in FA 1990 and FA 1991. Although the source legislation is restricted to the 1990 and 1991 reductions in pool betting duty, the subsection applies to payments made “in consequence of” any reduction in the duty. See *Change 36* in Annex 1.

2488. *Subsection (3)* sets out a further condition which needs to be satisfied. The subsection does not specify that payments in consequence of the 1990 reduction in pool betting duty must be paid for football safety and comfort (see section 126(3) of FA 1990) or that payments in consequence of the 1991 reduction must be paid to the Foundation for Sport and the Arts (see section 121(3) of FA 1991). Instead the subsection applies to a payment in consequence of any reduction in pool betting duty for either purpose. See *Change 35* in Annex 1.

Chapter 8: Income not otherwise charged

Overview

2489. This Chapter applies the charge to corporation tax on income to any income that is not so charged by any other corporation tax provision. The corresponding income tax charge is in Chapter 8 of Part 5 of ITTOIA.

2490. The Chapter also includes exemptions from the charge applied under this Chapter.

2491. In the source legislation, Schedule D is the residual Schedule into which income falls for corporation tax purposes if neither ITEPA nor Schedule A applies to it. The Schedule is set out in section 18 of ICTA. Section 18(1)(a) of ICTA charges “annual profits or gains arising or accruing… from any kind of property whatever…”. Section 18(1)(b) of ICTA charges “…other annual profits or gains not charged under Schedule A or under ITEPA 2003 as employment income, pension income or social security income, and not specially exempted from tax”.

2492. Schedule D Case VI is itself the residual Case under that Schedule. Tax is charged under Case VI “in respect of annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of Schedule A or by virtue of ITEPA 2003 as employment income, pension income or social security income”. Schedule D Case V includes an identical function for the income to which that Case applies. The scope of Case V is (subject to the override in section 18(3A) of ICTA giving priority to Schedule D Case III in respect of anything chargeable under Chapter 2 of Part 4 of FA 1996 as profits or gains from loan relationships) “income arising from possessions out of the United Kingdom not being employment income, pension income or social security income on which tax is charged under ITEPA 2003”. Case law has established the comprehensive scope of Case V in relation to “income from possessions out of the United Kingdom”. So far as any amount is “income from possessions out of the United Kingdom”, Case V is the “last resort” charging provision, not Case VI. And a corollary to that rule is that income charged by Case VI (other than deemed income which is directed by provisions other than section 18 of ICTA to be taxed under Case VI) can only derive from a source in the United Kingdom.

2493. This Chapter brings together the “sweep up” functions of Schedule D Cases V and VI.

2494. The charge under this Chapter is restricted to amounts that are “income” on first principles. That is, in terms of the source legislation they are “annual profits or gains” under section 18(1) of ICTA, as that phrase has been interpreted by case law, and do not include profits or gains of a capital nature even if such profits are directed to be charged to tax as income.

2495. Under section 396 of ICTA, Schedule D Case VI losses may be set against Case VI profits or gains. Although that relief is not rewritten in this Bill, consequential amendments of ICTA in Schedule 1 to this Bill ensure that the relief continues to work as before in respect of income within this Chapter despite the abolition by this Bill of the Schedules and the Cases of Schedule D.

Clause 979: Charge to tax on income not otherwise charged

2496. This clause applies the charge to corporation tax on income to income not so charged elsewhere. It is based on sections 9(1), (2), (2B), (2C), (3) and (4) and 18(1) and (3) of ICTA. The corresponding rule for income tax is in section 687 of ITTOIA.

2497. Schedule D Case V charges tax in respect of *income* from possessions out of the United Kingdom. Schedule D Case VI charges tax in respect of *annual profits or gains*. The scope of both Cases is derived from section 18(1) of ICTA, which refers to “annual profits or gains”. Case law does not indicate a difference, in the context of section 18 of ICTA, in the meaning of “annual profits or gains” and “income”. The choice of term appears to be dictated (although not consistently) by the degree to which a calculation of profit or loss is relevant to the calculation of the income charged. The clause uses *income* rather than *(annual) profits or gains*.

2498. *Subsection (2)* protects the effect of any exemption, whether provided by this Chapter or by Part 19 (general exemptions) of this Bill or by other legislation.

2499. That subsection disapplies the charge to "deemed income". This term refers to amounts that are treated as income by a provision of the Corporation Tax Acts, so that the charge to corporation tax on income applies to that amount. The disapplication applies in the event that such deemed income would not fall within any other application of the charge to corporation tax on income.

Clause 980: Exemption for commercial occupation of woodlands in UK

2500. This clause exempts income arising from the occupation of commercial woodlands from any charge under this Chapter. It is based on paragraphs 2 and 3 of Schedule 6 to FA 1988. The corresponding rule for income tax is in section 768 of ITTOIA.

2501. A consequence of this exemption is that no loss relief is available under section 396 of ICTA (losses from miscellaneous transactions). A requirement of that section is that any profit on the transaction would be liable to corporation tax.

2502. This clause is complemented by clauses 37 and 208 of this Bill. The combined effect of these three clauses is that income from the occupation of commercial woodlands is ignored for corporation tax purposes.

2503. The interpretation of commercial occupation of woodlands in *subsection (2)* is supplemented by the definition of "woodlands" in clause 1317(4) of this Bill.

Clause 981: Exemption for gains on financial futures

2504. This section removes gains on financial futures, traded options and financial options from the charge to corporation tax on income under this Chapter. It is based on section 128 of ICTA. The corresponding rule for income tax is in section 779 of ITTOIA.

2505. Because of this exemption, the gains in question (which do not include any gains falling within Part 3 (trading income)) are not charged to corporation tax as income but as chargeable gains (see section 143 of TCGA).

2506. In contrast to the equivalent income tax exemption (section 779 of ITTOIA), this exemption does not cover commodity futures. Commodity futures come within the scope of the derivative contracts regime rather than the chargeable gains rules (see Part 7 of this Bill). To the extent that any of the futures or options to which this exemption would otherwise apply are also within the scope of that Part, this exemption will not apply. See the definition of a "derivative contract" in clause 576.

2507. The section imports the definitions provided by section 143 of TCGA. The definition of "recognised futures exchange" is provided because, unlike the position in

ITTOIA (see section 558(3) of that Act), there is no definition of the term elsewhere in this Bill that applies here.

Chapter 9: Priority rules

Clause 982: Provisions which must be given priority over this Part

2508. This clause determines which Part takes priority in the event of an overlap of the charge on the profits of a trade or the profits of a UK property business and a charge under a Chapter of this Part. It is based on section 18(1), (2) and (3) of ICTA. The corresponding rules for income tax are in section 261 of ITTOIA.

2509. In the case of such an overlap, priority is given to the charge under Part 3 (trading income) or Part 4 (property income), as the case may be.

2510. *Subsection (1)* gives statutory effect to the Crown Option as regards the overlap between income charged under another Case of Schedule D and income of a United Kingdom trade charged under Schedule D Case I. See *Change 55* in Annex 1.

2511. *Subsection (2)* is based on the definition of the Cases of Schedule D in section 18 of ICTA so far as it gives priority to the charge under Schedule A.

Part 11: Relief for particular employee share acquisition schemes

Overview

2512. This Part and Part 12 give specific statutory deductions for various costs associated with setting up and operating employee share schemes. These are arrangements under which employers provide incentives for their employees in the form of shares. This Part gives relief for the provision of shares under an approved share incentive plan. It also gives relief for the cost of setting up particular types of approved share scheme. It is based on sections 84A and 85A of ICTA and Schedule 4AA to ICTA.

2513. Neither Part 11 nor Part 12 gives relief for the day to day costs of running a scheme. These must be considered according to the ordinary rules that apply to the calculation of business profits for corporation tax purposes. Those rules also apply if relief is not available under either of these Parts for the costs of setting up a scheme or providing the shares under the scheme.

2514. The rule in clause 53 in Part 3 (trading income), that prevents a deduction for items of a capital nature, is subject to contrary provision. This avoids a conflict between that general rule and, in the context of this Part, the specific relief given by some clauses of this Part. For example, the cost of setting up a SIP would normally be considered to be capital expenditure.

Chapter 1: Share incentive plans

Clause 983: Overview of Chapter

2515. This clause introduces the provisions within the Chapter. It is new.

2516. The Chapter gives a deduction for the costs of setting up an approved share incentive plan (SIP) and for the provision of shares under the SIP. The qualifying conditions for approval of the SIP itself are in Schedule 2 to ITEPA and this Chapter is treated as part of the SIP code. See clause 984.

Clause 984: Chapter to form part of SIP code etc

2517. This clause provides that this Chapter forms part of the SIP code. The clause also deals with the trustees' acquisition of forfeited shares. It is based on paragraphs 1 and 6 of Schedule 4AA to ICTA.

2518. S*ubsection (2)* makes clear that a consequence of treating the Chapter as part of the SIP code is that the definitions in Schedule 2 to ITEPA apply to the Chapter.

2519. *Subsection (4)* deals with the trustees' acquisition of forfeited shares. The plan rules may require an employee to forfeit his or her plan shares if the employee leaves the company. No further deduction is allowed to the company if the forfeited shares are re-awarded. See clause 996 exclusion 5. But it may be necessary to identify whether these shares are included in a later award. See, for example, clause 994(6)(b). Subsection (4) identifies when forfeited shares are acquired for this purpose.

Clause 985: References to a deduction being allowed to a company

2520. This clause explains how a deduction allowed by this Chapter is given to companies carrying on different types of business. It is based on paragraphs 1 and 13 of Schedule 4AA to ICTA.

2521. Paragraph 1(3) of Schedule 4AA to ICTA allows a deduction in calculating trade profits. Section 21A of ICTA applies this rule to the calculation of the profits of a property business. These deductions are dealt with in *subsection (2)*.

2522. A property business may also be an investment business. *Subsection (3)* makes specific provision for a company with investment business. The deduction is allowed as an expense of management (see Chapter 2 of Part 16).

2523. If the business is both a property business and an investment business subsection (3) gives priority to subsection (2). This priority is based on section 75(2) of ICTA which provides that a deduction as an expense of management is not given if the deduction is otherwise allowable.

Clause 986: Treatment of receipts under Chapter

2524. This clause explains how a withdrawal of relief is taxed. It is based on section 21A of, and paragraphs 10 to 13 of Schedule 4AA to, ICTA.

2525. If relief is withdrawn the company is treated as receiving an amount equal to the deduction. See, for example, clause 990(4). This clause sets out how this is taxed.

2526. *Subsection (3)* applies if the relief is recovered after the trade or property business has ceased. It makes clear that the recoveries are taxed as post-cessation receipts. In the source legislation the amounts are taxed as trading receipts. See *Change 76* in Annex 1. This change also affects clauses 990(4) and (5), 992(4) and (6), 993(2) and (4) and 998(3) and (4).

2527. If the company is not carrying on a trade or property business or has not carried on a trade or property business the amount is one to which the charge to corporation tax on income is applied, see *subsection (4)*.

2528. This treatment is also applied to the recovery of relief given for contributions to a plan trust. In the source legislation paragraphs 10 and 12 of Schedule 4AA to ICTA charge these amounts as trade receipts. See *Change 76* in Annex 1.

2529. The amount charged by subsection (4) is included on the list of former Schedule D Case VI charges (in section 834A of ICTA as inserted by Part 1 of Schedule 1 to this Bill). This does not mean that loss relief is available under section 396 of ICTA against the amount charged by subsection (4). This is because the amount charged by subsection (4) does not arise from a transaction as required by that section.

Clause 987: Deduction for costs of setting up an approved share incentive plan

2530. This clause gives a deduction for the costs setting up a SIP. It is based on paragraph 7 of Schedule 4AA to ICTA.

2531. *Subsection (4)* applies if there is a delay between the company incurring the costs and the SIP being approved. The deduction is given for the period of account in which the scheme is approved. This avoids the company having to amend its company tax return for the period in which the expenditure was incurred or in an extreme case being outside the time limit for amending that return.

Clause 988: Deductions for running expenses of an approved share incentive plan

2532. This clause prevents any prohibitive rule in this Chapter denying a deduction for the costs of running a SIP. It is based on paragraph 8 of Schedule 4AA to ICTA.

2533. The trustees of a SIP will incur costs related to the day to day running of the SIP. For example, they will have to operate a PAYE scheme to deal with the employees’ income tax liabilities. They will also incur incidental costs in acquiring the shares. The employing company will have to meet these costs.

2534. The clause does not itself give the company a deduction for payments made to the trustees to enable them to meet the running costs. It provides that none of the prohibitive rules in this Chapter, such as clause 994(7), prevents a deduction being given for running expenses. As the SIP is run for the benefit of its employees the costs would usually be allowed as a normal deduction in calculating the company's taxable profits. Whether or not a deduction is allowed is considered on first principles.

2535. *Subsection (3)* makes clear that running expenses do not include the cost of acquiring the shares except for the incidental costs listed in *subsection (4)*. The reference to stamp duty reserve tax is new.

Clause 989: Deduction for contribution to plan trust
2536. This clause allows a deduction for a payment to the trustees which they use to buy shares for later award under the SIP. It is based on paragraphs 9 and 10 of Schedule 4AA to ICTA.

2537. In broad terms the purpose of this clause is to give the company a deduction at the time when it funds the purchase of the shares and not when the shares are awarded to the employee. Without this clause it could be difficult for companies to finance the purchase of shares in advance of them being awarded.

2538. The clause applies to payments made on or after 6 April 2003. This commencement is preserved in Schedule 2 (transitionals and savings).

2539. "Plan trust" has the meaning given in paragraph 71(3) of Schedule 2 to ITEPA.

2540. *Subsection (2)* provides that at the end of the period of 12 months beginning when the trustees make the acquisition with the payment the trustees must hold at least 10% of the ordinary share capital of the company in which the shares are acquired. This total applies to all the shares held. There is no requirement that the total is made up of shares acquired using the payment.

2541. Under the SIP rules shares will be appropriated to an employee but the employee is required to leave the shares with the trustees. For example, paragraph 36(1) of Schedule 2 to ITEPA requires free shares to remain in the hands of the trustees for a holding period of at least three years. *Subsection (3)* makes clear that these shares count towards the 10% total.

Clause 990: Withdrawal of deduction under section 989
2542. This clause withdraws the relief given by clause 989 if the shares acquired with the payment are not awarded within specified time limits. It is based on paragraph 10 of Schedule 4AA to ICTA.

2543. *Subsection (4)* provides that the relief is withdrawn by treating the deduction as an amount received by the company. This amount is taxed in accordance with the rules in clause 986.

2544. This clause refers to a deduction being given under clause 989. It is possible that the deduction may have been given under paragraph 9 of Schedule 4AA to ICTA if the relief was given in an accounting period before this Bill took effect. The general continuity of law provisions in Schedule 1 to this Bill provide that where necessary references to the new legislation should be read as applying also to the source legislation. So the recovery provisions still apply.

2545. This clause contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on clause 986.

Clause 991: Another deduction to be allowed if all acquired shares are awarded
2546. This clause allows a further deduction if the relief is withdrawn under clause 990 but all the acquired shares are awarded at a later date. It is based on paragraph 10 of Schedule 4AA to ICTA.

Clause 992: Award of shares to excluded employee
2547. This clause withdraws a proportion of the relief given under clauses 989 and 991 if shares are awarded to an excluded employee. It is based on paragraph 10 of Schedule 4AA to ICTA.

2548. The definition of excluded employee in *subsection (2)* is the same as that in paragraph 4(2) of Schedule 4AA to ICTA which is rewritten as Exclusion 1 in clause 996.

2549. This clause contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on clause 986.

Clause 993: Termination plan notice
2550. This clause withdraws a proportion of the relief given by clause 989 if the company terminates the SIP before all the shares have been awarded. It is based on paragraph 12 to Schedule 4AA to ICTA.

2551. This clause contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on clause 986.

Clause 994: Deduction for providing free or matching shares
2552. This clause gives a deduction for providing free or matching shares. It is based on paragraph 2 of Schedule 4AA to ICTA.

2553. A "free share" is defined in paragraph 2(1)(a) of Schedule 2 to ITEPA. It means a share appropriated to the employee without payment.

2554. A "matching share" is defined in paragraph 3(1) of Schedule 2 to ITEPA. It means a share appropriated to the employee without payment in proportion to the partnership shares acquired by the employee.

2555. A "group plan" is defined in paragraph 4 of Schedule 2 to ITEPA. It means a SIP established by a parent company in which the companies it controls are allowed to participate.

Clause 995: Deduction for additional expense in providing partnership shares

2556. This clause gives a deduction for any contribution the company makes towards the acquisition of partnership shares. It is based on paragraph 3 of Schedule 4AA to ICTA.

2557. A "partnership share" is defined in paragraph 2(1)(a) of Schedule 2 to ITEPA. It means a share acquired by the trustees on behalf of an employee out of sums deducted from the employee's salary.

2558. This clause is concerned with the case to which paragraph 52 of Schedule 2 to ITEPA applies. Partnership shares are acquired by the trustees with funds provided by the employee. The rules of the SIP may require the employee to make payments to the trustees over an accumulation period which cannot last longer than twelve months. Paragraph 52(3) of Schedule 2 to ITEPA provides the number of partnership shares awarded to the employee is calculated at the end of the accumulation period by reference to the lower of:

- the market value of the shares at the beginning of the period; or

- the market value of the shares on the date on which they are to be acquired.

2559. If the market value of the shares at the end of the period is greater than the value at the beginning the company will make up the difference. This clause gives the company a deduction for the excess.

Clause 996: Shares excluded from sections 994 and 995

2560. This clause identifies the shares that do not qualify for relief if they are awarded as free, matching or partnership shares. It is based on paragraphs 4, 6 and 9 of Schedule 4AA to ICTA.

2561. *Exclusion 1* is similar to the exclusion in clause 992(2). It requires the employee to whom the shares are awarded to be within the charge to income tax on any earnings from the employment in respect of which the shares were awarded. Generally, it has the effect of excluding any shares awarded to non-UK resident employees.

2562. *Exclusion 2* is intended to protect the employee by acting as a disincentive to the award of shares that are intended to reduce in value.

2563. *Exclusion 3* applies if the company or an associated company operates another share scheme, including another SIP, and has already had a deduction for the cost of providing the shares for use by that scheme. As shares are not identifiable individually, rules are needed to identify when the shares included in an award were acquired. *Subsection (6)(b)* identifies whether shares included in an award have already had relief under another SIP or share scheme.

Clause 997: No deduction for expenses in providing dividend shares

2564. This clause provides that no deduction is allowed for the cost of providing dividend shares. It is based on paragraph 5 of Schedule 4AA to ICTA.

2565. The expression "dividend shares" is defined in paragraph 62(3)(b) of Schedule 2 to ITEPA. They are shares acquired by the trustees reinvesting cash dividends declared on plan shares the trustees hold on behalf of employees participating in the SIP.

Clause 998: Withdrawal of deductions if approval for share incentive plan withdrawn

2566. This clause withdraws any deduction given under this Chapter if approval for the SIP is withdrawn. It is based on paragraph 11 of Schedule 4AA to ICTA.

2567. Paragraph 83 of Schedule 2 to ITEPA allows an officer of Revenue and Customs to issue a notice to the company withdrawing approval of a SIP. If approval is withdrawn a separate notice must be issued under *subsection (2)* of this clause to recover any relief given under this Chapter.

2568. The relief is withdrawn by treating the company as receiving an amount equal to the amount of the deduction. Clause 986 sets out how this amount is taxed.

2569. This clause contains a change to clarify and make more consistent the way in which withdrawn relief is treated. See *Change 76* in Annex 1 and the commentary on clause 986.

Chapter 2: SAYE option schemes, Company share option schemes and Employee share options trusts

Clause 999: Deduction for costs of setting up SAYE option scheme or CSOP scheme

2570. This clause allows a deduction for the costs of setting up an approved "save as you earn" (SAYE) option scheme or an approved "company share option plan" (CSOP) scheme. It is based on sections 21A, 75 and 84A of ICTA.

2571. A CSOP scheme is commonly known as a company share option plan.

2572. The clause is very similar to clauses 987 and 1000. The deduction is given in calculating the trade or property business profits, *subsection (3)*, or as an expense of managing an investment business, *subsection (4)*. If the business is both an investment business and a property business subsection (4) gives priority to the property business. This order of priority is based on section 75(2) of ICTA which provides that a deduction as an expense of management is not given if the deduction is otherwise allowable.

2573. *Subsection (6)* applies if there is a delay between the company incurring the costs and the scheme being approved. The deduction is given for the period of account in which the scheme is approved. This avoids the company having to amend its company tax return for the period in which the expenditure is incurred or in an extreme case being outside the time limit for amending that return.

2574. Relief for providing the shares under the schemes is given by Part 12, which rewrites Schedule 23 to FA 2003.

2575. A CSOP can be set up by a non-UK resident company which trades in the United Kingdom otherwise than through a permanent establishment. Such a non-UK resident company would be subject to income tax, rather than corporation tax.

Clause 1000: Deduction for costs of setting up employee share ownership trust

2576. This clause gives relief for the costs of setting up a qualifying employee share ownership trust (QUEST). It is based on sections 21A, 75 and 85A of ICTA.

2577. In practice it is unlikely that a QUEST would be set up in an accounting period to which this Bill applies. Section 67 of FA 1989 gave relief for employers' contributions to QUESTs. That relief was withdrawn by section 142 of FA 2003 with effect for contributions made in accounting periods beginning on or after 1 January 2003. Relief for the provision of shares through a QUEST is given now by Schedule 23 to FA 2003, rewritten in Part 12 of this Bill.

2578. The relief given by section 85A of ICTA for the setting up costs was not withdrawn and is still available in the event that a company did set up a new QUEST. The clause is very similar to clause 999.

2579. This Bill does not rewrite section 85 of ICTA (payments to trustees of approved profit sharing schemes). Approved profit sharing schemes were phased out by section 49 of FA 2000, and the deduction in section 85 of ICTA was phased out by section 50 of FA 2000. This Bill accordingly does not rewrite section 85 of ICTA (or section 50 of FA 2000).

Part 12: Other relief for employee share acquisitions

Overview

2580. This Part and Part 11 give specific statutory deductions for various costs associated with setting up and operating employee share schemes. These are arrangements under which employers provide incentives for their employees in the form of shares. This Part is based on Schedule 23 to FA 2003.

2581. The relief given is available to companies carrying on all types of business. There are no requirements as to how the company funds or structures the arrangements. It applies to shares that are newly issued, acquired in the market or acquired by private purchase. It applies to formal plans operated through trusts and to informal arrangements.

2582. Although the Part gives relief to a company, usually the employing company, in calculating its corporation tax profits the availability and the amount of the relief are closely related to the income tax position of the employee. Because of the links to employment income this Part makes frequent reference to provisions in ITEPA.

Chapter 1: Introduction
Clause 1001: Overview of Part
2583. This clause gives an overview of the Part. It is new.

Clause 1002: "Employment"
2584. This clause gives the meaning of "employment" for the purposes of the Part. It is based on paragraph 26 of Schedule 23 to FA 2003.

Clause 1003: "Shares" etc
2585. This clause gives the meaning of "shares" for the purposes of the Part. It is based on paragraphs 10, 17, 22, 22D and 30 of Schedule 23 to FA 2003.

2586. The test in *subsection (2)*, which determines when the shares are acquired, is identical to that in section 477(4) of ITEPA. This correlation is important as that section determines the income tax position of the employee for the purposes of clause 1017.

Clause 1004: Groups, consortiums and commercial associations of companies
2587. This clause gives various definitions that apply when considering employee share acquisitions within a group of companies. It is based on paragraphs 23, 28 and 29 of Schedule 23 to FA 2003.

2588. Any group company that owns shares in the consortium company is treated as a member of the consortium. But a member of a group of companies is not part of the consortium simply because another member of the group holds shares in the consortium company.

Clause 1005: Other definitions
2589. This clause gives various definitions used for the purposes of the Part. It is based on paragraph 30 of Schedule 23 to FA 2003.

2590. "Convertible securities" has the same meaning as that in section 436 of ITEPA.

2591. "Restricted shares" means shares that are restricted securities or a restricted interest in securities for the purposes of Chapter 2 of Part 7 of ITEPA. These terms are defined in section 423 of ITEPA.

Chapter 2: Relief if shares acquired by employee or other person
Overview
2592. This Chapter gives relief for an acquisition of shares. It is based on Part 2 of Schedule 23 to FA 2003. The source legislation describes the process by which the shares are acquired as an award of the shares. For the purposes of Schedule 23 it means any acquisition of shares that does not require the exercise of a right to make the acquisition. Relief for shares acquired through the exercise of an option is given by Part 3 of Schedule 23 to FA 2003, rewritten as Chapter 3 of this Part.

2593. This Chapter refers merely to shares being acquired by the employee or another person. The boundary between this Chapter and Chapter 3 is created by clause 1007(1)(e). This prevents relief being given under both Chapters and gives priority to Chapter 3.

2594. This Chapter applies to the acquisition of all types of shares including restricted shares and convertible shares. This is a different structure from that in the source legislation. In the source legislation the application of Part 2 of Schedule 23 is modified to deal with restricted shares and convertible shares. In this Chapter, and Chapter 3, the conditions to qualify for relief and the amount of the relief are set out in full. Chapters 4 and 5 then give additional relief for future events that affect restricted shares and convertible shares after they have been acquired.

Clause 1006: Overview of Chapter
2595. This clause gives an overview of the Chapter. It is new.

Clause 1007: Basic requirements for relief under Chapter 2
2596. This clause sets out the basic requirements for relief under this Chapter. It is based on paragraphs 1 and 3 of Schedule 23 to FA 2003.

Clause 1008: Conditions relating to shares acquired
2597. This clause identifies the type of shares that have to be acquired. It is based on paragraphs 4 and 6 of Schedule 23 to FA 2003.

Clause 1009: Conditions relating to employee's income tax position
2598. This clause gives the conditions that must be met in relation to the employee's income tax position. It is based on paragraphs 7 and 20 of Schedule 23 to FA 2003.

2599. The "employee" is the person defined in clause 1007(1)(a) as the person in respect of whose employment the shares are acquired.

2600. *Subsection (1)* deals with the acquisition of shares other than restricted shares. So it applies to the acquisition of convertible shares. The acquisition of the shares has to result in an income tax charge on the employee.

2601. Relief is not given if section 446UA of ITEPA applies to the shares. That provision applies to shares acquired for less than their market value under arrangements that seek to avoid the income tax charge or the national insurance contribution on the employment income.

2602. *Subsection (2)* applies if the shares are restricted shares.

2603. Relief will be available in two circumstances.

2604. First, if as a result of the acquisition there is an employment income tax charge on earnings as defined in Chapter 1 of Part 3 of ITEPA. This is a charge on the money's worth of the shares. The test is met at the time of acquisition.

2605. Second, if on acquisition there is no immediate employment income tax charge, but there will be such a charge if there occurs later a chargeable event in respect of the shares. The test is met at the time of acquisition. The company does not have to suspend its claim until that later event actually occurs. It is sufficient that on acquisition the circumstances are such that it appears that the employee will become subject to a charge under section 426 of ITEPA. One reason why there may be no immediate income tax charge is if the shares are forfeitable and the exemption in section 425(2) of ITEPA applies.

2606. The events that trigger a later charge are listed in section 427(3) of ITEPA. They include, for example, a lifting of the restrictions at a time when the recipient of the shares or an associated person still owns the shares. (The definition of associated person for the purposes of section 427 of ITEPA is in section 421C(1) of ITEPA and includes the person who acquired the shares.)

2607. This clause does not rewrite paragraph 20(3) of Schedule 23 to FA 2003. Paragraph 20(3) provides that the test in paragraph 20(2)(a)(ii) of Schedule 23 to FA 2003 is applied on the assumption that section 426 of ITEPA continues to apply after the employee dies. Paragraph 20(2)(a)(ii) of Schedule 23 to FA 2003 is rewritten as subsection (2)(b).

2608. Paragraph 20(3) of Schedule 23 to FA 2003 is not necessary where the employee dies after acquiring shares but before becoming subject to a charge. This is because the test in paragraph 20(2)(a)(ii) of Schedule 23 to FA 2003 is applied to the circumstances existing on acquisition. It does not apply on the subsequent chargeable event (for example, the lifting of the restriction). Since the test has already been met on acquisition, it is not necessary to rely on paragraph 20(3) to provide for the case in which section 426 of ITEPA ceases to apply because of some future event. The fact that the employee dies before the restriction is lifted and the section 426 charge does not materialise is irrelevant for the purposes of the test in paragraph 20(2)(a)(ii).

2609. Paragraph 20(3) of Schedule 23 to FA 2003 cannot be relevant to a company's entitlement to relief under this Part where the employee dies before acquiring shares. If while alive the employee possesses a right to acquire shares then the employee possesses an option and corporation tax relief will be available under Chapter 3 of this

Part. If while alive the employee does not enjoy a right to acquire shares and no shares are acquired by a person before the employee's death, but after the employee's death shares are acquired by a person, then for both practical and technical reasons corporation tax relief under this Part is not available. See also the commentary on clause 1025.

Clause 1010: Calculation of relief if shares are neither restricted nor convertible

2610. This clause gives the amount of the relief if the shares are neither restricted nor convertible. It is based on paragraph 8 of Schedule 23 to FA 2003.

Clause 1011: Calculation of relief if shares are restricted or convertible

2611. This clause gives the amount of relief if the shares are restricted or convertible. It is based on paragraphs 21 and 22C of Schedule 23 to FA 2003.

2612. *Subsections (2)* and *(3)* give the basic rule that the relief is equal to the amount that counts as earnings of the employee from the employment in respect of which the shares were acquired. This is the money's worth charge in Chapter 1 of Part 3 of ITEPA. It will be equal to the market value of the shares.

2613. If the shares are restricted shares the valuation takes account of the restriction unless the employer and employee have made a joint election under section 431 of ITEPA that the shares are valued as if they were not restricted shares (section 431(1)), or as if particular restrictions did not apply (section 431(2)). Either election will give the employee a higher employment income charge on acquisition which is mirrored in greater relief being given to the employer. If an election under section 431(1) is made there will be no later employment income charge if the restrictions are lifted and no additional relief will be available to the employer under Chapter 4 of this Part.

2614. If the shares are convertible shares the basis of valuation in section 437(1) of ITEPA applies. The shares are valued as if they are not convertible. Instead of referring the reader to section 437(1), and rewriting the disapplication of section 437(2) in paragraph 22C(4A) of Schedule 23 to FA 2003, the full out words in subsection (3) state the valuation rule in section 437(1).

2615. There is a difference between subsections (2) and (3) which is not apparent from the text. This is that the calculation under subsection (2) is made by reference to Chapter 2 of Part 7 of ITEPA, while the calculation under subsection (3) is made by reference to Chapter 3 of that Part. In effect, different rules apply to the calculation under these two subsections. It is therefore possible that the calculations under these two subsections will yield different amounts.

2616. *Subsection (5)* rewrites the comparison in paragraphs 21(5) and 22C(5) of Schedule 23 to FA 2003 if the shares are both restricted and convertible. The company may claim relief for the higher figure (as yielded by subsection (2) or (3)) even if the employee has or will be chargeable to tax on a different amount in respect of the shares acquired.

Clause 1012: Reduction in amount of relief

2617. This clause restricts the relief if the shares are given partly for employment in a qualifying business and partly for employment in a business that does not qualify. It is based on paragraphs 8, 21 and 22C of Schedule 23 to FA 2003.

Clause 1013: How the relief is given

2618. This clause explains how the relief is given. It is based on paragraphs 9, 10, 22 and 22D of Schedule 23 to FA 2003.

Chapter 3: Relief if employee or other person obtains option to acquire shares

Overview

2619. The Chapter gives relief for the acquisition of shares "pursuant to an option". It is based on Part 3 of Schedule 23 to FA 2003. "Option" is defined in clause 1005 to include "any right to acquire shares". This definition is based on the definition of "securities option" in section 420(8) of ITEPA. Using a similar definition of "option" relates the relief given to the employing company to the income tax charge on the employee.

2620. The definition is wider than the normal meaning of option as the shares may be acquired without the need to exercise any right. The Chapter follows the source legislation in describing this as the acquisition of shares "pursuant to an option". This is also to align the language in this Chapter with that used in ITEPA. See, for example, section 477(3)(a) of ITEPA.

2621. Like Chapter 2 this Chapter gives relief for the acquisition of all types of share including restricted shares and convertible shares. The Chapter has rules to deal with a change in circumstances between the grant of the option and the acquisition of the shares (for example, the death of the employee or original option holder or a take-over of the employing company).

Clause 1014: Overview of Chapter

2622. This clause gives an overview of the Chapter. It is new.

Clause 1015: Basic requirements for relief under Chapter 3

2623. This clause sets out the basic requirements for relief under this Chapter. It is based on paragraphs 1, 3 and 27 of Schedule 23 to FA 2003.

2624. The requirements are very similar to those which apply to relief under Chapter 2. See clause 1007.

Clause 1016: Conditions relating to shares acquired

2625. This clause identifies the type of shares that have to be acquired. It is based on paragraphs 4 and 12 of Schedule 23 to FA 2003.

Clause 1017: Condition relating to employee's income tax position

2626. This clause gives the conditions that must be met in relation to the employee's income tax position. It is based on paragraphs 14 and 27 of Schedule 23 to FA 2003.

2627. *Subsection (1)* gives the basic rule that the acquisition must be a chargeable event for the purposes of section 476 of ITEPA. Section 476(2) of ITEPA provides that "chargeable event" has the meaning given by section 477 of ITEPA. The list of chargeable events is given in section 477(3) of ITEPA.

2628. The only event relevant to this Chapter is section 477(3)(a) which applies to "the acquisition of securities pursuant to the employment-related securities option by an associated person". (The definition of "associated person" for the purposes of section 477 of ITEPA, in section 472(1) of ITEPA, includes the person who acquired the option.)

2629. The income tax condition is satisfied whether or not an amount counts as employment income as a result of the chargeable event. This covers the case in which the shares are acquired under an approved share option scheme under which there is no charge on the acquisition. For example, section 519 of ITEPA provides that no liability to income tax arises on the exercise of an option under an approved SAYE option scheme.

Clause 1018: Calculation of relief if shares are neither restricted nor convertible

2630. This clause gives the amount of the relief if the shares are neither restricted nor convertible. It is based on paragraph 15 of Schedule 23 to FA 2003.

Clause 1019: Calculation of relief if shares are restricted or convertible

2631. This clause gives the amount of the relief if the shares are restricted or convertible, where they are acquired pursuant to an option. It is based on paragraphs 21 and 22C of Schedule 23 to FA 2003.

2632. *Subsections (2)(a)* and *(3)(a)* give the basic rule. The relief is equal to the amount that counts as employment income under section 476 of ITEPA when the shares are acquired. The chargeable amount is given in section 478 of ITEPA. In broad terms it is the market value of the shares at the time they are acquired (section 479 of ITEPA) less any consideration given for the shares and any expenses incurred on the acquisition (section 480 of ITEPA).

2633. *Subsections (2)(b)* and *(3)(b)* modify the basic rule if the option is a qualifying option under the EMI (Enterprise Management Incentives) code. The effect of that code is ignored in calculating the amount of the relief. The EMI code is defined in section 527(3) of ITEPA. A qualifying option is defined in section 527(4) of ITEPA.

2634. This modification is needed to deal with the interaction between sections 476 and 531 of ITEPA. Section 531 of ITEPA sets out how to calculate the amount that counts as employment income under section 476 of ITEPA if the option allows the shares to be acquired at a discount to their market value at the date the option is granted. The amount that counts as employment income is that market value less any consideration given for the option and any consideration given for the shares. This limits the employment income charge on the employee to the amount of the discount.

2635. Subsections (2)(b) and (3)(b) ensure that the company gets a deduction for the market value of the shares at the date they are acquired under the option less any consideration given for the shares and any expenses incurred on the acquisition.

2636. The full out words at the end of subsection (3) are similar to the full out words at the end of clause 1011(3). If the shares are convertible shares they are valued on the basis that they are not convertible. This is the normal method of valuation that section 437(1) of ITEPA applies to such shares.

2637. There is a difference between subsections (2) and (3) which is not apparent from the text. This is that the calculation under subsection (2) is made by reference to Chapter 2 of Part 7 of ITEPA, while the calculation under subsection (3) is made by reference to Chapter 3 of that Part. In effect, different rules apply to the calculation under these two subsections. It is therefore possible that the calculations under these two subsections will yield different amounts.

2638. *Subsection (4)(a)* states the rule that, in calculating the amount of relief given to the company, no deduction is made for the relief given to the employee by sections 481 and 482 of ITEPA. These sections reduce the employment income charge by the amount of certain national insurance contributions paid by the employee.

2639. *Subsection (5)* rewrites the comparison in paragraphs 21(5) and 22C(5) of Schedule 23 to FA 2003 if the shares are both restricted and convertible. The company may claim relief for the higher figure (as yielded by subsection (2) or (3)) even if the employee has or will be chargeable to tax on a different amount in respect of the shares acquired.

2640. *Subsection (6)* deals with the case in which the employee dies before the shares are acquired so there is no employment income charge on which to calculate the relief. It is based on paragraph 27(1) of Schedule 23 to FA 2003.

2641. Strictly speaking paragraph 27(1) of Schedule 23 to FA 2003 deems the employee to be alive only for the purposes of the income tax condition in paragraph 14 of Schedule 23 to FA 2003. Subsection (6) extends that treatment to the calculation of the relief.

Clause 1020: Reduction in amount of relief

2642. This clause restricts the relief if the shares are given partly for employment in a qualifying business and partly for employment in a business that does not qualify. It is based on paragraphs 15, 21 and 22C of Schedule 23 to FA 2003.

2643. Its effect is identical to clause 1012.

Clause 1021: How the relief is given
2644. This clause explains how the relief is given. It is based on paragraph 16 of Schedule 23 to FA 2003 and is identical to clause 1013.

Clause 1022: Takeover of company whose shares are subject to option
2645. This clause gives relief if the company whose shares are to be acquired is taken over and the original option is exchanged for an option over shares in the new company. It is based on paragraph 13 of Schedule 23 to FA 2003.

Clause 1023: Supplementary provision for purposes of section 1022
2646. This clause gives the definitions needed for the purposes of clause 1022. It is based on paragraph 13 of Schedule 23 to FA 2003.

2647. *Subsection (3)* defines a takeover in terms of one company acquiring control of another. The definition of "control" in section 840 of ICTA applies for this purpose. See clause 1316.

Clause 1024: Transfer of qualifying business by group transfers
2648. This clause gives relief to a new employing company if the business carried on by the original employing company is transferred within a group of companies. It is based on paragraph 23 of Schedule 23 to FA 2003.

2649. The definition of group transfer is in clause 1004(3).

2650. Paragraph 23(1)(a) of Schedule 23 to FA 2003 applies the rule rewritten in this clause to an award of shares. The rule for relief given by Chapter 2 of this Part is not rewritten here as that Chapter gives no scope for a transfer of the business before the shares are acquired.

Chapter 4: Additional relief in cases involving restricted shares
Overview
2651. This Chapter applies if the shares acquired, either directly or pursuant to an option, are restricted shares. It gives the company further relief if an employment income charge arises after the shares have been acquired or if the employee dies. It is based on Part 4 of Schedule 23 to FA 2003.

2652. Schedule 2 (transitionals and savings) provides that the special rules for restricted shares in this Part do not apply to shares acquired before 16 April 2003. If shares acquired before that date are forfeitable shares as defined in paragraph 19 of Schedule 23 to FA 2003 (as originally enacted) that Schedule continues to apply.

Clause 1025: Additional relief available if shares acquired are restricted shares

2653. This clause sets out the basic conditions for the relief to apply and identifies the company to which the relief is given. It is based on paragraph 21 of Schedule 23 to FA 2003.

2654. *Subsection (1)* gives the two basic conditions for the relief to apply.

2655. First, subsection (1)(a), the company must have been entitled to relief under either Chapter 2 or Chapter 3 in relation to restricted shares which have been acquired either directly or through an option. This condition will still be met if the amount of the relief is nil possibly because section 425(1) of ITEPA has applied to an acquisition of forfeitable shares. See the commentary on clause 1009(2).

2656. For a number of years after this Bill takes effect initial relief on the acquisition of the shares will have been given not under Chapters 2 and 3 of this Part but under Schedule 23 to FA 2003. In that case the continuity of law provisions in Schedule 2 (transitionals and savings), apply to treat references to Chapters 2 and 3 as if they were references to the equivalent provisions in the source legislation. Schedule 2 gives a signpost to those provisions and states their effect.

2657. Second, subsection (1)(b), after the shares have been acquired either section 426 of ITEPA applies (so giving the employee an amount of employment income) or the employee dies.

2658. The chargeable events that can give rise to a post-acquisition employment income charge under section 426 of ITEPA are listed in section 427(3) of ITEPA.

2659. The definition of "associated person" in section 421C(1) of ITEPA includes the person who acquired the shares.

2660. There will be no employment income charge if the employee dies before any of the events listed in section 427(3) of ITEPA occurs. Section 421B(4) and (6) of ITEPA provides that Chapter 2 of Part 7 of ITEPA ceases to apply to the securities immediately before the death of the employee.

2661. Subsection (1) treats the death as a chargeable event and gives the relief that would have been given if there had been an actual chargeable event at the date of death. No further relief is available under subsection (1) as the death of the employee prevents any further charge arising under section 426 of ITEPA.

2662. This clause does not give relief if the employee has died before the shares are acquired. First, the deeming provision in paragraph 20(3) of Schedule 23 to FA 2003 (see the commentary on clause 1009) is not expressed to apply to paragraph 21 of Schedule 23. Second, paragraph 21(2)(c) of Schedule 23, when read with paragraph 21(7) of Schedule 23, can work sensibly only if the employee dies after the shares are acquired. Third, the inclusion of paragraph 21(2)(c) of Schedule 23 itself indicates that paragraph 21(2)(b) of Schedule 23 applies only while the employee is alive.

Clause 1026: Relief available on occurrence of chargeable event
2663. This clause gives the relief available if there is a chargeable event as defined in section 427(3) of ITEPA. It is based on paragraphs 21 and 22 of Schedule 23 to FA 2003.

2664. Various reliefs are available in calculating the amount that counts as employment income but these reliefs are not deducted from the relief given to the company (see *subsection (4)*).

Clause 1027: Relief available on death of employee
2665. This clause gives the relief available on the death of the employee. It is based on paragraphs 21 and 22 of Schedule 23 to FA 2003.

2666. The amount of the relief is calculated by deeming the shares to be sold to an unconnected person immediately before the death of the employee (see *subsection (3)*). This deemed sale is a chargeable event within section 427(3) of ITEPA.

Clause 1028: Supplementary provision for purposes of sections 1026 and 1027
2667. This clause explains how relief is given under the Chapter. It is based on paragraphs 9, 16 and 21 of Schedule 23 to FA 2003.

2668. The clause does not repeat the rules but cross-refers to the equivalent provisions in Chapters 2 and 3.

Clause 1029: Transfer of qualifying business by group transfers
2669. This clause gives relief to the successor company if the business carried on by the employing company is transferred before a chargeable event or the death of the employee. It is based on paragraph 23 of Schedule 23 to FA 2003.

2670. The clause is very similar to clause 1024 which gives relief to a successor company if the business is transferred some time between the grant of the option and the acquisition of shares pursuant to the option. Clause 1024 identifies this time-frame as the "option period".

2671. *Subsection (6)* provides that the "interim period" for this clause starts when the shares or option are acquired. If the original relief has been given under Chapter 3 this means the "interim period" will include the period before the shares are acquired. This rule is needed to give relief to the successor company if there is a group transfer before the shares are acquired.

2672. Clause 1024 will give relief under Chapter 3 and clause 1029 will give relief under this Chapter. Clause 1029 would apply also if there was a further transfer after the shares had been acquired but before a chargeable event or the death of the employee.

Chapter 5: Additional relief in cases involving convertible securities
Overview
2673. This Chapter provides relief if the shares acquired, either directly or pursuant to an option, are convertible shares. It gives additional relief if a further employment income charge arises or the employee dies after the shares have been acquired and it also applies if there is an acquisition of convertible securities which are converted into qualifying shares. It is based on Part 4A of Schedule 23 to FA 2003.

Clause 1030: Application of Chapter
2674. This clause gives the conditions for the Chapter to apply. It is based on paragraphs 22B and 22C of Schedule 23 to FA 2003.

2675. As with relief under Chapter 4 the continuity of law provisions will apply if the shares or securities were acquired when Schedule 23 to FA 2003 was still in force. See the commentary on clause 1025.

2676. *Subsection (5)* applies if the original recipient of an option dies and as a result the shares or securities are acquired by a different person. Relief under Chapter 3 on the acquisition of the shares is given by clause 1015(3) which treats the shares as acquired by the original recipient of the option. Subsection (5) does the same for relief under this Chapter.

2677. *Subsection (6)* applies if there has been a takeover of the company whose shares were to be acquired and the options have been exchanged for options in a new company. Clause 1022 gives relief under Chapter 3. Subsection (6) does the same for relief under this Chapter.

Clause 1031: Additional relief available if shares acquired are convertible shares etc
2678. This clause governs the events upon which and the timing on which relief is available. It is based on paragraphs 22C and 22D of Schedule 23 to FA 2003.

2679. *Subsection (2)* applies if the employee has died and there is a chargeable event that would have given rise to an employment income charge if the employee had been alive. Paragraph 22C(2)(c) of Schedule 23 to FA 2003 refers to relief being available on the death of the employee. In fact the availability of the relief is not triggered by the death of the employee but by the occurrence of a later chargeable event after the death. This sequence is reflected in *subsection (3)*.

Clause 1032: Meaning of "chargeable event"
2680. This clause gives the meaning of "chargeable event". It is based on paragraph 22C of Schedule 23 to FA 2003.

Clause 1033: Relief available on occurrence of chargeable event
2681. This clause identifies the amount and timing of relief available on a chargeable event. It is based on paragraphs 22C and 22D of Schedule 23 to FA 2003.

Clause 1034: Relief available following death of employee
2682. This clause identifies the amount of the relief available if the employee dies. It is based on paragraphs 22C and 22D of Schedule 23 to FA 2003.

2683. *Subsections (3)* and *(4*) provide relief which is similar to that given by clause 1027 for restricted shares in that it is the amount that would count as employment income if the employee were still alive. But, under *subsection (2)*, unlike clause 1027, relief is given for the accounting period in which the event occurs, not the period in which the employee dies.

Clause 1035: Supplementary provision for purposes of sections 1033 and 1034
2684. This clause explains how relief is given under the Chapter. It is based on paragraphs 9, 16 and 22C of Schedule 23 to FA 2003.

2685. The clause does not repeat the rules but cross-refers to the equivalent provisions in Chapters 2 and 3.

Clause 1036: Transfer of qualifying business by group transfers
2686. This clause gives relief to the successor company if the business carried on by the employing company is transferred before a chargeable event or the death of the employee. It is based on paragraph 23 of Schedule 23 to FA 2003.

2687. The clause performs the same function for convertible shares that clause 1029 performs for restricted shares.

Chapter 6 Relationship between relief under this Part and other reliefs
Clause 1037: Priority of Chapter 1 of Part 11
2688. This clause gives priority to any deduction available under Chapter 1 of Part 11 of this Bill. It is based on paragraph 24 to Schedule 23 to FA 2003.

2689. Chapter 1 of Part 11 of this Bill gives relief for SIP schemes.

Clause 1038: Exclusion of other deductions
2690. This clause provides that no other deduction is available for the provision of shares if relief is, or could be, given under this Part. It is based on paragraph 25 of Schedule 23 to FA 2003.

Part 13: Additional relief for expenditure on research and development

Overview

2691. This Part gives additional relief for expenditure by a company on research and development including research and development into certain vaccines. It is based on Schedule 20 to FA 2000 and Schedules 12 and 13 to FA 2002.

2692. The relief is given in addition to any deduction allowed in calculating the company's trade profits. For example, clause 87 in Part 3 (trading income) provides a deduction for expenditure on research and development.

2693. References to research and development are abbreviated to R&D when used in a longer phrase or a long clause title. See, for example, "R&D threshold" in clause 1050.

2694. In this Part, the rates at which the various reliefs are stated to be available apply only if the expenditure was incurred on or after 1 August 2008. Schedule 2 (transitionals and savings) preserves this commencement rule by providing that, in relation to expenditure incurred before that date, the reliefs are available at the rates previously applicable.

Chapter 1: Introduction

Clause 1039: Overview of Part

2695. This clause gives an overview of the Part. It is new.

2696. The source legislation refers to "tax relief" given to companies in calculating their trade profits. *Subsection (1)* makes clear that the relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1. This change affects the following clauses in this Part: clauses 1044, 1045, 1063, 1068, 1074, 1087 and 1092.

2697. The reference to Part 9A of Schedule 18 to FA 1998 in *subsection (10)* is to that Part as amended by this Bill (see Schedule 1). As this Bill brings all the additional reliefs for research and development together, it repeals Parts 9BA and 9C of Schedule 18 to FA 1998.

2698. Chapters 2 to 4 and 7 of this Part provide for relief in the case of companies which are small or medium-sized enterprises as defined for the purposes of European Union rules on state aid. Clause 1120 modifies the basic definition of "small or medium-sized enterprise" in clause 1119 by increasing the limits above which a company ceases to be a small or medium-sized enterprise. Schedule 2 (transitionals and savings) contains provision excluding that modified definition in relation to expenditure incurred before 1 August 2008.

Clause 1040: Relief may be available under more than one Chapter of Part
2699. This clause confirms that "double relief" may be available in certain circumstances. It is based on paragraphs 7 and 10A of Schedule 12 to FA 2002 and paragraph 1 of Schedule 13 to FA 2002.

Clause 1041: "Research and development"
2700. This clause applies the definition of "research and development" in section 837A of ICTA to this Part. It is based on paragraph 25 of Schedule 20 to FA 2000, paragraph 19 of Schedule 12 and paragraph 27 of Schedule 13 to FA 2002.

2701. This phrase is used because it has a specific meaning in guidelines published by the Department for Business, Enterprise and Regulatory Reform (formerly, the Department of Trade and Industry). Details can be found on the website www.businesslink.gov.uk.

Clause 1042: "Relevant research and development"
2702. This clause defines "relevant research and development". It is based on paragraph 4 of Schedule 20 to FA 2000, paragraph 17 of Schedule 12 and paragraph 5 of Schedule 13 to FA 2002.

2703. "Relevant research and development" is a key concept. All of the reliefs given in this Part include a condition that the expenditure is incurred on relevant research and development in relation to the company.

Chapter 2: Relief for SMEs: cost of R&D incurred by SME
Overview
2704. This Chapter sets out some rules that apply to a "small or medium sized enterprise" ("SME"). An SME is defined in clause 1119.

Clause 1043: Overview of Chapter
2705. This clause summarises the contents of this Chapter. It is new.

2706. This Chapter rewrites the reliefs given by Schedule 20 to FA 2000 if a small or medium-sized enterprise incurs expenditure on in-house direct research and development or research and development that is sub-contracted out by it.

Clause 1044: Additional deduction in calculating profits of trade
2707. This clause allows the company to claim the relief, gives the conditions that have to be met and the amount of the relief. It is based on paragraphs 1 and 13 of Schedule 20 to FA 2000.

2708. Relief under this Chapter is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (5)* and *(7)*). The amount of the deduction is increased by 75% (see *subsection (8)*).

2709. The relief has to be claimed (see *subsection (6)*). The procedure for making the claim is in Part 9A of Schedule 18 to FA 1998.

2710. This clause makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on clause 1039 (overview of Part).

Clause 1045: Alternative treatment for pre-trading expenditure: deemed trading loss

2711. This clause allows a small or medium-sized enterprise to claim immediate relief for qualifying research and development expenditure incurred in a pre-trading period. It is based on paragraphs 1 and 14 of Schedule 20 to FA 2000.

2712. The usual treatment of expenditure incurred before a company starts trading is given by clause 61 in Part 3 (trading income). Expenditure incurred up to seven years before the day the company starts to trade is treated as incurred on that day if it would have been deductible had the company been trading when the expenditure was incurred.

2713. This clause allows the company to elect for pre-trading expenditure to create a deemed trade loss for the accounting period in which it was actually incurred. Subject to the restrictions in clauses 1048 and 1049 the loss can be used in the same way as other trade losses. It can be set off against other profits under section 393A of ICTA or surrendered as group relief. Any part of the loss not used is carried forward. See the commentary on clause 1048.

2714. If the company is entitled to relief because it has made an election under this clause, *subsection (8)* provides that the expenditure is not allowed again under the ordinary rules in clause 61 for dealing with pre-trading expenditure.

2715. The company has to meet the other qualifying conditions for the relief. In particular the pre-trading expenditure must exceed the threshold for relief (see *subsection (3)*) See the commentary on clause 1050(5)(b) for more details on the treatment of pre-trading expenditure for the purposes of the threshold test.

2716. This clause makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on clause 1039 (overview of Part).

Clause 1046: Relief only available where company is going concern

2717. This clause sets out a precondition for relief under clauses 1044 and 1045. It is based on paragraph 18A of Schedule 20 to FA 2000.

Clause 1047: Elections under section 1045

2718. This clause sets out the procedure for making an election under clause 1045. It is based on paragraph 14 of Schedule 20 to FA 2000.

Clause 1048: Treatment of deemed trading loss under section 1045

2719. This clause imposes a restriction on the use of a deemed trade loss and explains how any unused loss is to be dealt with. It is based on paragraph 23 of Schedule 20 to FA 2000.

2720. It is not a condition of clause 1045 that the pre-trading research and development leads to the establishment of a trade. But if it does any of the loss created by the clause 1045 election that is unused when the trade starts is treated as a trade loss brought forward (see *subsections (3)* and *(4)*).

Clause 1049: Restriction on consortium relief

2721. This clause prevents a loss created by relief given under this Chapter being surrendered as consortium relief unless the claimant company is also a small or medium-sized enterprise. It is based on paragraph 22 of Schedule 20 to FA 2000.

Clause 1050: R&D threshold

2722. This clause gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 20 to FA 2000.

2723. *Subsection (2)* reduces this limit proportionately if the accounting period is less than 12 months. The source legislation does not explicitly state how the reduction is done. Subsection (2) eliminates uncertainty by prescribing the arithmetic formula to be used where an accounting period is less than 12 months. The formula adopted has been widely used in the rewrite Acts. It incorporates a denominator of 365 days, regardless of the length of the calendar year. In this case, it makes a small change adverse to the taxpayer. See *Change 78* in Annex 1. This Change also affects clauses 1064, 1075, 1097 (see paragraphs 2766, 2803 and 2848).

2724. S*ubsection (5)(b)* deals with pre-trading expenditure by deeming the company to be carrying on a trade for the purpose of deciding whether the expenditure would be deductible. In the absence of any special tax rule to the contrary pre-trading expenditure is allocated to periods of account in accordance with generally accepted accounting practice.

2725. Subsection (5)(b) is needed for the purposes of clause 1045. That clause allows a company to elect to create a trade loss out of its pre-trading expenditure on qualifying research and development. Clause 1045(3) requires the company to meet the threshold test in the period covered by the election.

2726. Clause 1137 may also be relevant in this regard. It applies to a company that incurs qualifying Chapter 2 or 7 expenditure at a time when it does not have an accounting period. In practice this must be pre-trading expenditure. The clause deems the company to have the accounting periods it would have had if it had been trading when it incurred the expenditure.

2727. *Subsections (7)* and *(8)* deal with expenditure that qualifies under Chapters 3 and 4 of this Part. The basic rule applies. The expenditure must be deductible in calculating the trade profits for the accounting period. In this case the ordinary operation of clause 61 is not suspended.

2728. There is no requirement in this clause that the expenditure is incurred in the same trade or pre-trading activity. So qualifying expenditure on one trade can be used to meet the threshold required to make a claim under clause 1045 in respect of pre-trading expenditure on a separate activity.

2729. There have been a number of changes to the threshold since the relief was introduced by Schedule 20 to FA 2000. Most of these are not relevant to the accounting periods affected by this Bill. But Schedule 2 (transitionals and savings), provides that expenditure incurred before 1 April 2002 is ignored for the purposes of subsection (3)(b) and (c), and that clause 61 (which provides for up to 7 years' worth of pre-trading expenses to be treated as incurred on the start date of the trade) is ignored in applying this rule.

2730. In relation to qualifying Chapter 3 expenditure the transitional rule preserves the effect of paragraph 2(2) of Schedule 15 to FA 2002. That provision extended the threshold test to include expenditure that qualifies under Part 2 of Schedule 12 to FA 2002, rewritten in Chapter 3 of this Part.

2731. Paragraph 2(2) of Schedule 15 to FA 2002 provides that the extension does not apply to expenditure incurred before 1 April 2002 and that for this purpose no account is taken of section 401 of ICTA.

2732. In relation to qualifying Chapter 4 expenditure the transitional preserves the effect of paragraph 3(2) of Schedule 31 to FA 2003. That provision extended the threshold test to include qualifying additional SME expenditure as defined in paragraph 10B of Schedule 12 to FA 2002, rewritten in this Part in Chapter 4.

2733. Paragraph 10B(a) of Schedule 12 to FA 2002 provides that:

> "qualifying additional expenditure" is any expenditure which had the SME been a large company throughout the accounting period in question, would have been qualifying R&D expenditure of that company

2734. This brings into play the commencement provision in paragraph 20(1) of Schedule 12 to FA 2002, which provides that Schedule 12 does not apply to expenditure incurred before 1 April 2002 and that "for this purpose no account shall be taken of section 401 of ICTA".

2735. There are very limited circumstances in which the transitional will apply. This Bill will have effect for accounting periods ending after 31 March 2009. The earliest date on which an accounting period covered by the Bill could start is 2 April 2008.

For the transitional rule to apply the expenditure would have to be incurred in the period between 2 April 2001 and 31 March 2002.

Clause 1051: Qualifying Chapter 2 expenditure

2736. This clause identifies the expenditure that qualifies for relief under this Chapter. It is new.

Clause 1052: Qualifying expenditure on in-house direct R&D

2737. The clause defines "qualifying expenditure on in-house direct research and development". It is based on paragraph 3 of Schedule 20 to FA 2000.

2738. The broad aim of Schedule 20 to FA 2000 is to give relief to the company that incurs the expenditure on the research and development. Paragraph 3(3) of Schedule 20 to FA 2000 describes that as research and development directly undertaken "by the company" or "on its behalf". A common set of conditions is used to decide whether expenditure on either type of research and development qualifies for relief.

2739. This Bill uses the labels "in-house direct research and development" and "contracted out research and development" to describe the two types of research and development. It also rewrites the conditions that apply to each type of research and development separately. In part this is because the two types of activity are quite distinct and in part because the rules on sub-contractor payments apply only to contracted out research and development.

2740. The term "in-house direct research and development" is merely a label. It is not a condition of the relief that the research and development is incurred "in-house". The condition that the research and development is directly undertaken by the company is rewritten in s*ubsection (3).* This requires that the research and development is undertaken "by the company itself".

2741. The expression "in-house direct research and development" is used because it has a specific meaning in the Department for Business, Enterprise and Regulatory Reform guidelines on the meaning of research and development for tax purposes. See paragraph 2701. But the definition of what constitutes "direct research and development" in paragraph 3 of Schedule 12 and paragraph 3 of Schedule 13 to FA 2002 is identical in all material aspects to that in paragraph 3 of Schedule 20 to FA 2000. So referring to "in-house *direct* research and development" in this clause does not introduce a new condition into the rewrite of paragraph 3 of Schedule 20.

2742. The clause does not reproduce the condition in paragraph 3(2) of Schedule 20 to FA 2000 that the expenditure is not of a capital nature. This condition is unnecessary because clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Clause 1053: Qualifying expenditure on contracted out R&D

2743. This clause defines what is meant by "qualifying expenditure on contracted out research and development". It is based on paragraph 3 of Schedule 20 to FA 2000.

2744. The clause does not reproduce the condition in paragraph 3(2) of Schedule 20 to FA 2000 that the expenditure is not of a capital nature. This condition is unnecessary because clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Clause 1054: Entitlement to and payment of tax credit

2745. This clause allows a small or medium-sized enterprise to claim an R&D tax credit. It is based on paragraphs 15 and 18 of Schedule 20 to FA 2000.

2746. Clauses 1054 to 1062 rewrite the paragraphs of Schedule 20 to FA 2000 that allow a small or medium-sized enterprise to surrender a loss, created as a result of the relief, in return for a cash payment described as an "R&D tax credit".

2747. The clause clarifies that a company may make part claims (*subsection (2)*).

2748. This Bill does not rewrite paragraph 24 of Schedule 20 to FA 2000. This provision is no longer required, since the rule allowing the Commissioners for HMRC to deduct money for tax credits before paying their receipts into the Consolidated Fund is set out in sufficiently general terms in section 44 of CRCA (see subsections (1) and (3)(d) of that section). It is worth noting that paragraph 25 of Schedule 13 to FA 2002, which made similar provision to that made by paragraph 24 of Schedule 20 to FA 2000, was repealed by paragraph 96 of Schedule 4 to CRCA.

Clause 1055: Meaning of "Chapter 2 surrenderable loss"

2749. This clause defines "Chapter 2 surrenderable loss". It is based on paragraph 15 of Schedule 20 to FA 2000.

Clause 1056: Amount of trading loss which is "unrelieved"

2750. This clause identifies the amount of a trading loss that is "unrelieved" It is based on paragraph 15 of Schedule 20 to FA 2000.

Clause 1057: Tax credit only available where company is going concern

2751. This clause sets out a precondition for relief under clause 1054. It is based on paragraph 18A of Schedule 20 to FA 2000.

Clause 1058: Amount of tax credit

2752. This clause gives the amount of the R&D tax credit. It is based on paragraph 16 of Schedule 20 to FA 2000.

Clause 1059: Total amount of company's PAYE and NIC liabilities

2753. This clause explains how to calculate the total amount of a company's PAYE and NIC liabilities. It is based on paragraph 17 of Schedule 20 to FA 2000.

2754. In *subsection (4)*, amount B includes both primary and secondary Class 1 NIC liabilities. But amount B does not include Class 1 contributions where under paragraph 3B of Schedule 1 to the Social Security Contributions and Benefits Act 1992, the company and the employee have jointly elected to transfer liability to the employee.

2755. "National insurance contributions" is defined in clause 1319. This definition is based on paragraph 25 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

Clause 1060: Payment of tax credit

2756. This clause explains the circumstances in which the payment of an R&D tax credit can be withheld or set against arrears of corporation tax. It is based on paragraph 18 of Schedule 20 to FA 2000.

2757. In *subsection (7)(a)*, the words "PAYE regulations" are to be interpreted in accordance with section 684(8) of ITEPA.

Clause 1061: Tax credit payment not income of company

2758. This clause makes clear that a payment of an R&D tax credit is not income of the company for tax purposes. It is based on paragraph 20 of Schedule 20 to FA 2000.

Clause 1062: Restriction on losses carried forward where tax credit claimed

2759. This clause provides that any losses that are surrendered in return for an R&D tax credit are not available for carry forward. It is based on paragraph 19 of Schedule 20 to FA 2000.

Chapter 3: Relief for SMEs: R&D sub-contracted to SME

Overview

2760. This Chapter allows a company which is a small or medium-sized enterprise to claim relief for research and development sub-contracted to it. It is based on Part 2 of Schedule 12 to FA 2002.

2761. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Bill, is relevant only to pre-trading expenditure).

Clause 1063: Additional deduction in calculating profits of trade

2762. This clause allows a small or medium-sized enterprise to claim relief for expenditure on research and development contracted out to it. It is based on paragraph 11 of Schedule 12 to FA 2002.

2763. As with relief under Chapter 2, relief under this Chapter is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (4)* and *(6)*). The amount of the deduction is increased by 30% (see *subsection (7)*).

2764. This clause makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on clause 1039 (overview of Part).

Clause 1064: R&D threshold

2765. This clause gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 7 of Schedule 12 to FA 2002.

2766. The rules are very similar to those in clause 1050. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in clause 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

2767. A significant difference to clause 1050 is the treatment of pre-trading expenditure.

2768. Under *subsection (5)*, unlike clause 1050, the normal rules in clause 61 for dealing with pre-trading expenditure are not suspended. Pre-trading expenditure is bunched into the accounting period in which the trade starts and counts towards the threshold for that period. This includes expenditure that qualifies under Chapter 2 of this Part. For the purposes of claiming relief under Chapter 2 itself clause 61 is suspended (see clause 1050(6)).

Clause 1065: Qualifying Chapter 3 expenditure

2769. This clause identifies the expenditure that qualifies for relief under this Chapter. It is based on paragraph 8 of Schedule 12 to FA 2002.

2770. Relief is given to companies that undertake the research and development themselves (clause 1066), and to companies that commission the research and development from certain other persons (clause 1067). This clause prevents more than one company claiming the relief and the relief leaking out into the income tax sector.

2771. If a large company commissions the research and development that company will not be able to claim relief under Chapter 5 of this Part. This is because that Chapter requires the company to carry out the research and development itself. If the research and development is contracted out to a small or medium-sized enterprise the effect of s*ubsection (2)* is to allow that small or medium-sized enterprise company to claim relief under this Chapter.

2772. If the research and development is contracted out by another small or medium-sized enterprise that company will be able to claim relief itself under Chapter 2. Subsection (2) prevents relief being given to the sub-contractor company under this Chapter.

2773. The relief given by this Part is restricted to corporation tax payers. Subsection (2) prevents a sub-contractor company getting relief if the work has been contracted out by a person, other than a large company, who could get a deduction for the payment in calculating its trade profits. This prevents the sub-contractor passing on some of the benefit of the relief to an income tax payer by charging lower prices.

Clause 1066: Expenditure on sub-contracted R&D undertaken in-house
2774. This clause identifies the expenditure which qualifies for relief if the company undertakes the research and development itself. It is based on paragraph 9 of Schedule 12 to FA 2002.

2775. As in clause 1052, this clause uses the label "in-house" to describe research and development that the source legislation describes as being "directly undertaken" by the company.

2776. The clause does not reproduce the condition in paragraph 9(4) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This condition is unnecessary because clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Clause 1067: Expenditure on sub-contracted R&D not undertaken in-house
2777. This clause identifies the expenditure which qualifies for relief if the company commissions another person to do the research and development. It is based on paragraph 10 to Schedule 12 to FA 2002.

2778. The clause does not reproduce the condition in paragraph 10(4) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This condition is unnecessary because clause 53 in Part 3, the trading income Part, already prohibits a deduction for capital expenditure.

Chapter 4: Relief for SMEs: subsidised and capped expenditure on R&D
Overview
2779. This Chapter allows small or medium-sized enterprises to claim relief for expenditure on research and development that is subsidised on the same basis as provided for large companies (see Chapter 5 of this Part). It is based on Part 2A of Schedule 12 to FA 2002.

2780. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Bill, is relevant only to pre-trading expenditure).

Clause 1068: Additional deduction in calculating profits of trade
2781. This clause allows a small or medium-sized enterprise to claim relief for expenditure on research and development that is subsidised. It is based on paragraph 11 of Schedule 12 to FA 2002.

2782. As with relief under Chapters 2 and 3, relief under Chapter 4 is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (4)* and *(7)*). The amount of the deduction is increased by 30% (see *subsection (8)*).

2783. This clause makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on clause 1039 (overview of Part).

Clause 1069: R&D threshold
2784. This clause gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 10A of Schedule 12 to FA 2002.

Clause 1070: Qualifying Chapter 4 expenditure
2785. This clause identifies the two categories of expenditure that qualify for relief under this Chapter. It is based on paragraph 10B of Schedule 12 to FA 2002.

2786. This Bill takes a different approach to identifying the qualifying conditions from that taken in the source legislation. Paragraph 10B of Schedule 12 to FA 2002 defines what it calls "qualifying additional SME expenditure" by providing first that the expenditure would qualify for relief under Part 1 of Schedule 12 to FA 2002. It then superimposes the qualifying conditions in Schedule 20 to FA 2000. But it removes the condition that the expenditure must not be subsidised.

2787. In this Chapter the qualifying conditions are set out in full to avoid the reader having to make these modifications.

Clause 1071: Subsidised qualifying expenditure on in-house direct R&D
2788. This clause defines what is meant by "subsidised qualifying expenditure on in-house direct research and development". It is based on paragraph 10B of Schedule 12 to FA 2002.

2789. The clause does not rewrite the condition in paragraph 10B(c) of Schedule 12 to FA 2002 that the expenditure "is not qualifying sub-contracted R&D expenditure for the purposes of this Schedule". It is unnecessary.

2790. To qualify under Part 2A of Schedule 12 to FA 2002 the expenditure must qualify for relief under Schedule 20 to FA 2000 but for the fact it is subsidised. Expenditure would not qualify under Schedule 20 to FA 2000 if it were paid in respect of activities sub-contracted to the company. Condition E in *subsection (6)*, which reproduces condition D in clause 1052, is all that is required.

2791. This clause does not reproduce the condition that the expenditure must not be capital in nature. This condition is unnecessary because clause 53 in Part 3, the trading income Part, already prohibits a deduction for capital expenditure.

Clause 1072: Subsidised qualifying expenditure on contracted out R&D
2792. This clause defines what is meant by "subsidised qualifying expenditure on contracted out research and development". It is based on paragraph 10B of Schedule 12 to FA 2002.

2793. The clause does not allow a small or medium-sized enterprise to claim relief for a subsidised contribution to independent research and development. A large company can claim relief for such expenditure (see clause 1079). But a small or medium-sized enterprise cannot and therefore the condition in paragraph 10B(b) of Schedule 12 to FA 2002 would not be satisfied.

2794. This clause does not reproduce the condition that the expenditure must not be capital in nature. This condition is unnecessary because clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Clause 1073: Capped R&D expenditure
2795. This clause defines what is meant by "capped R&D expenditure". It is based on paragraph 10C of Schedule 12 to FA 2002.

Chapter 5: Relief for large companies
Overview
2796. This Chapter gives relief for expenditure on direct research and development undertaken by a large company itself and for research and development that is contracted out to it. It is based on Part 1 of Schedule 12 to FA 2002.

2797. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Bill, is relevant only to pre-trading expenditure).

2798. A "large company" is any company which is not a small or medium-sized enterprise (see clause 1122).

Clause 1074: Additional deduction in calculating profits of trade
2799. This clause allows a large company to claim an additional deduction for qualifying expenditure on research and development. It is based on paragraph 11 of Schedule 12 to FA 2002.

2800. As with the reliefs given to small or medium-sized enterprises, relief under Chapter 5 is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsection (6)*). The amount of the deduction is increased by 30% (see *subsection (7)*).

2801. This clause makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on clause 1039 (overview of Part).

Clause 1075: R&D threshold

2802. This clause gives the minimum amount of expenditure that a company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 12 to FA 2002.

2803. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in clause 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

2804. The normal operation of clause 61 is not suspended. So pre-trading expenditure that is bunched into the accounting period in which the trade starts counts towards the threshold (see *subsection (4)*).

Clause 1076: Qualifying Chapter 5 expenditure

2805. This clause identifies the three categories of expenditure that qualify for relief under this Chapter. It is based on paragraph 3 of Schedule 12 to FA 2002.

Clause 1077: Qualifying expenditure on in-house direct R&D

2806. This clause defines “qualifying expenditure on in-house direct research and development”. It is based on paragraph 4 of Schedule 12 to FA 2002.

2807. “In-house direct research and development” is the term this Bill uses to describe research and development that is undertaken directly by the company.

2808. The clause does not reproduce the condition in paragraph 4(5) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

2809. Condition C in *subsection (4)* identifies the expenditure that qualifies if the research and development is contracted out to the company. It prevents more than one company claiming the relief and the benefit of the relief leaking into the income tax sector.

2810. If a large company commissions the research and development the company will not be able to claim relief under this Chapter. This is because that Chapter requires the company to carry out the research and development itself. So subsection (4) allows a large company to which the research and development is sub-contracted to claim the relief.

2811. If the research and development is contracted out by a small or medium-sized enterprise that company will be able to claim relief itself under Chapter 2 of this Part. The effect of subsection (4) is to prevent relief also being given to the sub-contractor large company.

2812. The relief given by this Part is restricted to corporation tax payers. Subsection (4) prevents a sub-contractor company getting relief if the work has been contracted out by a person, other than a large company, who could get a deduction for the payment in calculating its trade profits. This prevents the sub-contractor passing on some of the benefit of the relief to an income tax payer by charging lower prices.

Clause 1078: Qualifying expenditure on contracted out R&D
2813. This clause defines "qualifying expenditure on contracted out research and development". It is based on paragraph 5 of Schedule 12 to FA 2002.

2814. The clause does not reproduce the condition in paragraph 5(5) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Clause 1079: Qualifying expenditure on contributions to independent R&D
2815. This clause defines "qualifying expenditure on contributions to independent research and development". It is based on paragraph 6 of Schedule 12 to FA 2002.

2816. The main purpose of this clause is to support research and development carried out by universities and other non-taxpaying research institutions.

Clause 1080: Entitlement to relief: I minus E basis
2817. This clause describes the way a claim for R&D relief is given effect in the case of a company carrying on life assurance business. It is based on paragraph 13 of Schedule 12 to FA 2002.

Chapter 6: Chapters 2 to 5: further provision
Clause 1081: Insurance companies treated as large companies
2818. This clause provides that a company which carries on life assurance business in an accounting period and which qualifies as a small or medium-sized enterprise (see clause 1119) is to be treated as a large company (see clause 1122) for the purposes of Chapters 2 to 5. It is based on paragraph 12 of Schedule 12 to FA 2002.

Clause 1082: R&D expenditure of group companies

2819. This clause deals with the case where the research and development in a group of companies is undertaken by particular members of the group on behalf of other group companies. It is based on paragraph 14 of Schedule 12 to FA 2002.

2820. *Subsection (3)* extends the scope of the provisions to cover work contracted out to third parties.

Clause 1083: Refunds of expenditure treated as income chargeable to tax

2821. This clause applies the charge to tax under Chapter 2 of Part 3 if the company gets a refund of expenditure for which it has received certain of the reliefs given by this Part. It is based on paragraph 15 of Schedule 12 to FA 2002.

Clause 1084: Artificially inflated claims for relief or tax credit

2822. This clause denies relief for transactions that are intended to increase artificially the amount of relief or R&D tax credit. It is based on paragraph 21 of Schedule 20 to FA 2000 and paragraph 16 of Schedule 12 to FA 2002.

Chapter 7: Relief for SMEs and large companies: vaccine research etc

Overview

2823. This Chapter provides relief for research into certain vaccines and medicines. It is based on Schedule 13 to FA 2002.

2824. The Chapter applies only to expenditure incurred on or after 22 April 2003. See paragraph 28(1) of Schedule 13 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Bill, is relevant only to pre-trading expenditure).

Clause 1085: Overview of Chapter

2825. This clause describes the contents of the Chapter. It is new.

Clause 1086: Meaning of "qualifying R&D activity"

2826. This clause defines "qualifying R&D activity" for the purposes of the relief available for vaccine research. It is based on paragraph 4 of Schedule 13 to FA 2002.

2827. The relief is intended to encourage research into vaccines that protect against diseases that are particularly prevalent in the developing world. This is reflected in the scope of *subsections (1)* and *(2)*. A clade is a type of genetic grouping. Subsection (2) limits relief to research into the varieties of HIV that are most common in the developing world.

Clause 1087: Deduction in calculating profits of trade

2828. This clause allows the company to claim relief as a trade deduction for qualifying expenditure on vaccine research. It is based on paragraphs 14 and 21 of Schedule 13 to FA 2002.

2829. The clause combines the qualifying conditions that apply to small or medium-sized enterprises in paragraph 14 and to large companies in paragraph 21 of Schedule 13 to FA 2002. The amount of the relief is then given separately for each type of company in the following clauses. Also, clause 1092 allows a small or medium-sized enterprise to elect to create a trade loss in respect of pre-trading expenditure.

2830. This clause makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on clause 1039 (overview of Part).

Clause 1088: Large companies: declaration about effect of relief
2831. This clause requires that a claim for relief under clause 1087 be accompanied by a declaration. It is based on paragraph 21 of Schedule 13 to FA 2002.

Clause 1089: SMEs: amount of deduction
2832. This clause gives the amount of the deduction if a small or medium-sized enterprise claims relief as a trade deduction. It is based on paragraph 14 of Schedule 13 to FA 2002.

2833. The normal operation of clause 61 in Part 3 is suspended when allocating qualifying expenditure to an accounting period (see clause 1099(2)). Pre-trading expenditure is allocated to periods of account in accordance with generally accepted accounting practice and is not treated as incurred when the company starts to trade.

2834. The company may be carrying on one trade and incur pre-trading expenditure in respect of another activity. *Subsections (5)* and *(6)* make clear that relief can be claimed on the pre-trading activity and given as a deduction in calculating the profits of the existing trade. This follows from paragraph 14(1)(b) of Schedule 13 to FA 2002, which requires only that the company be carrying on *a* trade. There is no requirement that the relief is given in calculating the profits of *the* trade for which the relief is given.

Clause 1090: Modification of section 1089 for larger SMEs
2835. This clause modifies clause 1089. It is based on paragraphs 13, 14 and 15A of Schedule 13.

2836. The purpose of this modification is to keep the deduction in clause 1089 within the European Union limit on state aid. “Larger SME” is defined in clause 1121. Schedule 2 (transitionals and savings) disapplies the “larger SME” category of company in relation to expenditure incurred before 1 August 2008. This preserves the commencement rule in section 50(7) of FA 2007.

Clause 1091: Large companies: amount of deduction
2837. This clause gives the amount of the deduction if a large company claims relief as a trade deduction. It is based on paragraph 21 of Schedule 13 to FA 2002.

Clause 1092: SMEs: deemed trading loss for pre-trading expenditure

2838. This clause allows a small or medium-sized enterprise to claim immediate relief for qualifying expenditure incurred in a pre-trading period. It is based on paragraph 15 of Schedule 13 to FA 2002.

2839. The clause is very similar to clause 1045. A small or medium-sized enterprise can elect to create a trading loss in respect of pre-trading expenditure that qualifies for relief under this Chapter.

2840. Clause 1099(1)(b) has an important role to play in the operation of this clause. It determines how pre-trading expenditure is allocated to accounting periods. This determines whether the threshold test in *subsection (3)* is met and the amount on which relief is given.

2841. This clause makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on clause 1039 (overview of Part).

Clause 1093: Modification of section 1092 for larger SMEs

2842. This clause modifies clause 1092. It is based on paragraphs 13, 14 and 15A of Schedule 13. The purpose of this modification is to keep the deduction in clause 1092 within the European Union limit on state aid. “Larger SME” is defined in clause 1121.

Clause 1094: Relief only available to SME where company is going concern

2843. This clause sets out a precondition for relief under clauses 1087 and 1092. It is based on paragraph 18A of Schedule 13 to FA 2002.

Clause 1095: Elections under section 1092

2844. This clause gives the procedure for making an election under clause 1092. It is based on paragraph 15 of Schedule 13 to FA 2002.

Clause 1096: Treatment of deemed trading loss under section 1092

2845. This clause imposes a restriction on the use of the trade loss and explains how any unused loss is to be dealt with. It is based on paragraph 15 of Schedule 13 to FA 2002.

2846. The clause is identical in effect to clause 1048.

Clause 1097: R&D threshold

2847. This clause gives the minimum amount of expenditure that a company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 13 to FA 2002.

2848. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in clause 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

Clause 1098: Meaning of "qualifying Chapter 7 expenditure"

2849. This clause identifies the three categories of expenditure which qualify for relief. It is based on paragraph 2 of Schedule 13 to FA 2002.

Clause 1099: SMEs: qualifying expenditure "for" an accounting period

2850. This clause explains how qualifying expenditure is allocated to the accounting periods of a small or medium-sized enterprise. It is based on paragraph 2 of Schedule 13 to FA 2002.

2851. *Subsection (2)* suspends the normal operation of clause 61 in Part 3 for pre-trading expenditure. Pre-trading expenditure is not treated as incurred on the first day of trading. Instead s*ubsection (1)(b)* treats the expenditure as incurred for an accounting period if it would have been deductible in calculating the trade profits for that period if the company had been trading.

2852. Relief is available for pre-trading expenditure not just under clause 1092 but also under the main rule in clause 1089 if it can be deducted in calculating the profits of a trade.

Clause 1100: Large companies: qualifying expenditure "for" an accounting period

2853. This clause explains how qualifying expenditure is allocated to the accounting periods of a large company. It is based on paragraph 2 of Schedule 13 to FA 2002.

2854. *Subsection (1)* deals with in-house direct research and development and contracted out research and development. Expenditure is incurred for an accounting period if it is deductible in calculating the trade profits for that period. Unlike small or medium-sized enterprises the normal rules for pre-trading expenditure in clause 61 in Part 3 apply (see *subsection (2)*). Any pre-trading expenditure will be treated as incurred the day the company starts trading.

Clause 1101: Qualifying expenditure on in-house direct R&D

2855. This clause defines "qualifying expenditure on in-house direct research and development". It is based on paragraph 3 of Schedule 13 to FA 2002.

2856. "In-house direct research and development" is the term this Bill uses to describe research and development that is undertaken directly by the company.

2857. *Subsections (2)* and *(3)* rewrite sub-paragraphs (2) and (3) of paragraph 3 of Schedule 13 to FA 2002 which refer to the expenditure being *on* qualifying R&D activity. This clause refers to the expenditure being *attributable* to qualifying R&D activity in order to align the language with that in Chapters 2 to 5 of this Part.

2858. Paragraph 3(3) of Schedule 20 to FA 2000 and paragraphs 4(4) and 9(3) of Schedule 12 to FA 2002 all require that the qualifying expenditure is attributable to relevant research and development. The provisions that define particular classes of expenditure have rules for determining if the expenditure is attributable to relevant research and development.

2859. Paragraph 3(3) of Schedule 13 to FA 2002 requires that the "qualifying R&D activity on which the expenditure is incurred is relevant research and development in relation to the company". This test is the same as requiring the expenditure to be attributable to relevant research and development and the clause adopts the language of the earlier Chapters.

2860. The clause does not reproduce the condition in paragraph 3(4) of Schedule 13 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Clause 1102: Qualifying expenditure on contracted out R&D

2861. This clause defines "qualifying expenditure on contracted out research and development". It is based on paragraphs 6 and 7 of Schedule 13 to FA 2002.

2862. The clause covers payments to a sub-contractor. The conditions in the clause have to be satisfied but it also necessary to isolate the sub-contractor element of the payment. This is described in clauses 1134 to 1136.

2863. *Subsections (3)* and *(4)* also refer to the expenditure being attributable to qualifying R&D activity. See the commentary on clause 1101.

2864. The clause does not reproduce the condition in paragraph 7(5) of Schedule 13 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as clause 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

Clause 1103: Entitlement to and payment of tax credit

2865. This clause allows a small or medium-sized enterprise to claim an R&D tax credit. It is based on paragraphs 16 and 18 of Schedule 13 to FA 2002.

2866. The clause clarifies that a company may make part claims (*subsection (2)*).

Clause 1104: Meaning of "Chapter 7 surrenderable loss"

2867. This clause defines "Chapter 7 surrenderable loss". It is based on paragraph 16 of Schedule 13 to FA 2002.

2868. The clause follows the same pattern as clause 1055 (meaning of "Chapter 2 surrenderable loss") but the restriction in *subsection (2)* if the claim is made by a trading company is slightly different.

2869. Clause 1055(2)(b) gives relief both for the additional deduction and for the underlying expenditure. Subsection (2) denies relief for the underlying expenditure. This is because if the company has had relief under Chapter 2 it will already have had relief for the underlying expenditure in making an R&D tax credit claim under clause 1055.

Clause 1105: Amount of trading loss which is "unrelieved"
2870. This clause lists the other ways in which a company may get relief for the loss. It is based on paragraph 16 of Schedule 13.

Clause 1106: Tax credit only available where company is going concern
2871. This clause sets out a precondition for relief under clause 1103. It is based on paragraph 18A of Schedule 13 to FA 2002.

Clause 1107: Amount of tax credit
2872. This clause gives the amount of the R&D tax credit. It is based on paragraph 17 of Schedule 13 to FA 2002.

Clause 1108: Total amount of company's PAYE and NIC liabilities
2873. This clause explains how to calculate the total amount of a company's PAYE and NIC liabilities. It is based on paragraph 17 of Schedule 13 to FA 2002.

Clause 1109: Payment of tax credit
2874. This clause explains the circumstances in which the payment of an R&D tax credit can be withheld or set against arrears of corporation tax. It is based on paragraph 18 of Schedule 13 to FA 2002.

Clause 1110: Tax credit payment not income of company
2875. This clause makes clear that a payment of an R&D tax credit is not income of the company for tax purposes. It is based on paragraph 20 of Schedule 13 to FA 2002.

Clause 1111: Restriction on losses carried forward where tax credit claimed
2876. This clause provides that any losses that are surrendered in return for an R&D tax credit are not available for carry forward. It is based on paragraph 19 of Schedule 13 to FA 2002.

Clause 1112: Artificially inflated claims for relief or tax credit
2877. This clause denies relief for transactions that are intended to increase artificially the amount of relief or R&D tax credit. It is based on paragraph 24 of Schedule 13 to FA 2002.

Chapter 8: Cap on aid for R&D
Overview
2878. This Chapter sets out the rules for calculating the cap on R&D aid for the purposes of Chapters 2 and 7. It sets out the formula for the calculation of the cap, and brings together the definitions of terms that constitute that formula.

2879. Schedule 2 (transitionals and savings) preserves the transitional provision in paragraph 7 of Schedule 10 to FA 2008. This provides that no account is to be taken, for the purpose of calculating "total R&D aid" in accordance with clause 1089, of any relief or tax credit under Chapter 2 or 7 of Part 13 in respect of expenditure incurred before 1 August 2008.

Clause 1113: Cap on R&D aid under Chapter 2 or 7

2880. This clause imposes a cap on the total amount of R&D aid which may be claimed in respect of a project. It is based on section 29 of, and paragraph 6 of Schedule 10 to, FA 2008.

Clause 1114: Total R&D aid

2881. This clause sets out the rules for calculating the cap on R&D aid for a project. It is based on paragraph 1 of Schedule 10 to FA 2008.

Clause 1115: "The tax credits"

2882. This clause defines "the tax credits" for the purposes of the formula prescribed in clause 1114. It is based on paragraph 2 of Schedule 10 to FA 2008.

Clause 1116: "The actual reduction in tax liability"

2883. This clause defines "the actual reduction in tax liability" for the purposes of the formula prescribed in clause 1114. It is based on paragraph 3 of Schedule 10 to FA 2008.

Clause 1117: "The potential relief"

2884. This clause defines "the potential relief" for the purposes of the formula prescribed in clause 1114. It is based on paragraph 4 of Schedule 10 to FA 2008.

Clause 1118: "The notional relief"

2885. This clause defines "the notional relief" for the purposes of the formula prescribed in clause 1114. It is based on paragraph 5 of Schedule 10 to FA 2008.

Chapter 9: Supplementary

Overview

2886. This Chapter brings together the definitions of terms that apply to each of the earlier Chapters. Most of these definitions are given in Schedule 20 to FA 2000 but they are applied to Schedules 12 and 13 to FA 2002 by the respective paragraphs 17 and 5 of those Schedules. In such cases the commentary refers only to the Schedule 20 provision on which the definition is based.

Clause 1119: "Small or medium-sized enterprise"

2887. This clause defines "small or medium-sized enterprise". It is based on paragraph 2 of Schedule 20 to FA 2000, paragraph 2 of Schedule 12 and paragraph 5 of Schedule 13 to FA 2002.

Clause 1120: Qualifications to section 1119

2888. This clause makes two qualifications to the European Union definition of small or medium-sized enterprise. It is based on paragraph 2 of Schedule 20 to FA 2000, paragraph 2 of Schedule 12 to FA 2002 and 5 of Schedule 13 to FA 2002.

2889. The European Union definition is in the Annex to Commission Recommendation 2003/361/EC of 6 May 2003, as incorporated by reference in clause 1119(1). Article 3 of the Annex requires a company to include figures from a partner or linked enterprise in determining whether it breaches the qualifying thresholds (aggregation). This is called "aggregation".

2890. Article 4(2) of the Annex gives the company a period of grace if the inclusion of those figures means it ceases to be a small or medium-sized enterprise. The company will cease to be a small or medium-sized enterprise within the European Union definition only if the limits are exceeded in two consecutive accounting periods.

2891. The purpose of Qualification 2 in this clause is to remove that period of grace for the purposes of this Part, so that the company ceases to be a small or medium-sized enterprise in the second accounting period. The effect of Qualification 2 in this clause is to disapply Article 4(2) of the Annex so that Article 2 of the Annex applies instead. Article 2 of the Annex provides: "In respect of any year, you must use the year end accounts for that year to classify the company, according to these criteria."

Clause 1121: "Larger SME"

2892. This clause defines "larger SME". It provides a convenient label for companies falling within Qualification 1 of clause 1120. It is based on paragraphs 15A and 16A of Schedule 13 to FA 2002.

Clause 1122: "Large company"

2893. This clause defines "large company". It is based on paragraph 2 of Schedule 12 to FA 2002.

Clause 1123: "Staffing costs"

2894. This clause defines "staffing costs". It is based on paragraph 5 of Schedule 20 to FA 2000.

2895. Paragraph 5(1)(a) of Schedule 20 to FA 2000 refers to "emoluments paid by the company … including all salaries, wages, perquisites and profits whatsoever other than benefits in kind". This is based on the definition of emoluments that section 131 of ICTA applied for Schedule E before that Schedule was rewritten by ITEPA.

2896. None of the definitions of "earnings" in ITEPA is appropriate, because none matches the scope of the definition in paragraph 5(1)(a) of Schedule 20 to FA 2000.

2897. In rewriting Schedule 20 to FA 2000 the language has been modernised and the definition has been adapted so that it applies more clearly from the position of the company making the payment, rather than the employee receiving it. This is achieved by referring to money earnings and reimbursed expenses. When interpreting these definitions, it should be borne in mind that this Part does not create a new class of deduction. It merely enhances an existing staffing costs deduction, the scope of which is determined on ordinary principles. Before an expense can be considered for the purposes of this Part, it must first be deductible on ordinary principles. See for example clause 1050(5).

2898. *Subsection (2)* rewrites the reference to salaries and wages by reference to money earnings. "Earnings" takes its ordinary meaning. The statutory definitions of "earnings" in ITEPA are not relevant to the scope of "earnings" in this subsection. See *Change 79* in Annex 1.

2899. *Subsection (3)* rewrites the reference to perquisites or profits whatsoever by reference to reimbursed expenses but making clear that it does not include benefits in kind. See *Change 79* in Annex 1.

2900. In subsections (2) and (3), the phrase "because of employment" is used instead of the ITEPA phrase "by reason of employment". The effect is that interpretations developed in relation to ITEPA, which might not be appropriate to this clause, cannot simply be read across into this clause.

2901. ITEPA amended paragraph 5 of Schedule 20 to FA 2000 so that it referred to earnings which constitute employment income. In doing so it inadvertently expanded the definition to include benefits in kind. This change was reversed by paragraph 7 of Schedule 17 to FA 2004, which reinstated the original wording. Schedule 2 (transitionals and savings) preserves the wider definition inserted by ITEPA for the brief window in which it applies to accounting periods covered by this Bill. It is relevant only to expenditure incurred before 1 April 2004.

Clause 1124: Staffing costs: attributable expenditure

2902. This clause identifies when staffing costs are attributable to relevant research and development. It is based on paragraph 5 of Schedule 20 to FA 2000.

2903. In *subsection (4)* and in clauses 1126(4) and 1132(4) the phrase "appropriate proportion" is used, while in clauses 1129(7), 1134(6) and 1138(4) the concept of a just and reasonable apportionment is used. The two phrases have different meanings and are used in different circumstances. "Appropriate proportion" is used where the quantities or qualities to be determined are objectively measurable. "Just and reasonable" is used where the quantities to be determined are not objectively measurable and the apportionment exercise requires a measure of subjectivity.

2904. When the legislation was introduced the test was that 80% of the director or employee's working time had to be spent on relevant research and development.

Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Bill applies. It is relevant only to expenditure incurred before 9 April 2003 (Chapters 3 and 5) and 27 September 2003 (Chapters 2 and 7).

Clause 1125: "Software or consumable items"
2905. This clause defines "software or consumable items". It is based on paragraph 6 of Schedule 20 to FA 2000.

2906. When the legislation was introduced relief under all the Chapters in this Part was given for expenditure on "consumable stores". Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Bill applies. It is relevant only to expenditure incurred before 1 April 2004.

Clause 1126: Software or consumable items: attributable expenditure
2907. This clause identifies when expenditure on software or consumable items is attributable to relevant research and development. It is based on paragraph 6 of Schedule 20 to FA 2000.

Clause 1127: "Qualifying expenditure on externally provided workers"
2908. This clause defines "qualifying expenditure on externally provided workers". It is based on paragraph 8A of Schedule 20 to FA 2000.

2909. This clause is the first of six clauses that deal with the relief given in relation to expenditure on externally provided workers. Clauses 1129 to 1131 explain how to calculate this amount. These clauses focus on the subject matter of the expenditure. Clause 1132 then identifies whether that expenditure is incurred on relevant research and development.

2910. The relief applies only to expenditure incurred on or after 9 April 2003 (Chapters 3 and 5) or 27 September 2003 (Chapters 2, 4 and 7). Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Bill applies.

Clause 1128: "Externally provided worker"
2911. This clause defines "externally provided worker". It is based on paragraph 8B of Schedule 20 to FA 2000.

Clause 1129: Qualifying expenditure on externally provided workers: connected persons
2912. This clause gives the amount of the qualifying expenditure if the company and the staff provider are connected. It is based on paragraph 8C of Schedule 20 to FA 2000.

2913. The definition of connected persons in section 839 of ICTA (applied by clause 1316(1)) applies.

2914. *Subsection (3)* defines “relevant expenditure”. It provides for the exclusion for expenditure of a capital nature that is omitted in the rewrite of other provisions of the source legislation for this Part. Clause 53 in Part 3 (trading income), which denies a deduction for capital expenditure, applies to determine if the expenditure would be deductible in calculating the trading profits. It would not apply to exclude capital expenditure from the staff provider’s actual relevant expenditure.

2915. The definition of “agency workers’ remuneration” in *subsection (6)* omits the reference to section 134 of ICTA in paragraph 8C(4)(b) of Schedule 20 to FA 2000. The ICTA provision was repealed by ITEPA and the cross-reference is no longer required.

Clause 1130: Election for connected persons treatment

2916. This clause allows a company and a staff provider who are not connected to elect for connected persons treatment. It is based on paragraph 8D of Schedule 20 to FA 2000.

2917. The word “other” in *subsection (2)* does not appear in paragraph 8D(2) of Schedule 20 to FA 2000 (the source for this subsection). It does appear in a similar context in paragraph 11(2) of Schedule 20 (the source for clause 1131(2)). The inclusion of the word in subsection (2) of this clause promotes consistency without changing the meaning of the law.

Clause 1131: Qualifying expenditure on externally provided workers: other cases

2918. This clause identifies the amount of the qualifying expenditure if the company and staff provider are not connected and have not made an election under clause 1130. It is based on paragraph 8E of Schedule 20 to FA 2000.

Clause 1132: External workers: attributable expenditure

2919. This clause identifies when qualifying expenditure on externally provided workers is attributable to relevant R&D. It is based on paragraph 8A of Schedule 20 to FA 2000.

2920. The clause follows the pattern of clause 1124 which performs a similar function for staffing costs.

Clause 1133: “Sub-contractor” and “sub-contractor payment”

2921. This clause defines “sub-contractor” and “sub-contractor payment”. It is based on paragraph 9 of Schedule 20 to FA 2000 and paragraph 6 of Schedule 13 to FA 2002.

2922. This clause is the first of a group of clauses that apply to sub-contractor payments. The clauses are very similar to those that apply to qualifying expenditure on externally provided workers.

Clause 1134: Qualifying element of sub-contractor payment: connected persons

2923. This clause identifies the qualifying element of a sub-contractor payment if the company and the sub-contractor are connected persons. It is based on paragraph 10 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 8 of Schedule 13 to FA 2002.

2924. The definition of connected persons in section 839 of ICTA (applied by clause 1316(1)) applies.

2925. *Subsection (3)* defines "relevant expenditure". It provides for the exclusion for expenditure of a capital nature that is omitted in the rewrite of other provisions of the source legislation for this Part. See the commentary on clause 1129(3) for an explanation of this.

Clause 1135: Election for connected persons treatment

2926. This clause allows a company and a sub-contractor which are not connected to elect to be treated as if they were connected. It is based on paragraph 11 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 10 of Schedule 13 to FA 2002.

2927. Subsection (4) provides for a time limit in which the election must be made. This time limit does not apply in certain circumstances in the case of companies affected by the repeal of paragraph 6(3) of Schedule 13 to FA 2002 (100% relief where the subcontractor is a charity etc). Schedule 2 (transitionals and savings) provides that where the notice is given before 31 July 2009, the time limit does not apply.

Clause 1136: Qualifying element of sub-contractor payment: other cases

2928. This clause identifies the qualifying element of a sub-contractor payment if the company and the sub-contractor are not connected persons. It is based on paragraph 12 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 11 of Schedule 13 to FA 2002.

Clause 1137: Accounting periods: company not within charge to corporation tax

2929. This clause treats a company as having an accounting period if it incurs qualifying Chapter 2 or 7 expenditure at a time when it is not within the charge to corporation tax. It is based on paragraph 25 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

2930. An accounting period is the basis for the determination of tax liability. If a company does not have an accounting period, or is not deemed to have one, then that company will not be able to perform the calculations which are necessary for it to take advantage of the provisions in clauses 1045 and 1092. Those clauses allow a company to elect to create a loss in respect of pre-trading expenditure. A company that is not yet trading may not have an accounting period. Clauses 1045 and 1092 operate by reference to accounting periods. This clause treats the company as having the accounting periods it would have had if it had been trading when it incurred the expenditure.

Clause 1138: "Subsidised expenditure"
2931. This clause defines "subsidised expenditure". It is based on paragraph 8 of Schedule 20 to FA 2000.

Clause 1139: "Intellectual property"
2932. This clause defines "intellectual property". It is based on paragraph 7 of Schedule 20 to FA 2000.

Clause 1140: "Relevant payments to the subjects of a clinical trial"
2933. This clause defines "relevant payments to the subjects of a clinical trial". It is based on paragraph 6A of Schedule 20 to FA 2000.

2934. Schedule 2 (transitionals and savings) excludes the application of this Part in relation to this category of expenditure if the expenditure was incurred before 1 August 2008 (for the purposes of Chapters 2, 3 and 7) or 1 April 2006 (for the purposes of Chapters 4 and 5). This preserves the commencement set out in section 28 of FA 2006.

Clause 1141: "Payment period"
2935. This clause defines "payment period". It is based on paragraph 17 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

Clause 1142: "Qualifying body"
2936. This clause defines "qualifying body". It is based on paragraph 18 of Schedule 12 to FA 2002.

Part 14: Remediation of contaminated land
Overview
2937. This Part allows a company to claim relief for qualifying expenditure it incurs on the remediation of contaminated land. It is based on Schedule 22 to FA 2001.

2938. Relief under the Part is given as a deduction in calculating the company's trade profits or the profits of a UK property business carried on by the company.

Chapter 1: Introduction
Clause 1143: Overview of Part
2939. This clause gives an overview of the Part. It is new.

Clause 1144: "Qualifying land remediation expenditure"

2940. This clause sets out the conditions that expenditure on land remediation must satisfy to qualify for relief under this Part. It is based on paragraph 2 of Schedule 22 to FA 2001.

Clause 1145: Land "in a contaminated state"

2941. This clause sets out when land is "in a contaminated state" for the purposes of this Part. It is based on paragraph 3 of Schedule 22 to FA 2001.

Clause 1146: "Relevant land remediation"

2942. This clause identifies the activities that make up "relevant land remediation". It is based on paragraph 4 of Schedule 22 to FA 2001.

2943. "Relevant land remediation" can either be the remediation activity itself or activities in preparation for the remediation activity, see *subsection (1)*. "Relevant preparatory activity" comes within the definition of "relevant land remediation" only if it leads to remediation activity being carried out, see *subsection (4)(b)*.

Chapter 2: Reliefs for expenditure on contaminated land

Clause 1147: Deduction for capital expenditure

2944. This clause gives the company a deduction for capital expenditure included in qualifying land remediation expenditure subject to certain conditions. It is based on paragraph 1 of Schedule 22 to FA 2001.

2945. The company must elect to make the deduction. The procedure for making the election is in clause 1148.

2946. Capital expenditure is not defined. It is expenditure for which a deduction would normally be denied by clause 53. But this clause permits a deduction for capital expenditure in calculating the profits of a trade or UK property business of a company in spite of the rule in clause 53.

2947. The existence of clause 53 means it is not necessary to rewrite paragraph 1(4)(a) of Schedule 22 to FA 2001. That provision denies relief for expenditure that has already been allowed as a deduction in calculating the profits of a trade or of a UK property business carried on by the company. It is not needed if there is already a specific rule preventing a deduction for such expenditure.

2948. *Subsection (7)* is a similar provision to clause 61. It treats capital expenditure incurred on contaminated land that will be used for the purposes of a trade or UK property business as incurred on the day the trade or business starts. Unlike clause 61 there is no time limit on how far in advance of the trade or business starting the expenditure must be incurred.

Clause 1148: Election under section 1147

2949. This clause sets out the requirements for making an election. It is based on paragraph 1 of Schedule 22 to FA 2001.

Clause 1149: Additional deduction for qualifying land remediation expenditure

2950. This clause entitles a company to make a claim increasing the deduction given in calculating its trade or UK property business profits if certain conditions are met. It is based on paragraphs 12 and 13 of Schedule 22 to FA 2001.

2951. *Subsection (1)* is a further example of *Change 77* in Annex 1 where it is made clear that the additional relief applies only for corporation tax.

2952. This clause applies to expenditure that is allowed as a deduction in computing taxable profits either as a normal revenue deduction or through the operation of clause 1147. The relief increases the amount of the deduction by 50%.

2953. The additional deduction has to be claimed. There is no special procedure for making the claim. The ordinary rules in Part 7 of Schedule 18 to FA 1998 apply.

Clause 1150: No relief if company responsible for contamination

2954. This clause denies relief if the company or a person connected with it was responsible for any part of the contamination. It is based on paragraphs 1 and 12 of Schedule 22 to FA 2001.

Chapter 3: Land remediation tax credit

Clause 1151: Entitlement to and payment of tax credit

2955. This clause allows a company to claim a land remediation tax credit if it has a "qualifying land remediation loss". It is based on paragraphs 14 and 16 of Schedule 22 to FA 2001.

2956. The clause clarifies that a company may make part claims (*subsection (2)*). This is in line with current HMRC policy and is supported by paragraph 17(5)(b) of Schedule 22 to FA 2001.

Clause 1152: Meaning of "qualifying land remediation loss"

2957. This clause defines "qualifying land remediation loss". It is based on paragraph 14 of Schedule 22 to FA 2001.

2958. *Subsection (2)* limits the amount of the qualifying land remediation loss to the lesser of two amounts.

Clause 1153: Amount of a loss which is "unrelieved"

2959. This clause explains what is meant by the amount of a UK property business loss or trading loss that is "unrelieved". It is based on paragraph 14 of Schedule 22 to FA 2001.

Clause 1154: Amount of tax credit

2960. This clause gives the amount of the cash payment the company will receive. It is based on paragraph 15 of Schedule 22 to FA 2001.

Clause 1155: Payment of tax credit

2961. This clause gives a number of administrative rules that affect the payment of a land remediation tax credit. It is based on paragraph 16 of Schedule 22 to FA 2001.

Clause 1156: Tax credit payment not income of company

2962. This clause states that the payment of a land remediation tax credit is not income of the company for any tax purposes. It is based on paragraph 18 of Schedule 22 to FA 2001.

Clause 1157: Exclusion for capital gains purposes of certain expenditure

2963. This clause prevents any expenditure for which a land remediation tax credit has been claimed from also being deducted in the calculation of any chargeable gain on the disposal of the land. It is based on paragraph 19 of Schedule 22 to FA 2001.

2964. Section 39 of TCGA prevents expenditure that is allowable as a deduction in calculating income tax profits from being deducted again in the calculation of the chargeable gain. Section 8(3) and (4) of TCGA applies this principle to the calculation of a company’s income and chargeable gains.

2965. The ordinary operation of section 39 of TCGA will prevent a double deduction for expenditure which attracts relief under clauses 1147 and 1149. Amounts allowed under those clauses will be deducted in calculating the company’s profits charged to corporation tax. But it is arguable that a loss surrendered in return for the payment of a land remediation tax credit falls outside this rule as the loss is not used in the ordinary calculation of the company’s profits.

2966. This clause makes clear that expenditure that contributed to the surrendered qualifying land remediation loss is not deductible in calculating the chargeable gain or allowable loss on the disposal of the land. It is not necessary to apply the rule to the 50% additional deduction itself as it is a notional figure and not an amount of actual expenditure.

Clause 1158: Restriction on losses carried forward where tax credit claimed

2967. This clause ensures that the amount of any qualifying land remediation loss surrendered in return for the payment of a land remediation tax credit is not available for carry forward for set-off against future profits. It is based on paragraph 17 of Schedule 22 to FA 2001.

Chapter 4: Special provision for life assurance business

Clause 1159: Limitation on relief under Chapter 2

2968. This clause provides that the deductions allowed in Chapter 2 do not apply to the calculation of the profits of a company’s life assurance business where the calculation is made in accordance with the provisions of Part 3 (trading income). It is based on paragraph 20 of Schedule 22 to FA 2001.

Clause 1160: Provision in respect of I minus E basis

2969. This clause provides that the provisions of this Chapter apply where the profits of an insurance company are charged to tax under the I minus E basis in respect of its life assurance business. It is based on paragraph 21 to Schedule 22 to FA 2001.

Clause 1161: Relief in respect of I minus E basis: enhanced expenses payable

2970. This clause sets out the three conditions that companies with life assurance business must satisfy in order to claim relief for expenditure on the remediation of contaminated land. It also sets out the relief that is available (*subsection (6)*). It is based on paragraphs 22 and 23 of Schedule 22 to FA 2001.

2971. The relief takes the form of an enhancement in the expenses payable which the company may bring into account at Step 1 of section 76(7) of ICTA.

Clause 1162: Meaning of “qualifying Chapter 4 expenditure”

2972. This clause defines a company’s “qualifying Chapter 4 expenditure” as the amount of its qualifying land remediation expenditure reduced by any amount not attributable to basic life assurance and general annuity business (BLAGAB). It is based on paragraph 22 of Schedule 22 to FA 2001.

2973. Qualifying Chapter 4 expenditure may include expenditure of a capital nature.

Clause 1163: No relief if company responsible for contamination

2974. This clause denies relief if the company or a person connected with it was responsible for any part of the contamination. It is the life assurance company equivalent of clause 1150. It is based on paragraph 22 of Schedule 22 to FA 2001.

Clause 1164: Entitlement to tax credit

2975. This clause allows a company to claim a life assurance company tax credit if it has a “qualifying life assurance business loss”. It is the life assurance company equivalent of clause 1151 and is based on paragraph 24 of Schedule 22 to FA 2001.

Clause 1165: Meaning of “qualifying life assurance business loss”

2976. This clause defines “qualifying life assurance business loss”. It is the life assurance company equivalent of clause 1152. It is based on paragraph 24 of Schedule 22 to FA 2001.

Clause 1166: Amount of tax credit

2977. This clause gives the amount of the cash payment the company carrying on life assurance business will receive. It is the life assurance company equivalent of clause 1154 and is based on paragraph 25 of Schedule 22 to FA 2001.

Clause 1167: Payment of tax credit etc

2978. This clause applies various provisions contained in Chapter 3 (namely clauses 1151(4), 1155, 1156 and 1157) with appropriate modifications for companies carrying on life assurance business. Those provisions include provision relating to the payment of a life assurance company tax credit. It is based on paragraphs 26 and 28 of Schedule 22 to FA 2001.

Clause 1168: Restriction on carrying forward expenses payable where tax credit claimed

2979. This clause ensures that the amount of any qualifying life assurance business loss that is surrendered in return for the payment of a life assurance company tax credit is not available for carry forward. It is the life assurance company equivalent of clause 1158. It is based on paragraph 27 of Schedule 22 to FA 2001.

Chapter 5: Tax avoidance

Clause 1169: Artificially inflated claims for relief or tax credit

2980. This clause restricts the amount of relief or tax credit available under the Part if there are arrangements that artificially increase the amount of that relief or tax credit. It is based on paragraph 29 of Schedule 22 to FA 2001.

Chapter 6: Supplementary

Clause 1170: "Staffing costs"

2981. This clause gives the meaning of staffing costs. It is based on paragraph 5 of Schedule 22 to FA 2001. That paragraph uses the term "employee costs", but in rewriting the source legislation it was felt that the term "staffing costs", which is the term used for the equivalent purpose in Part 13 of the Bill, was more appropriate.

2982. Paragraph 5(1)(a) of Schedule 22 to FA 2001 refers to "emoluments paid by the company … including all salaries, wages, perquisites and profits whatsoever other than benefits in kind". This is based on the definition of emoluments that section 131 of ICTA applied for Schedule E before that Schedule was rewritten by ITEPA.

2983. ITEPA amended paragraph 5 of Schedule 20 to FA 2000 so that it referred to earnings which constitute employment income. In doing so it inadvertently expanded the definition to include benefits in kind. This change was reversed by paragraph 7 of Schedule 17 to FA 2004, which reinstated the original wording.

2984. In rewriting Schedule 22 to FA 2001 it was decided that the language and format of the definition should be adapted so that the definition applies more clearly from the position of the company making the payment rather than the employee receiving it. Hence the reference to money earnings and reimbursed expenses.

2985. *Subsection (2)* rewrites the reference to salaries and wages by reference to money earnings. *Subsection (3)* rewrites the reference to perquisites and profits by reference to reimbursed expenses. See *Change 79* in Annex 1.

2986. Paragraph 5(1)(c) of Schedule 22 to FA 2001 refers to "contributions paid by the company to any pension fund (within the meaning of section 231A(4) of [ICTA])". Section 231A of ICTA was repealed by F(No 2)A 1997 with effect for distributions made on or after 6 April 1999. But a consequential amendment was not made to paragraph 5 of Schedule 22 so as to set out in full the definition of "pension fund".

2987. The parallel definition in paragraph 5(1)(c) of Schedule 20 to FA 2000 also used to refer to section 231A(4) of ICTA. It was amended by paragraph 3 of Schedule 15 to FA 2002. The wording of the definition is the same but it is now free-standing. *Subsection (6)* provides a freestanding definition of "pension fund" that reflects the definition used in paragraph 5(1A) of Schedule 20 to FA 2000.

Clause 1171: Staffing costs attributable to relevant land remediation
2988. This clause identifies when staffing costs are attributable to relevant land remediation. It is based on paragraph 5 of Schedule 22 to FA 2001.

Clause 1172: Expenditure on materials
2989. This clause outlines whether expenditure on materials is attributable to land remediation. It is based on paragraph 6 of Schedule 22 to FA 2001.

Clause 1173: Expenditure incurred because of contamination
2990. This clause identifies two specific circumstances in which condition B in clause 1144 – the condition that expenditure on contaminated land would not have been incurred if the land had not been in a contaminated state - is treated as met. It is based on paragraph 7 of Schedule 22 to FA 2001.

Clause 1174: Sub-contractor payments
2991. This clause defines "sub-contractor payment" and is the first of three clauses that deal with such payments. It is based on paragraph 9 of Schedule 22 to FA 2001.

Clause 1175: "Qualifying expenditure on sub-contracted land remediation": connected persons
2992. This clause identifies the amount of qualifying expenditure on sub-contracted land remediation if the parties are connected. It is based on paragraph 10 of Schedule 22 to FA 2001.

Clause 1176: "Qualifying expenditure on sub-contracted land remediation": other cases
2993. This clause identifies the amount of qualifying expenditure on sub-contracted land remediation if the parties are not connected. It is based on paragraph 11 of Schedule 22 to FA 2001.

Clause 1177: "Subsidised expenditure"
2994. This clause defines "subsidised expenditure". It is based on paragraph 8 of Schedule 22 to FA 2001.

Clause 1178: Persons having a "relevant connection" to a company

2995. This clause sets out when a person has a "relevant connection" to a company for the purposes of the Part. It is based on paragraph 31 of Schedule 22 to FA 2001.

Clause 1179: Other definitions

2996. This clause provides definitions and is based on paragraph 31 of Schedule 22 to FA 2001.

2997. "National insurance contributions" is defined in clause 1319.

2998. This Bill does not rewrite paragraph 30 of Schedule 22 to FA 2001. This provision is no longer required, since the rule allowing the Commissioners for HMRC to deduct money for tax credits before paying their receipts into the Consolidated Fund is set out in sufficiently general terms in section 44 of CRCA (see subsections (1) and (3)(d) of that section). Paragraph 26 of Schedule 13 to FA 2002, which made similar provision to that made by paragraph 30 of Schedule 22 to FA 2001, was repealed by paragraph 96 of Schedule 4 to CRCA.

Part 15: Film production

Overview

2999. This Part treats certain film production and exploitation activity by certain companies as separate film trades for corporation tax. It is based on Chapter 3 of Part 3 of, and Schedules 4 and 5 to, FA 2006 (films and sound recordings).

3000. In relation to some separate film trades, this Part also provides for:

- additional trading deductions; and
- payments for the surrender of losses.

3001. This Part deals solely with film production companies. Provisions about the corporation tax treatment of sound recordings are dealt with in Chapter 9 of Part 3 (trade profits: other specific trades).

Chapter 1: Introduction

Clause 1180: Overview of Part

3002. This clause gives an overview of the Part. It is new.

Clause 1181: "Film" etc

3003. This clause provides for the meaning of "film" in this Part, when a series of films is treated as a single film and when a film is completed. It is based on section 31 of FA 2006.

3004. The definitions are the same as those in paragraph 1 of Schedule 1 to the Films Act 1985 (certification of British films for purposes of film tax relief) which was substituted by paragraph 17 of Schedule 5 to FA 2006.

Clause 1182: "Film production company"

3005. This clause defines "film production company" for this Part. It is based on section 32 of FA 2006.

3006. There can be at most one company that fits the description of "film production company" in relation to a particular film. There may be no such company. A company might be a film production company in relation to some of the films that it is involved with but not in relation to others.

3007. If a company is the film production company in relation to a particular film its production and exploitation activities in relation to the film are, for corporation tax purposes, treated as a separate trade (see Chapter 2: taxation of activities of film production company). A film production company may, but need not, be entitled to additional reliefs in relation to the film concerned (see Chapter 3: film tax relief).

3008. *Subsection (7)* provides for a company to elect that it is not to be treated as a film production company in relation to films. Such an election is likely to be helpful to companies that are not entitled to additional reliefs in relation to films that they are involved with.

Clause 1183: "Film-making activities" etc

3009. This clause gives the meaning of "film-making activities" for this Part and gives the Treasury power to make regulations that alter the meaning. It is based on section 33 of FA 2006.

3010. The activities mentioned in *subsection (1)* are not further defined. Those activities are however well understood in the film industry.

3011. *Subsection (2)* ensures that principal photography has an appropriate meaning in cases where images for a film are generated by computer.

Clause 1184: "Production expenditure", "core expenditure" and "limited-budget film"

3012. This clause defines the terms "production expenditure", "core expenditure" and "limited-budget film". It is based on section 34 of FA 2006.

3013. Limited-budget films are eligible for more generous reliefs than other films (see clauses 1200(3) and 1202(3)). To reduce the risk of exploitation by arrangements involving connected parties, *subsection (3)* substitutes, in certain cases, (greater) arms length prices in determining whether a film is a limited-budget film.

Clause 1185: "UK expenditure" etc

3014. This clause gives the meaning of "UK expenditure" in this Part and gives the Treasury power to make regulations that alter the meaning. It is based on section 35 of FA 2006.

3015. *Subsection (2)* provides that any apportionment of expenditure be made on a "just and reasonable basis". The source legislation refers to "fair and reasonable". The formulation used in this clause has generally been adopted in ITTOIA and ITA. See *Change 12* in Annex 1.

Clause 1186: "Qualifying co-production" and "co-producer"
3016. This clause defines "qualifying co-production" and "co-producer" for this Part. It is based on section 36 of FA 2006.

Clause 1187: "Company tax return"
3017. This clause defines "company tax return". It is based on section 32(10) of FA 2006.

3018. Whilst the definition in section 32(10) of FA 2006 is not explicitly applied to instances where the term "company tax return" appears in Schedules 4 and 5 to FA 2006, it is considered that the same meaning applies in those instances. So the definition in this clause applies to the whole Part.

Chapter 2: Taxation of activities of film production company
Clause 1188: Activities of film production company treated as a separate trade
3019. This clause treats a film production company's activities in relation to the film as a separate trade for corporation tax purposes and provides for when that trade is treated as starting. It is based on section 37 of, and paragraphs 2 and 3 of Schedule 4 to, FA 2006.

3020. *Subsection (3)* introduces the label "the separate film trade" in this Chapter as a means of avoiding cumbersome references such as "the separate trade that a film production company is treated as carrying on in relation to the film in respect of which it is the film production company".

Clause 1189: Calculation of profits or losses of separate film trade
3021. This clause provides rules for bringing into account income from the film (as defined) and costs of the film (as defined) in calculating the profit or loss of the separate film trade for a period of account. It is based on paragraph 7 of Schedule 4 to FA 2006.

Clause 1190: Income from the film
3022. This clause gives the meaning in this Chapter of the term "income from the film". It is based on paragraph 6 of Schedule 4 to FA 2006.

3023. *Subsection (3)* provides that capital receipts are treated as having a revenue nature for this purpose. So, for instance, all receipts from the sale of the film will be treated as income for the purposes of this clause.

Clause 1191: Costs of the film

3024. This clause gives the meaning in this Chapter of the term "costs of the film". It is based on paragraph 5 of Schedule 4 to FA 2006.

3025. *Subsection (3)* prevents expenditure being treated as capital purely because it is on the creation of the film. It does not therefore apply to, say, capital expenditure on plant and machinery since that would be capital regardless of the creation of the film.

Clause 1192: When costs are taken to be incurred

3026. This clause makes provision about when costs are taken to be incurred. It is based on paragraph 9 of Schedule 4 to FA 2006.

3027. To prevent avoidance costs are, for instance, not to be treated as incurred before they are the subject of an unconditional obligation and are reflected in the state of completion of the work in progress.

Clause 1193: Pre-trading expenditure

3028. This clause allows expenditure incurred on development of the film, but before the separate film trade starts, to be treated as incurred immediately after the separate film trade starts. It is based on paragraph 4 of Schedule 4 to FA 2006.

3029. If pre-trading expenditure is treated in this fashion, the company must amend any company tax returns that have previously taken account of the same expenditure.

Clause 1194: Estimates

3030. This clause provides that estimates for the purposes of this Chapter are to be made at the balance sheet date and on a just and reasonable basis. It is based on paragraph 8 of Schedule 4 to FA 2006.

3031. The clause provides that any estimate is to be made on a "just and reasonable basis". The source legislation refers to "fair and reasonable". The formulation used in this clause has generally been adopted in ITTOIA and ITA. See *Change 12* in Annex 1.

Chapter 3: Film tax relief

Clause 1195: Availability and overview of film tax relief

3032. This clause gives an overview of the Chapter and gives signposts to film tax relief and to the three conditions that must be satisfied in order for the relief to be available. It is new.

Clause 1196: Intended theatrical release

3033. This clause sets out the condition about intended theatrical release. It is based on section 39 of FA 2006.

Clause 1197: British film

3034. This clause sets out the condition about certification as a British film. It is based on section 40 of FA 2006.

Clause 1198: UK expenditure

3035. This clause sets out conditions about the minimum percentage of core expenditure that must be UK expenditure and gives the Treasury power to alter that percentage. It is based on section 41 of FA 2006.

Clause 1199: Additional deduction for qualifying expenditure

3036. This clause allows a company, entitled to film tax relief, to claim additional trading deductions in respect of core expenditure on the film and gives the Treasury powers in relation to such additional deductions. It is based on paragraphs 1 to 3 of Schedule 5 to FA 2006.

Clause 1200: Amount of additional deduction

3037. This clause sets out the amount of additional deduction for which a claim may be made under clause 1199 and gives the Treasury power to alter the percentages in subsections (1) and (2). It is based on paragraphs 4 and 5 of Schedule 5 to FA 2006.

3038. *Subsection (3)* provides for a higher rate of enhancement if the film is a limited-budget film.

Clause 1201: Film tax credit claimable if company has surrenderable loss

3039. This clause allows a company, entitled to film tax relief, to surrender a tax loss for a payment if it has a surrenderable loss for the accounting period concerned. It is based on paragraph 6 of Schedule 5 to FA 2006.

Clause 1202: Surrendering of loss and amount of film tax credit

3040. This clause allows a company to claim a film tax credit for only part of its surrenderable loss and quantifies the film tax credit. It is based on paragraphs 7, 8 and 11 of Schedule 5 to FA 2006.

3041. *Subsection (3)* provides for a higher payable credit rate if the film is a limited-budget film.

3042. *Subsection (4)* provides that the company’s loss is reduced by the amount for which it claims a film tax credit.

Clause 1203: Payment in respect of film tax credit

3043. This clause requires the Commissioners for HMRC to pay to the company any film tax credit to which it is entitled and for which a claim has been made. It is based on paragraphs 9, 10 and 14 of Schedule 5 to FA 2006.

3044. Various circumstances in which a payment need not be made are set out. These include cases where the company has not yet made certain payments that it is required to make.

3045. *Subsection (5)* provides that a payment in respect of film tax credit does not count as income of the company.

Clause 1204: No account to be taken of amount if unpaid
3046. This clause requires costs that remain unpaid four months after the end of a period of account to be treated, for the purposes of this Chapter, as if they had not been incurred by the end of that period. It is based on paragraph 12 of Schedule 5 to FA 2006.

3047. The restriction in this clause is additional to that in clause 1192. Clause 1192 is concerned with whether, and when, a trading deduction may be made in respect of expenditure in calculating the profit or loss of the single film trade. The further restriction in this clause applies in deciding whether (and, if so, how much of) an additional trading deduction may be claimed or a trading loss may be surrendered for payment.

Clause 1205: Artificially inflated claims for additional deduction or film tax credit
3048. This clause requires transactions to be ignored for film tax relief purposes if they are attributable to arrangements whose sole or main purpose is obtaining, or increasing, entitlement to that relief. It is based on paragraph 13 of Schedule 5 to FA 2006.

Clause 1206: Confidentiality of information
3049. This clause permits disclosure of information by HMRC for the purpose of the Secretary of State's functions relating to certification of films, but prevents the recipient of such information making further disclosure except in specified cases. It is based on paragraph 24 of Schedule 5 to FA 2006.

Clause 1207: Wrongful disclosure
3050. This clause makes it an offence to disclose information in contravention of clause 1206(3) if the disclosure reveals, or one can deduce, the identity of the person to whom the information relates. It is based on paragraph 25 of Schedule 5 to FA 2006.

3051. *Subsection (6)(b)* does not reproduce the reference to "Scotland" in paragraph 25(7) of Schedule 5 to FA 2006. That is because section 45(1) of the Criminal Proceedings etc (Reform) (Scotland) Act 2007 (ASP 6) (brought into force on 10 December 2007) has the effect that the 12 month limit in paragraph 25(4)(b) of Schedule 5 to FA 2006 applies in Scotland.

Chapter 4: Film losses

Clause 1208: Application of sections 1209 and 1210

3052. This clause introduces, and provides defined terms for, the next two clauses dealing with losses of separate film trades. It is based on section 43(3) and 44(5) of FA 2006.

Clause 1209: Restriction on use of losses while film in production

3053. This clause restricts the offset of single film trade losses arising in accounting periods ending before the film is completed or abandoned ("pre-completion periods"). It is based on section 43(1) and (2) of FA 2006.

3054. The profits against which pre-completion period single film trade losses can be offset are restricted to those provided for by section 393(1) of ICTA (carry forward against trading profits of the same trade). But this restriction may effectively cease to apply in respect of some, or all, of those single film trade losses from the accounting period in which the film is completed or abandoned (see clause 1210).

Clause 1210: Use of losses in later periods

3055. This clause modifies, for accounting periods from that in which the film is completed or abandoned ("the completion period"), the rules on trade losses and their offset against other profits. It is based on section 44(1) to (4) and (6) of FA 2006.

3056. *Subsection (1)(b)* refers to the separate film trade continuing in accounting periods after the completion period. This deals with the possibility that a film production company might decide to exploit the completed film, rather than sell it. In such a case the separate film trade may continue after the completion period.

3057. *Subsections (2)* and *(3)* allow part (or all) of single film trade losses brought forward to the completion period to be treated as if they were single film trade losses of the completion period. Single film trade losses of the completion period are not subject to the restrictions in clause 1209. Any brought forward losses that are attributable to film tax relief (see *subsection (6)*) will not be "freed-up" in this manner. Nor will losses be "freed-up" if they are brought forward because of clause 1211 (terminal losses) (see *subsection (7)*).

3058. *Subsections (4)* and *(5)* prevent single film trade losses being offset against other profits to the extent that such losses are attributable to film tax relief (see subsection (6)).

Clause 1211: Terminal losses

3059. This clause allows certain single film trade losses, attributable to a trade that ceases, to be treated as if they were brought forward losses of certain other single film trades and it allows the Treasury to make regulations appropriate to the operation of the clause. It is based on section 45 of FA 2006.

3060. The normal rule is that trade losses do not survive the cessation of the trade in which the losses were made. This clause operates if the trade that ceases (trade A) is a single film trade that qualifies for film tax relief and, at the time of cessation, there is another single film trade (trade B) carried on which also qualifies for film tax relief. Subject to conditions being met, the losses of trade A that would otherwise have been available for carry forward under section 393(1) of ICTA may be treated as if they were losses of trade B that are carried forward under section 393(1) of ICTA.

3061. Trade B may be carried on either by the film production company that had carried on trade A or by another member of the same group (for group relief) as that film production company.

3062. The Corporation Tax (Surrender of Terminal Losses on Films and Claims for Relief) Regulations 2007 (SI 2007/678) have been made under section 45(5) of FA 2006.

Chapter 5: Provisional entitlement to relief

Overview

3063. It may not be established that a film qualifies for film tax relief, or transfer of terminal losses, until the accounting period in which the film is completed or abandoned ("the final accounting period"). This Chapter provides for film tax relief to be obtained, or terminal losses transferred, for earlier accounting periods ("interim accounting periods") on the basis of provisional assumptions and for later adjustments where those assumptions are wrong.

Clause 1212: Introduction

3064. This clause defines terms used in the Chapter and requires the appropriate company tax return of the film production company to state that the film has been completed or abandoned. It is based on paragraph 30 of Schedule 5 to FA 2006.

3065. The term "special film relief" covers both film tax relief (which requires that the film in question satisfy the requirements listed in clause 1195(2)) and the transfer of terminal losses (which requires that both of the films in question satisfy those requirements).

Clause 1213: Certification as a British film

3066. This clause relates to the requirement that a film must be certified as a British film in order for there to be entitlement to special film relief. It is based on paragraph 31 of Schedule 5 to FA 2006.

3067. Special film relief cannot be claimed for an interim accounting period unless the company tax return is accompanied by an interim certificate. For the final accounting period the company tax return must be accompanied by a final certificate or, if the film was abandoned rather than completed, an interim certificate. Special film relief previously obtained is withdrawn if the conditions in this clause are not met.

Clause 1214: The UK expenditure condition

3068. This clause relates to the requirement that a film must meet the UK expenditure condition in order for there to be entitlement to special film relief. It is based on paragraph 32 of Schedule 5 to FA 2006.

3069. Special film relief cannot be claimed for an interim accounting period unless the company tax return indicates that the UK expenditure condition will be met. For the final accounting period the company tax return must show that the UK expenditure condition is met. Special film relief previously obtained is withdrawn if the conditions in this clause are not met.

3070. *Subsection (3)* does not rewrite the requirement, in paragraph 32(3)(a)(i) of Schedule 5 to FA 2006, that the company's tax return for the final accounting period state that the film has been completed or abandoned. That is because it duplicates the requirement in paragraph 30(2) of Schedule 5 to FA 2006 (rewritten in clause 1212(2)).

Clause 1215: Film tax relief on basis that film is limited-budget film

3071. This clause relates to the requirement that a film must be a limited-budget film in order for there to be entitlement to film tax relief at the enhanced rates in clauses 1200(3)(a) and 1202(3)(a). It is based on paragraph 33 of Schedule 5 to FA 2006.

3072. Film tax relief at an enhanced rate cannot be claimed for an interim accounting period unless the company tax return indicates that the film will be a limited-budget film. For the final accounting period the company tax return must show that the film is, or if it had been completed would have been, a limited-budget film. Film tax relief previously obtained at an enhanced rate tax relief is reduced if the conditions in this clause are not met.

3073. *Subsection (3)* does not rewrite the requirement, in paragraph 33(3)(a)(i) of Schedule 5 to FA 2006, that the company's tax return for the final accounting period state that the film has been completed or abandoned. That is because it duplicates the requirement in paragraph 30(2) of Schedule 5 to FA 2006 (rewritten in clause 1212(2)).

Clause 1216: Time limit for amendments and assessments

3074. This clause allows an amendment or assessment, required by this Chapter, to be made even if it would otherwise be out of time to do so. It is based on paragraph 34 of Schedule 5 to FA 2006.

Part 16: Companies with investment business

Overview

3075. Expenses of management (generally known as "management expenses") are designed to give relief for the cost of managing an investment business on broadly the same basis as relief for trading expenses or expenses of a property business.

3076. Originally relief was given for expenses "disbursed" but changes in 2004 brought the relief (and the recovery of relief) more closely into line with the treatment of the corresponding items in a company's accounts. So, for instance, clauses 1225 and 1231 rely on the concept of "generally accepted accounting practice".

Chapter 1: Introduction
Clause 1217: Overview of Part
3077. This clause introduces the Part. It is new.

3078. This Bill does not rewrite section 76 of ICTA (expenses of insurance companies). Instead, it inserts sections 76ZA to 76ZO into ICTA, to provide a version of the trading income rules adapted to insurance companies to which section 76 of ICTA applies. For companies carrying on life assurance business, but not charged in accordance with the trading income rules, this Part does not apply. Instead, the rules in section 76 apply.

Clause 1218: "Company with investment business" and "investment business"
3079. This clause sets out which companies are within the rules in this Part of the Bill. It is based on sections 75 and 130 of ICTA.

3080. *Subsection (2)* is the rule that a credit union is not a company with investment business.

3081. The rule applies for the purposes of this Part of the Bill. So there is no possibility of a charge on a credit union under clause 1254 on a FISMA repayment. See *Change 80* in Annex 1.

3082. *Subsection (3)* is a signpost to clause 1219(2) which restricts the application of this Part of the Bill to the part of the company's business which is an investment business. But that restriction does not affect the basic definition of a "company with investment business".

3083. Schedule 1 to this Bill amends section 18 of CAA so that "managing the investments of a company with investment business" in section 15(1)(g) of CAA is defined by reference to clauses 1218 and 1219 of the Bill. So there is no need for a separate rule to the effect that a credit union is not a company with investment business for the purposes of CAA.

Chapter 2: Management expenses
Clause 1219: Expenses of management of a company's investment business
3084. This clause sets out what are "expenses of management". It is based on section 75 of ICTA.

3085. There is no explicit definition of "expenses of management" either in the source legislation or in this Bill. Instead, the limits of the expression are set by:

- case law, in which the expression (retained in this Bill) has been considered;
- general exclusions set out in this clause;
- specific reliefs set out in Chapter 3 of this Part; and
- specific restrictions set out in Chapter 4 of this Part.

3086. *Subsection (1)* ties the expenses to the management of the company's investment business (defined in clause 1218), and to the accounting period to which the expenses are "referable" (see clause 1224).

3087. The clause provides that the expenses are "allowed as a deduction", echoing the words of Part 3 (trading income). HMRC guidance (see paragraph 8580 of the Company Taxation Manual) suggests that the deduction of management expenses is mandatory. But this amounts to the same thing.

3088. Both restrictions in *subsection (2)* apply for the purposes of this Part (see clause 1218).

3089. *Subsection (3)* excludes capital expenditure, in terms that follow closely the trading income rule. It also prevents a deduction as management expenses for anything that is otherwise allowable for tax purposes.

Clause 1220: Meaning of "unallowable purpose"
3090. This clause explains "unallowable purpose", an expression used in clause 1219(2)(b). It is based on section 75 of ICTA.

3091. *Subsection (1)* is the basic rule that explains the ordinary meaning of "unallowable purpose".

3092. *Subsection (2)* extends "unallowable purpose" to include investments held in connection with arrangements to secure a tax advantage.

Clause 1221: Amounts treated as expenses of management
3093. This clause makes clear the relationship between two of the rules in clause 1219 and rules elsewhere in this Part. It is based on section 75 of ICTA.

3094. The rule in clause 1219(3)(a) which excludes capital expenditure is not applied to a rule that treats an amount as an expense of management.

3095. Similarly, the rule in clause 1219(2) that expenses must be "in respect of" the company's investment business is not applied to a rule that makes an amount deductible as an expense of management. See *Change 81* in Annex 1.

Clause 1222: Income from a source not charged to tax
3096. This clause requires non-taxable income to be set off against management expenses. It is based on section 75 of ICTA.

Clause 1223: Carrying forward expenses of management and other amounts
3097. This clause allows excess management expenses to be carried forward. It is based on section 75 of ICTA.

Clause 1224: Accounting period to which expenses are referable
3098. This clause introduces the timing rules for management expenses. It is based on section 75A of ICTA.

3099. *Subsection (2)* makes clear that the general rules in this Chapter may be overridden by a specific timing rule elsewhere.

Clause 1225: Accounts conforming with GAAP
3100. This clause gives the timing rule in the two most common cases. It is based on section 75A of ICTA.

3101. *Subsection (1)* deals with the first most common case. The management expenses are "referable to" the accounting period for which accounts are drawn up in accordance with generally accepted accounting practice ("GAAP"). GAAP is defined in section 50(1) of FA 2004.

3102. UK generally accepted accounting practice is defined in section 50(4) of FA 2004.

3103. *Subsection (2)* deals with the second most common case. GAAP accounts are drawn up. But the period of the accounts does not coincide with the company's accounting period. The expenses are apportioned.

3104. *Subsection (3)* sets out the basis of apportionment. It retains the words "it appears that" because they may make the test easier to meet than an apparently objective test ("if the method would work unreasonably …"). But the second "appears" in section 75A(5) of ICTA ("such other method … as appears just and reasonable") is dropped as it adds nothing. So the wording here is consistent with other "just and reasonable" apportionments in the Bill. The same point arises in connection with clause 1229(6).

Clause 1226: Accounts not conforming with GAAP
3105. This clause gives the timing rule if accounts are not GAAP compliant. It is based on section 75A of ICTA.

Clause 1227: Accounts not drawn up
3106. This clause gives the timing rule if there are no accounts. It is based on section 75A(7) and (8) of ICTA.

3107. The rule is that the management expenses are "referable to" the accounting period into which they would have fallen if GAAP accounts had been drawn up.

3108. There are alternative definitions of GAAP in section 50 of FA 2004. International standards apply if the company "prepares accounts in accordance with international accounting standards". In any other case (including the case where no accounts are prepared), the United Kingdom standard (UK GAAP) applies.

3109. The combined effect of section 50(1) and (4) of FA 2004 is that in section 75A(8) GAAP means UK GAAP. A similar point arises in clause 1231. In each case the clause specifies UK GAAP.

Clause 1228: Credits that reverse debits

3110. This clause explains that the credits in accounts with which clauses 1229 and 1230 are concerned include repayments and amounts never paid. It is based on section 75B of ICTA.

Clause 1229: Claw back of relief

3111. This clause applies the corporation tax charge to credits in accounts that reverse management expenses. It is based on section 75B of ICTA.

3112. *Subsection (5)* provides for any necessary apportionment of the company's accounts to accounting periods.

3113. *Subsection (6)* sets out the basis of apportionment. It retains the words "it appears that" because they may make the test easier to meet than an apparently objective test ("if the method would work unreasonably …"). But the second "appears" in section 75B(6) of ICTA ("such other method … as appears just and reasonable") is dropped as it adds nothing. So the wording here is consistent with other "just and reasonable" apportionments in the Bill. The same point arises in connection with clause 1225(3).

Clause 1230: Meaning of "reversal amount"

3114. This clause calculates the reversal amount. It is based on section 75B of ICTA.

3115. The calculation is set out in a method statement that excludes from the credit in the accounts:

- anything that does not relate to management expenses previously allowed; and
- anything that has already been taxed.

Clause 1231: Absence of accounts

3116. This clause sets out what happens if there are no accounts. It is based on sections 75B and 578A of ICTA.

3117. The reversal amount is the amount that would have been credited to GAAP accounts for the company's accounting period.

3118. There are alternative definitions of GAAP in section 50 of FA 2004. International standards apply if the company "prepares accounts in accordance with international accounting standards". In any other case (including the case where no accounts are prepared), UK GAAP applies.

3119. The combined effect of section 50(1) and (4) of FA 2004 is that in section 75B(10) GAAP means UK GAAP. A similar point arises in clause 1227. In each case the clause specifies UK GAAP.

Chapter 3: Amounts treated as expenses of management
Clause 1232: Chapter applies to amounts not otherwise relieved
3120. This clause is a priority rule. It is based on section 75 of ICTA.

3121. If an expense falls within the general rule for management expenses in clause 1219(1) that clause takes priority over the rules in this Chapter. And if an expense is otherwise deductible for tax purposes the rules in this Chapter do not apply to it.

Clause 1233: Excess capital allowances
3122. This clause gives a deduction for some capital allowances. It is based on section 75 of ICTA.

3123. A company with an investment business carries on a "qualifying activity" (see section 15(1)(g) of CAA). The rule in section 253 of CAA is that capital allowances are to be deducted in calculating the profits of the business. But, if there is an excess of allowances, the excess is treated as management expenses and can be set against profits generally.

Clauses 1234 to 1246
Overview
3124. The following 13 clauses are equivalent to trading income clauses.

3125. Generally there are no timing rules in the clauses. So a deduction is made in the accounting period to which it is "referable" in accordance with clause 1224. There are two exceptions: clauses 1240(4) and 1242(4) require the deduction for a redundancy payment to be made in the final accounting period of the business if the payment is made after the business has ceased.

Clause 1234: Payments for restrictive undertakings
3126. This clause allows a company to deduct certain amounts paid to employees for restrictive undertakings. It is based on section 73 of FA 1988. The corresponding rule for trading income is in clause 69.

Clause 1235: Employees seconded to charities and educational establishments
3127. This clause allows a company carrying on investment business to deduct the cost of an employee seconded to a charity or educational establishment. It is based on section 86 of ICTA. The corresponding rule for trading income is in clause 70.

3128. The rule in section 86 of ICTA is that the cost of the employee "shall continue to be deductible in the manner and to the like extent" as if the employee continued to work in the employer's business. This clause allows the employer to deduct *all* costs attributable to the seconded employee during the period of the secondment, regardless of whether those costs would have been allowed if the employee had not been seconded. See *Change 14* in Annex 1.

Clause 1236: Payroll deduction schemes
3129. This clause allows an employer a deduction for expenses incurred in operating the payroll deduction scheme. It is based on section 86A of ICTA. The corresponding rule for trading income is in clause 72.

Clause 1237: Counselling and other outplacement services
3130. This clause gives a deduction for certain expenses of counselling provided for employees. It is based on section 589A of ICTA. The corresponding rule for trading income is in clause 73.

Clause 1238: Retraining courses
3131. This clause gives a deduction for certain expenses of retraining provided for employees. It is based on section 588 of ICTA. The corresponding rule for trading income is in clause 74.

3132. The clause does not rewrite section 588(3)(b) of ICTA. That provision makes a deduction as a management expense conditional on the employee's exemption under section 311 of ITEPA in respect of the expenditure in question. This condition is not consistent with the similar provision in clause 1237 and does not serve any material purpose. See *Change 16* in Annex 1.

Clauses 1239 to 1243: Redundancy payments etc
3133. These five clauses are based on sections 90, 579 and 580 of ICTA. The parts of the rules that deal with the employee's liability are in section 309 of ITEPA. The corresponding rules for trading income are in clauses 76 to 81.

Timing
3134. In clauses 1240(4) and 1242(4) there is a special timing rule for management expenses. For trading income the Bill adopts a "person-based" approach. So the corresponding trading income rules refer to a "payment … made after the employer has permanently ceased to carry on the trade [or part of the trade]".

3135. In these clauses the rules refer to a payment "referable to … an accounting period beginning after the business [or the part of the business] has [permanently] ceased to be carried on”. This produces the same result as the trading income clauses, without the need to explain the rule for businesses carried on in partnership.

3136. If an investment business ceases, the closing words of the second sentence of section 90(1) and section 579(3A) of ICTA make the payments referable to the “accounting period ending on the last day on which the … business was carried on”. These clauses specify instead “the last accounting period in which the business was carried on”. See *Change 82* in Annex 1.

Just and reasonable apportionment

3137. Clause 1241(2) requires a “just and reasonable” apportionment. Section 579(5) of ICTA does not specify the basis of apportionment. See *Change 12* in Annex 1.

Part of a business

3138. Clause 1242 applies to payments in connection with the cessation of *part* of a business in the same way as it applies to payments in connection with the cessation of a whole business. See *Change 17* in Annex 1.

Devolution

3139. Clause 1243(2)(b) reflects the effect of the devolution settlements. See *Change 15* in Annex 1.

Clause 1244: Contributions to local enterprise organisations or urban regeneration companies

3140. This clause allows deductions for contributions to local enterprise agencies, training and enterprise councils, local enterprise companies in Scotland, business links and urban regeneration companies. It is based on sections 79, 79A and 79B of ICTA. The corresponding rule for trading income is in clause 82.

3141. *Subsection (3)* is an anti-avoidance rule. It prevents a company using the clause to obtain a deduction for non-commercial expenditure, such as funding the training of a member of a shareholder’s family, by passing funds through one of these bodies. The source legislation disallows any deduction if there is a benefit to the company (or a connected person). This clause merely restricts the deduction by the value of the benefit. See *Change 18* in Annex 1.

3142. *Subsection (6)* of this clause invokes the supporting clauses 83 and 86.

3143. If a disqualifying benefit is later received it is charged to tax by clause 1253.

Clause 1245: Payments to Export Credits Guarantee Department

3144. This clause allows a company to deduct the cost of certain payments to the Export Credits Guarantee Department. It is based on section 88 of ICTA. The corresponding rule for trading income is in clause 91.

Clause 1246: Levies under FISMA 2000

3145. This clause allows a deduction for certain payments arising from FISMA. It is based on section 76B of ICTA. The corresponding rule for trading income is in clause 92.

3146. A company carrying on investment business may be called upon to make payments in connection with FISMA. The payments are of two sorts:

- a "levy" to meet the running costs of the schemes set up by FISMA; and

- "costs" which may be awarded at the conclusion of a hearing of a complaint.

3147. Section 76B of ICTA allows as a management expense both sorts of payment. But there is a difficulty with one sort of levy. So some changes are made in this clause and in the trading income clause to ensure that all the payments under FISMA qualify for a deduction. Schedule 1 to this Bill makes a corresponding relaxation in section 155 of ITTOIA. See *Change 22* in Annex 1.

Chapter 4: Rules restricting deductions

Clause 1247: Introduction

3148. This clause introduces the Chapter. It is new.

3149. *Subsection (2)* lists rules outside this Part that affect the calculation of management expenses. All these rules in the source legislation are drafted in wide terms (for instance, "for the purpose of calculating profits or other income charged to corporation tax"). The rules apply to the calculation of management expenses because that is part of the calculation of profits charged to corporation tax.

3150. In some cases the application of the rewritten rules is restricted so that they do not apply in calculating the profits of a trade or property business. That is because there is an equivalent rule in Part 3 (trading income) which is also applied to property income by clause 210.

3151. The permissive rules for management expenses in Chapter 3 of this Part say that expenses are "treated for the purposes of Chapter 2 as expenses of management". The restrictive rules in this Chapter "restrict the deduction of expenses of management under section 1219" (which is in Chapter 2). So it is clear that the restrictive rules have priority.

3152. This is the reverse of the position for trading income, where the general rule in clause 51 is that the permissive rules have priority. But, in the unusual cases where it is possible for the rules to overlap, the result is the same.

3153. *Subsection (3)* draws attention to section 196A of FA 2004. This rule about pension scheme contributions does not itself restrict management expenses. But it gives HMRC power to make regulations that may make such a restriction.

Clause 1248: Expenses in connection with arrangements for securing a tax advantage

3154. This clause disallows expenses incurred in connection with arrangements to secure a tax advantage. It is based on section 75 of ICTA.

3155. *Subsections (1)* and *(2)* are the basic rule that the expenses are not allowed as management expenses. The wording of the subsections echoes that of clause 1220, which treats investments held in connection with arrangements to secure a tax advantage as held for a disallowable purpose.

3156. *Subsection (3)* establishes an order of priority for "disallowable purposes" rules.

- If the investments concerned are held for an unallowable purpose, the expenses are not expenses of management of the company's investment business (clause 1219(2)(b)).

- Otherwise, if a manufactured payment is made in pursuance of arrangements that have an unallowable purpose, relief may be denied for the payment by paragraph 7A of Schedule 23A to ICTA.

- If neither of these applies, this clause may apply.

Clause 1249: Unpaid remuneration

3157. This clause delays a deduction for employees' (or an office-holder's) pay if it is paid late. The clause is based on section 44 of FA 1989. The corresponding rule for other businesses (based on section 43 of FA 1989) is in clause 1288.

Clause 1250: Unpaid remuneration: supplementary

3158. This clause provides definitions and further explanation of the main rule in clause 1249. It is based on section 44 of FA 1989. The corresponding rule for other businesses (based on section 43 of FA 1989) is in clause 1289.

3159. *Subsection (1)* applies clause 1249 to provisions made in the accounts for amounts that may become employees' remuneration.

3160. *Subsection (3)* deals with the case in which the company submits its tax return before the end of the nine month limit in clause 1249(2) and all or any of the remuneration is unpaid. The company must assume the remuneration will remain unpaid. If, subsequently, the remuneration is paid within the time limit the calculation can be adjusted and the return amended. See *Change 68* in Annex 1.

Clause 1251: Car or motor cycle hire

3161. This clause restricts the amount that a company can deduct in respect of the cost of hiring certain cars or motor cycles with a retail price (when new) of more than

£12,000. The clause is based on sections 578A and 578B of ICTA. The corresponding rule for trading income is in clause 56.

3162. Under section 75B(3) of ICTA any recovery of the hire charge is restricted to the reversal of "so much of the debit as represents the expenses of management." *Subsection (4)* makes this restriction explicit and mirrors the trading income rule in clause 56(4). See *Change 83* in Annex 1.

3163. *Subsection (7)* of the clause invokes the supporting clauses 57 and 58. So the definition of "qualifying hire car or motor cycle" includes a car or motor cycle where ownership passes without the exercise of an option to purchase. See the commentary on clause 57 and *Change 10* in Annex 1.

Chapter 5: Companies with investment business: receipts
Clause 1252: Industrial development grants

3164. This clause deals with the treatment of certain grants under the Industrial Development Act 1982 or the corresponding provision in Northern Ireland. It is based on section 93 of ICTA. The corresponding rule for trading income is in clause 102.

3165. Under section 93(1) of ICTA the payment of a grant is "taken into account as a receipt in computing [the company's] profits under Case VI of Schedule D". Under section 70(1) of ICTA the basis of assessment for Schedule D is the "profits gains or income arising" in an accounting period. But there is no explicit rule to say into which accounting period the grant falls.

Clause 1253: Contributions to local enterprise organisations or urban regeneration companies: disqualifying benefits

3166. This clause sets out what happens if a company (or a connected person) receives a benefit in connection with a contribution to a local enterprise organisation or urban regeneration company (see clause 1244). It is based on sections 79, 79A and 79B of ICTA. The corresponding rule for trading income is in clause 82.

3167. Section 79(9) of ICTA refers to relief having been given "under subsection (1) above". Strictly, relief for management expenses is given under subsection (2) by reference to a "deduction under subsection (1)". But it is clear in the context of the section that the recovery under subsection (9) is intended to apply to management expenses as it applies to a trading deduction. The same analysis applies to the corresponding provisions in sections 79A and 79B of ICTA. This clause clarifies the position.

3168. The charge is restricted to the amount of the "disqualifying benefit". That expression is explained in clause 1244(5). See the commentary on that clause and *Change 18* in Annex 1.

Clause 1254: Repayments under FISMA 2000

3169. This clause charges tax on a repayment made to a company under FISMA. It is based on section 76B of ICTA. The corresponding rule for trading income is in clause 92.

3170. Under section 76B(2) of ICTA the repayment is "charged to tax under Case VI of Schedule D". Under section 70(1) of ICTA the basis of assessment for Schedule D is the "profits gains or income arising" in an accounting period. But there is no explicit rule to say in which accounting period the repayment falls.

Chapter 6: Supplementary

Clause 1255: Meaning of some accounting terms

3171. This clause provides definitions of some accounting terms used in this Part. It is based on sections 75A and 75B of ICTA.

3172. *Subsection (1)* deals with the concept of management expenses being "debited in accounts". This expression is used in the rules that determine to which accounting period expenses are referable.

3173. *Subsection (2)* deals with the concept of an amount being "brought into account". This expression is used in the rule that deals with the claw back of relief. There is no reason why the expression should be defined differently in sections 75A(10) and 75B(8) of ICTA. So this clause adopts the fuller words of section 75A(10).

3174. *Subsection (3)* removes a small inconsistency between sections 75A(10) and 75B(12) of ICTA by referring to a debit that increases *or creates* a loss.

Part 17: Partnerships

Overview

3175. This Part contains the rules that apply to partnerships. The corresponding rules for income tax are in Part 9 of ITTOIA.

3176. Section 1 of the Partnership Act 1890 defines partnership as "the relation which subsists between persons carrying on a business in common with a view of profit". Section 4 of the Partnership Act 1890 explains that "firm" is the term used for the purposes of that Act for persons in partnership.

3177. The clauses in this Bill follow the Partnership Act 1890 and refer to the partners collectively as a "firm". But the word "partnership" is commonly used as a synonym for "firm". So the title of the Part and some of the titles of the clauses use the word "partnerships", again following the lead of the Partnership Act 1890.

3178. The rules in this Part determine each partner's share of the income of the firm. That income share is then charged under the normal rules for the type of income concerned.

Clause 1256: Overview of Part
3179. This clause introduces this Part of the Bill. It is new. The corresponding rule for income tax is in section 846 of ITTOIA.

Clause 1257: General provisions
3180. This clause introduces the concept of a "firm". It is new. The corresponding rule for income tax is in section 847 of ITTOIA.

3181. The clause drops the references in sections 111 and 114 of ICTA to professions. See *Change 2* in Annex 1 and the commentary on clause 35.

Clause 1258: Assessment of partnerships
3182. This clause makes it clear that, for corporation tax purposes, a firm is not an entity distinct from the partners in the firm. It is based on section 111 of ICTA. The corresponding rule for income tax is in section 848 of ITTOIA.

3183. The clause extends the treatment of trades carried on by firms to businesses that are not trades. It is based on section 111(10) of ICTA which was repealed in error by ITTOIA. This brings the income tax and corporation tax codes back into line. See *Change 84* in Annex 1.

3184. In the case of firms established under English law this provision merely confirms their position under that law. But Scottish firms, for example, are legal entities. This provision ensures that all firms are treated in the same way.

Clause 1259: Calculation of firm's profits and losses
3185. This clause contains the basic rules for calculating the profits of a firm. It is based on sections 114 and 115 of ICTA. The corresponding rule for income tax is in section 849 of ITTOIA.

3186. Section 6(4) of ICTA extends the meanings of "profits" and "trades" in sections 114 and 115 of ICTA. None of the partnership rules in this Bill applies to chargeable gains. So the extension of "profits" to include chargeable gains is not needed. And for corporation tax purposes a company cannot:

- carry on a vocation (see *Change 2* in Annex 1);
- be employed; or
- hold an office in partnership.

3187. So this Bill does not rewrite either extension in section 6(4) of ICTA.

3188. If some of a firm's partners are resident in the United Kingdom and some are not, the profits of the firm's trade must be determined on different bases. For the resident partners, the determination includes profits arising outside the United

Kingdom; for the non-UK resident partners, the determination is restricted to profits arising from a permanent establishment in the United Kingdom. (If there are other United Kingdom profits, a non-UK resident company is chargeable to income tax on those profits and the rules in ITTOIA apply.)

3189. Section 114 of ICTA is not explicit that the profits may have to be determined on more than one basis. This clause brings together the rules for resident and non-UK resident partners. *Subsection (2)* introduces the idea that more than one determination may be needed.

3190. *Subsection (3)* sets out the normal basis for determining the profits, for a partner resident in the United Kingdom. The profits are determined as if the firm were a company resident in the United Kingdom.

3191. *Subsection (4)* sets out an alternative basis for determining the profits. If the company partner is not resident in the United Kingdom the profits of the firm are determined as if the firm were a company not resident in the United Kingdom. That determination is restricted to the profits arising from a permanent establishment in the United Kingdom. So there is no need to rewrite the requirement in section 115(4)(b) of ICTA that the partner's share of the profits is treated as arising from such a permanent establishment.

3192. The profits of the firm are determined by reference to the extent to which they would be *chargeable* to corporation tax. So, in the case of a non-UK resident, the profits of which the partner has a share are those attributable to a permanent establishment in the United Kingdom.

Changes in partnership

3193. Section 114(1) of ICTA provides that the business profits of a firm are calculated for corporation tax "as if the partnership were a company" (referred to in this part of the commentary as the "deemed company"). This rule applies "so long as" a company carries on the business in partnership.

3194. The deemed company exists only during the life of the partnership. So a company is treated as ceasing to carry on a business when that company takes another person into partnership (because the deemed company then carries on the business). And the deemed company is treated as ceasing to carry on a business when the partnership business is taken over by a company on its own.

3195. Furthermore, the deemed company calculation is made without regard to any change in the persons carrying on the business except that a change in the persons is treated as a transfer of the business to a different company if there is no company which carries on the business before and after the change.

3196. The occasions on which a company is treated as ceasing to carry on a business are set out in the rules to which they are relevant (see clauses 77(5), 80 and 162(3)). They also appear in this Part in clauses 1267(3) and (4) and 1271(3).

Clause 1260: Section 1259: supplementary

3197. This clause sets out the treatment of losses and distributions in the calculation of the firm's profits under clause 1259. It is based on section 114 of ICTA.

3198. The usual rule is that the profits of the firm are calculated as if the firm were a company. On that assumption it is possible that losses brought forward should be deducted before the (net) profits are allocated to the partners. Instead, *subsection (1)* makes clear that losses are not taken into account in the calculation of the firm's profit or loss to be allocated to the partners.

3199. Capital allowances are given as a deduction in calculating profits. So there is no need for the rule in section 114(1)(b) and (2) that gives special treatment to capital allowances. The same applies to balancing charges, which are treated as business receipts. And the rule about charges (also in section 114(1)(b) of ICTA) is not needed because charges cannot be a deduction in calculating the profits of a trade.

3200. There is a closely related rule in section 116(5) of ICTA. It is that, for the purposes of that section, capital allowances and charges *are* taken into account. As there is no longer a partnership rule that allowances and charges are ignored, there is no need for section 116(5) of ICTA. So it is repealed by Schedule 1 to this Bill.

3201. Schedule 1 to the Bill introduces a new subsection (4) to section 849 of ITTOA to make clear similarly that losses brought forward are ignored in calculating the firm's profits for income tax purposes.

3202. *Subsection (2)* is based on section 114(1)(a) of ICTA, which provides that "references to distributions shall not apply". It is clear from the context that this rule applies to payments made *by* the firm. So there is no question of a payment of, say, interest being treated as a distribution by the firm under section 209 of ICTA and being disallowed in calculating the firm's profit. See Schedule 1 and *Change 85* in Annex 1.

Clause 1261: Accounting periods of firms

3203. This clause sets out how accounting periods of a firm are determined. It is based on section 114 of ICTA. The concept of an accounting period of a firm is used in clause 1259 for the calculation of the firm's profit or loss.

3204. An accounting period of a firm begins when the rule in section 114(1) of ICTA first applies. That is, when a company first carries on the trade etc in partnership. That circumstance is set out in *subsections (2)(b)* and *(3)* of the clause.

3205. An accounting period of a firm ends when the rule in section 114(1) of ICTA no longer applies. That is, when the last company leaves a firm, or (if the company continues to carry on the trade etc) when the company is no longer in partnership. That circumstance is set out in *subsections (2)(c)* and *(4)* of the clause.

3206. An accounting period of a firm ends when there is a change in the persons carrying on the trade etc and the change is treated by 114(1)(c) of ICTA as the transfer of the trade etc to a different company. That is, when there is no "corporate continuity" between the members of the firm before and after the change. That circumstance is set out in *subsections (2)(d)* and *(5)* of the clause.

3207. The usual rules about an accounting period ending on a date to which the firm makes up accounts and about an accounting period ending on the expiration of 12 months apply without being specifically mentioned in this clause.

Clause 1262: Allocation of firm's profits or losses between partners

3208. This clause is the link between the firm's profit or loss and the amounts assessable on the partners. It is based on section 114 of ICTA. The corresponding rule for income tax is in section 850 of ITTOIA.

3209. The basic rule in this clause applies in most cases. But, if the basic rule produces a loss for a partner when the firm's result is a profit, the allocation is adjusted under clause 1263. Similarly, if the basic rule produces a profit for a partner when the firm's result is a loss, the allocation is adjusted under clause 1264.

3210. In a firm where some partners are liable to income tax and others liable to corporation tax, the rules requiring an adjusted allocation are not straightforward. In this Bill they are set out in two separate clauses. The Bill amends ITTOIA to set out the income tax rules in the same way (in new sections 850A and 850B of ITTOIA) – see Schedule 1.

Clause 1263: Profit-making period in which some partners have losses

3211. This clause sets out what happens if the calculation of a partner's share of the firm's profit or loss under clause 1262 produces a loss, even though the overall result for the firm is a profit. It is new. The corresponding rule for income tax was in section 850 of ITTOIA but is now in the new section 850A of ITTOIA.

3212. The clause is most likely to apply when one or more partners are entitled to a salary or interest on the firm's capital. A partner's "loss" determined under clause 1262 is, in effect, reallocated to the other partners, to reduce their shares of the profit. See *Change 86* in Annex 1.

3213. *Subsection (2)* sets out the position for company A if it has a profit but any of the other partners has a loss determined under clause 1262. The rule is that company A's profit is reduced so that the total of the shares of the profit-making partners is no more than the amount of the firm's profits.

3214. If some of the members of the firm are UK resident and some are non-UK resident (see clause 1259), the measure of the firm's profit may vary, depending on the residence of the partner "in relation to" which the firm's profit is calculated. Similarly, if any of the partners is chargeable to income tax, that partner's share is determined under ITTOIA and not under clause 1262.

3215. So subsection (2) refers to "the comparable amount" for a partner. This amount may be on a basis different from that appropriate for that partner under clause 1259 or the corresponding ITTOIA rule.

Clause 1264: Loss-making period in which some partners have profits

3216. This clause sets out what happens if the calculation of a partner's share of the firm's profit or loss under clause 1262 produces a profit, even though the overall result for the firm is a loss. It is new. The corresponding rule for income tax was in section 850 of ITTOIA but is now in the new section 850B of ITTOIA.

3217. The clause is the mirror-image of clause 1263. It is most likely to apply when one or more partners are entitled to a salary or interest on the firm's capital. A partner's "profit" determined under clause 1262 is, in effect, reallocated to the other partners, to reduce their shares of the loss. See *Change 86* in Annex 1.

3218. *Subsection (2)* sets out the position for company A if it has a loss but any of the other partners has a profit determined under clause 1262. The rule is that company A's loss is reduced so that the total of the shares of the loss-making partners is no more than the amount of the firm's losses.

3219. If some of the members of the firm are UK resident and some are non-UK resident (see clause 1259), the measure of the firm's loss may vary, depending on the residence of the partner "in relation to" which the firm's loss is calculated. Similarly, if any of the partners is chargeable to income tax, that partner's share is determined under ITTOIA and not under clause 1262.

3220. So subsection (2) refers to "the comparable amount" for a partner. This amount may be on a basis different from that appropriate for that partner under clause 1259 or the corresponding ITTOIA rule.

Clause 1265: Apportionment of profit share between partner's accounting periods

3221. This clause allocates a partner's share of the firm's profit or loss to accounting periods of the partner. It is based on section 114 of ICTA.

Clause 1266: Resident partners and double taxation agreements

3222. This clause ensures that a UK resident company partner's share of the income of a foreign firm remains liable to United Kingdom corporation tax even though the income of the firm as a whole is exempt from United Kingdom corporation tax in accordance with a double taxation agreement. It is based on section 115 of ICTA. The corresponding rule for income tax is in section 858 of ITTOIA.

3223. The business profits article of the United Kingdom/Jersey double taxation arrangement exempts the profits of a Jersey firm from United Kingdom tax. In the case of Padmore v CIR (1989), 62 TC 352 CA[1], the Court of Appeal decided that the exemption extended to the share of the profits arising to a United Kingdom resident individual. The rules in section 115(5) to (5B) of ICTA were enacted to remove the exemption.

3224. *Subsection (1)* sets out the type of company and firm with which the clause is concerned. It goes on to identify the sort of exemption from tax that was considered in the Padmore case.

3225. For United Kingdom tax purposes, if it is necessary to consider where a firm is resident, the question is likely to be decided by the place where the firm's business is controlled and managed. But it is possible that, under foreign law, a firm may be considered to be resident elsewhere, for example, by reference to where the firm was established. So the clause uses both the "control and management" test and the "resides" test.

3226. *Subsection (2)* makes it clear that the clause does no more than remove any exemption under a double taxation arrangement. It does not deny other reliefs, such as tax credit relief. See *Change 87* in Annex 1.

3227. *Subsection (3)* deals with United Kingdom tax credits, which may be relevant to the calculation of a company's "shadow ACT" (see SI 1999/358, made under section 32 of FA 1998). A double taxation arrangement may give a non-UK resident "person" an entitlement to payment of a tax credit on a distribution by a United Kingdom company. This subsection makes it clear that, where that "person" is a firm, only a UK resident partner has the entitlement.

3228. Section 115(5A) of ICTA applies also to capital gains. That part of the rule is not rewritten in this Bill. It is moved to TCGA by an amendment to section 59 of TCGA (see Part 2 of Schedule 1 to the Bill).

Clause 1267: Various rules for trades and property businesses

3229. This clause clarifies the position of firms that are affected by the rules in Chapter 14 of Part 3 or clause 262 of the Bill. It is based on paragraph 13 of Schedule 22 to FA 2002 (as applied to property businesses by section 21B of ICTA). The corresponding rule for income tax is in section 860 of ITTOIA.

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3230. The clause differs from its income tax equivalent because a positive adjustment on a change of basis is dealt with differently for income tax and corporation tax. For income tax, such an adjustment is the subject of a separate charge, in section 228 or 330 of ITTOIA. For corporation tax, the adjustment is treated as a trade or property business receipt and so is charged to tax under clause 35 or 209.

3231. This clause explicitly applies to property businesses. In ITTOIA the position is different because the extension to non-trade businesses in section 847 of ITTOIA does not apply to section 860. But section 860 of ITTOIA does apply to property businesses as a result of section 272(1) of ITTOIA, because the restriction in section 272(2) does not exclude rules outside Part 2 such as those in Chapter 7 of Part 3 of ITTOIA. Schedule 1 to the Bill amends section 860 of ITTOIA to clarify the income tax position, with a minor related amendment to section 847 of ITTOIA.

Clause 1268: Election for spreading under Chapter 14 of Part 3

3232. This clause sets out two rules for firms that make an election under clause 186. It is based on section 114 of ICTA and paragraphs 9 and 13 of Schedule 22 to FA 2002. The corresponding rules for income tax are in section 860 of ITTOIA.

3233. *Subsection (1)* ensures that the adjustment charge is not “rolled up” under clause 186 just because a company leaves or joins the firm.

3234. *Subsection (2)* is the rule about making an election under clause 186. The “date on which the new basis was adopted” is defined in clause 1269.

Clause 1269: Interpretation of clauses 1267 and 1268

3235. This clause explains expressions used in the two preceding clauses. It is based on paragraph 13 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 860(6) of ITTOIA.

Clause 1270: Special provisions about farming and property income

3236. This clause clarifies the position of firms that carry on a farming trade or property business. It is based on sections 15, 53 and 70A of ICTA. The corresponding rule for income tax is in section 859 of ITTOIA.

3237. In section 53(2) of ICTA there is a rule that all farming carried on in the United Kingdom by a company is a single trade. The section refers to a “particular company or partnership”.

3238. In section 15 of ICTA there is a similar rule that all property income activity carried on by a person forms a single property business. Paragraph 1(3) of Schedule A refers to a “particular person or partnership”. Section 70A(4) of ICTA, which deals with overseas property businesses, refers to a “particular company or partnership”.

3239. *Subsection (1)* is the rule that all farming carried on by a firm is a single trade. The subsection also makes it clear that the firm's single farming trade does not include any farming trade carried on by a company separately from the firm.

3240. *Subsections (2)* and *(3)* are the corresponding rules for UK property businesses and overseas property businesses.

Clause 1271: Sale of patent rights: effect of partnership changes

3241. This clause sets out what happens when there is a sale of patent rights by a trader and there is change in the membership of any firm that carries on the trade. It is based on section 558 of CAA. The corresponding rule for income tax is in section 861 of ITTOIA.

3242. The rules for intellectual property are split:

- the rules that give capital allowances are in CAA;
- the rules that charge capital receipts from the sale of patent rights are in Chapter 3 of Part 9; and
- the special rules that apply to firms are set out in this clause and clause 1272.

3243. If a trader receives a sum from the sale of patent rights in the ordinary course of the trade the sum is a trade receipt. In that case, it is not a "capital sum" and clause 913(1)(a) of this Bill ensures that the special rules do not apply.

3244. If a trader receives a capital sum from the sale of patent rights, the sum is excluded from the calculation of the trade profits by the general rule that excludes capital receipts. Instead, the sum is separately charged to corporation tax under Chapter 3 of Part 9 of this Bill. The profit on the sale is charged to tax over six years. But the seller may elect to have the sum charged in the year in which the proceeds of sale are received. Or the charge may be spread in accordance with clause 916 or 917 of this Bill.

3245. In the case of a taxpayer liable to corporation tax, Part 8 of this Bill sets out rules for the taxation of gains and losses on companies' intangible fixed assets. Those rules take priority over any other tax rules (see clause 906(1)). So the Part 8 rules generally apply instead of the rule in this clause. But Chapter 16 of Part 8 ensures that the Part 8 rules apply only to assets created or acquired on or after 1 April 2002.

3246. *Subsection (1)* sets out the conditions for the clause to apply. In particular, there has to be:

- a charge (to income tax or corporation tax) on the proceeds from the sale of patent rights; and

- a change in the persons carrying on the trade during periods in which tax is chargeable.

3247. *Subsection (4)* determines the amount to be charged as income of each company in the period of change. That amount is in two parts:

- for the period up to the change, a time-apportioned part of the amount that would otherwise have been charged for the whole period; and

- for the period after the change, the company's share of the amount still to be charged after the change, apportioned to the period on a time basis.

3248. *Subsection (5)* sets out the general assumption that all the current partners step into the shoes of the persons who were partners at the time of the original sale. The amount charged in each accounting period is arrived at by spreading the remaining charge evenly over the rest of the period for which tax would otherwise have been charged.

3249. One of the consequences of the current partners stepping into the shoes of the original partners is that an amount originally charged to income tax may become charged to corporation tax, and vice versa. This consequence was not explicitly acknowledged in ITTOIA. So Part 2 of Schedule 1 to this Bill amends sections 861 and 862 of ITTOIA to clarify how the rule works for income tax. See *Change 89* in Annex 1.

Clause 1272: Sale of patent rights: effect of later cessation of trade
3250. This clause sets out what happens when there has been a sale of patent rights to which the previous clause applied and the last corporate partner leaves the firm. It is based on section 525 of ICTA. The corresponding rule for income tax is in section 862 of ITTOIA. See also paragraph 3245 of this commentary about the effect of Part 8 of this Bill and *Change 89* in Annex 1.

3251. *Subsection (2)* sets out how the "rolled-up" charge is split between the current partners on cessation of the trade. As in section 525(4) of ICTA, the charge is made on the persons who are partners immediately before the cessation. Otherwise, the charge would be allocated by reference to the profit-sharing arrangements in the whole of the final accounting period. Schedule 1 to this Bill amends section 862 of ITTOIA to clarify how the rule works for income tax.

Clause 1273: Limited liability partnerships
3252. This clause contains the rules that treat limited liability partnerships ("LLPs") in the same way for tax purposes as ordinary partnerships ("firms" in this Bill). It is based on section 118ZA of ICTA. The corresponding rule for income tax is in section 863 of ITTOIA.

3253. *Subsection (1)(a)* ascribes the *activities* of the LLP to its members. Subsection (1) does not refer to an LLP carrying on a profession. See *Change 2* in Annex 1.

Part 18: Unremittable income

Overview

3254. This Part provides relief from corporation tax if income arising in a territory outside the United Kingdom cannot be remitted to the United Kingdom. It also provides for withdrawal of relief if such income ceases to be unremittable. And it explains how unremittable income is to be valued if relief is not in fact claimed. The Part is based on section 584 of ICTA. The corresponding rules for income tax are in Chapter 4 of Part 8 of ITTOIA.

3255. This Part applies to "income arising in a territory outside the United Kingdom". In the source legislation for this Bill, income arising outside the United Kingdom is charged to corporation tax mainly under Schedule D Case V (section 18 of ICTA). But some foreign income is charged under Schedule D Case VI (in circumstances that that Case is applied by a provision other than section 18 of ICTA), or under a non-schedular provision, if the provision covers income arising outside the United Kingdom.

3256. Profits made by the foreign branch of a United Kingdom trade are charged in Part 3. Such profits are not income arising in a territory outside the United Kingdom and this Part does not apply. (But Chapter 12 of Part 3 (deductions from profits: unremittable amounts) provides an equivalent relief in relation to a United Kingdom trade.)

3257. The paragraph headed "unremittable income that arose in an accounting period ending before 1 April 2009" in Part 21 of Schedule 2 to this Bill (transitionals and savings), the equivalent for corporation tax purposes of paragraph 153(1) and (2) of Schedule 2 to ITTOIA, ensures that this Part applies for an accounting period ending on or after 1 April 2009 even though the income in question arose in an accounting period ending before that date.

3258. This Part does not rewrite the appeal jurisdiction rules in section 584(9) of ICTA. See Change 98 in Annex 1. (But sub-paragraph (7) of the paragraph headed "tribunal reform" in Part 21 of Schedule 2 to this Bill, the equivalent for corporation tax purposes of paragraph 153(3) and (4) of Schedule 2 to ITTOIA, preserves the effect of section 584(9) of ICTA in the circumstances set out in the first-mentioned paragraph if the appeal involves income that arose in an accounting period ending before 1 April 2009.)

Clause 1274: Unremittable income: introduction

3259. This clause defines unremittable income and sets out the circumstances in which this Part applies. It is based on section 584(1) of ICTA. The corresponding rule for income tax is in section 841 of ITTOIA.

3260. The source legislation refers to "foreign currency". This means a currency other than the currency of the territory in question. Since the *local* currency must be obtainable, it is superfluous to add that currency not obtainable is 'foreign'.

3261. Condition A for unremittable income refers to the impossibility of obtaining currency in the territory in question and makes explicit that this means currency that could be transferred to the United Kingdom (whether the currency of that or another territory). See *Change 90* in Annex 1.

3262. The requirement in the source legislation, that the inability to transfer the income to the United Kingdom is not due to any want of reasonable endeavours on the part of the claimant, is omitted. See again *Change 90* in Annex 1.

Clause 1275: Claim for relief for unremittable income

3263. This clause deals with claims for relief and sets out how the relief applies. It is based on section 584(1), (2),(5) and (6) of ICTA. The corresponding rule for income tax is in section 842 of ITTOIA.

3264. The effect of *subsection (1)* is that the unremittable income is omitted from the company's taxable income for the accounting period in which it arises.

3265. *Subsection (4)* defines an Export Credits Guarantee Department payment ("ECGD payment"). The statutory references in the source legislation have been updated. As section 13(1) of the Export and Investment Guarantees Act 1991 delegates the functions of the Secretary of State under section 2 of that Act to the Export Credits Guarantee Department, the clause refers to the role of that Department (rather than the Secretary of State) in administering this scheme.

Clause 1276: Withdrawal of relief

3266. This clause brings together the consequences both of unremittable income becoming remittable and of a payment being made by the Export Credits Guarantee Department. It is based on section 584(2A) and (5) of ICTA. The corresponding rule for income tax is in section 843 of ITTOIA.

3267. *Subsections (3)* and *(5)* set out when, and at what value, income ceasing to be unremittable is treated as arising. Income so treated as arising is charged under the provision appropriate to the income type (or types) that would have applied to the income when it arose but for the relief.

3268. *Subsection (4)* provides that, when an ECGD payment is made, income is treated as arising at that time to the extent of the payment. This reflects the intention of the legislation as originally drafted. Amendments made by FA 1996 obscured the point. See *Change 91* in Annex 1. Subsection (5) deals with the value of that income.

3269. *Subsection (6)* prevents a double charge under this clause. For example, if relief has already been withdrawn because an ECGD payment has been received, there is no further charge – to the extent of that payment – if the income itself subsequently becomes remittable.

Clause 1277: Income charged on withdrawal of relief after source ceases

3270. This clause sets out how relief given under this Part is withdrawn when income ceases to be unremittable after the source of the income has ceased. It is based on section 584(4) of ICTA. The corresponding rule for income tax is in section 844 of ITTOIA.

3271. If relief cannot be withdrawn in accordance with clause 1276, because the trade or property business in question has permanently ceased, the amount in respect of which relief is withdrawn is dealt with as a post-cessation receipt under Chapter 15 of Part 3 (trading income) or Chapter 9 of Part 4 (property income) of this Bill. In both cases, the provision in the relevant Chapter limiting its application is disapplied as unnecessary.

3272. For any other case where relief is withdrawn after the source has ceased, *subsection (4)* provides that the income should be taxed as if the source had not ceased. See *Change 19* in Annex 1.

3273. Income charged by virtue of this clause is, in the source legislation, charged under Schedule D Case VI (rather than Schedule D Case V or another charge). The potential relevance of such income to relief under section 396 of ICTA (losses from miscellaneous transactions) is preserved by consequential amendments in Schedule 1 to this Bill, which amend that section and insert section 834A of ICTA. See the commentary on Schedule 1 for the insertion of section 834A of ICTA.

Clause 1278: Valuing unremittable income

3274. This clause sets out how unremittable income is valued if relief under this Part is not claimed. It is based on section 584(8) of ICTA. The corresponding rule for income tax is in section 845 of ITTOIA.

3275. The clause applies if no claim is made under clause 1275 for relief under this Part. In such a case, the charge to tax is not deferred. So the income is charged to corporation tax in the accounting period to which it refers. This clause determines the sterling value of the amount to be charged.

Part 19: General exemptions

Overview

3276. This Part groups all of the clauses which provide exemption for income otherwise charged to corporation tax by this Bill. The exemptions, where relevant, apply to both United Kingdom and foreign income unless one of these kinds of income is expressly excluded in the clause.

Clause 1279: Exemption of profits from securities free of tax to residents abroad ("FOTRA securities")
3277. This clause exempts FOTRA securities specified in clause 1280(1) from corporation tax and sets out the two conditions that must be met if that exemption is to apply. It is based on section 154 of FA 1996. The corresponding rule for income tax is in section 714 of ITTOIA.

Clause 1280: Section 1279: supplementary provision
3278. This clause sets out the three different classes of United Kingdom Government securities exempt in the hands of non-UK residents (FOTRA securities) and defines the term "the exemption condition" and "gilt-edged security" used in this clause. It is based on section 154(8) of FA 1996 and section 161 of FA 1998. The corresponding rule for income tax is in section 713 of ITTOIA.

Clause 1281: Income from savings certificates
3279. This clause provides an exemption for income from savings certificates where the holding is within specified limits. It is based on section 46(1), (3), (4) and (6) of ICTA. The corresponding rule for income tax is in section 692 of ITTOIA.

3280. The source legislation refers to the limits in terms of purchase by, or on behalf of, a person. *Subsection (2)* rewrites this as "acquisition" to avoid confusion for situations such as joint ownership where special regulations apply. It also refers to the regulations as limiting a person's holding in line with the way the regulations are written.

3281. Subsection (2) introduces the words "so far as". This allows exemption to be conferred in part in respect of multiple savings certificates. See *Change 92* in Annex 1.

Clause 1282: Income from Ulster Savings Certificates
3282. This clause provides an exemption for income from Ulster Savings Certificates for holdings within specified limits. It is based on section 46 of ICTA, which also deals with savings certificates generally (see clause 1281). The corresponding rule for income tax is in section 693 of ITTOIA.

3283. Although Ulster Savings Certificates have not been issued since March 1997, there are still holdings which have not been redeemed. Consequently it is necessary to rewrite this provision to ensure that interest continuing to be paid in respect of these holdings is exempt from corporation tax.

3284. *Subsection (4)* introduces the words "so far as". This allows exemption to be conferred in part in respect of multiple savings certificates. See *Change 92* in Annex 1.

3285. Subsection (4) uses "acquisition" rather than purchase and refers to a person's holding in line with the way the regulations are written.

3286. *Subsection (5)* does not specify that the claim for exemption is to be made to the Board. Where a notice to deliver a corporation tax return has been issued, paragraphs 57 and 58 of Schedule 18 to FA 1998 require the claim to be made in the return or by amendment of the return if possible. See *Change 1* in Annex 1.

Clause 1283: Interest from tax reserve certificates

3287. This clause exempts interest on tax reserve certificates from corporation tax. It is based on section 46(2) of ICTA.

Clause 1284: Housing grants

3288. This clause exempts from corporation tax grants paid under legislation intended to assist in providing, maintaining or improving housing. It is based on section 578 of ICTA. The corresponding rule for income tax is in section 769 of ITTOIA.

3289. *Subsection (1)* reflects the effect of the devolution settlements. See *Change 15* in Annex 1.

Clause 1285: UK company distributions

3290. This clause sets out the exemption from the charge to corporation tax on dividends and other distributions made by a UK resident company. It is based on section 208 of ICTA.

3291. The judgement in the case of Strand Options and Futures Ltd v Vojak, 76 TC 220 CA[2], provides judicial interpretation of section 208 of ICTA. The Court of Appeal held that the exemption referred specifically to leaving dividends and other distributions out of account in computing *income*, which does not mean that the amount of a distribution should be left out of account in computing a chargeable gain.

3292. *Subsection (2)* encapsulates the court's interpretation of the legislation in respect of distributions and their inclusion in a chargeable gains computation.

3293. Section 337A(1)(a) of ICTA, rewritten as clause 1305, denies a deduction in computing profits for corporation tax purposes in respect of dividends and other distributions. The wording of section 208 of ICTA makes no distinction between receipts and deductions in computing income, and it therefore potentially overlaps with section 337A(1)(a) of ICTA. The words "as receipts" have therefore been added to this clause to clarify its role.

3294. The clause also provides signposts to certain exceptions to the general rule.

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Clause 1286: VAT repayment supplements
3295. This clause exempts VAT repayment supplement from corporation tax. It is based on section 827 of ICTA. The corresponding rule for income tax is in section 777 of ITTOIA.

Clause 1287: Incentives to use electronic communications
3296. This clause exempts from corporation tax incentives provided under regulations for the use of electronic communications. It is based on section 143 of FA 2000. The corresponding rule for income tax is in section 778 of ITTOIA.

Part 20: General calculation rules

Overview
3297. This Part contains a number of generally applicable rules. They apply to all income charged to corporation tax.

3298. The rules are included here to save repetition at numerous points in the Bill. Some of the rules apply mainly to trading and property income within Parts 3 and 4 of this Bill. The approach for income tax in ITTOIA is to put one version of the rule in the trading income Part, with another version of the rule in the general provisions Part. But for corporation tax the rules apply also to expenses of management (see Part 16 of this Bill) and expenses of insurance companies (see section 76 of ICTA).

Chapter 1: Restriction of deductions

Clause 1288: Unpaid remuneration
3299. This clause defers a deduction for employees' (or an office-holder's) remuneration in a period of account if that remuneration remains unpaid nine months after the period has ended. It is based on section 43 of FA 1989. The corresponding rule for income tax is in section 36 of ITTOIA.

3300. Section 43 of FA 1989 was introduced when the assessment of employment income was put on a receipts basis. A deduction for employees' pay may be linked to the time when the pay is received by the employees.

3301. This clause uses "income from any source" rather than "profits or gains", to define the scope of the rule. See the commentary on the omission of "gains" in the overview of Part 3 of this Bill. There is a separate rule for expenses of management in clause 1249.

3302. Schedule 2 to this Bill preserves the commencement rule for the amendment of the source legislation by Schedule 24 to FA 2003.

Clause 1289: Unpaid remuneration: supplementary
3303. This clause provides definitions and further explanation of the main rule in clause 1288. It is based on section 43 of FA 1989. The corresponding rule for income tax is in section 37 of ITTOIA.

3304. *Subsection (1)* applies clause 1288 to provisions made in the accounts for amounts that may become employees' remuneration.

3305. *Subsection (3)* deals with the case in which the company submits its tax return before the end of the nine month limit in clause 1288(2) and all or any of the remuneration is unpaid. The company must assume the remuneration will remain unpaid. If, subsequently, the remuneration is paid within the time limit the calculation can be adjusted and the return amended. See *Change 68* in Annex 1.

Employee benefit contributions

Overview

3306. The next eight clauses deal with the deduction allowed in respect of an employer's contribution to an employee benefit scheme. They are based on Schedule 24 to FA 2003. The corresponding rules for income tax are in sections 38 to 44 of ITTOIA.

3307. The clauses give a comprehensive set of rules for determining when deductions can be made for payments made by an employer to a third party to hold or use to provide benefits for the employer's employees.

Clause 1290: Employee benefit contributions

3308. This clause sets out the conditions under which a deduction may be allowed. It is based on paragraphs 1 and 8 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 38 of ITTOIA.

3309. The legislation rewritten in this clause does not apply to deductions that would otherwise be allowed for periods ending before 27 November 2002, or in respect of employee benefit contributions made before that date. This limitation is preserved in Schedule 2 (transitionals and savings).

Clause 1291: Making of "employee benefit contributions"

3310. This clause defines the transactional characteristics which must be present if a payment is to qualify for relief as an "employee benefit contribution". It is based on paragraphs 1 and 9 of Schedule 24 to FA 2003. The corresponding rule for income tax is in section 39 of ITTOIA.

Clause 1292: Provision of qualifying benefits

3311. This clause sets out what is meant by the provision of qualifying benefits. It is based on paragraph 2 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 40 of ITTOIA.

Clause 1293: Timing and amount of certain qualifying benefits
3312. This clause sets out:

- when benefits in the form of money are treated as provided; and

- how to calculate the value of benefits provided by the transfer of an asset.

3313. It is based on paragraphs 2 and 5 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 41 of ITTOIA.

Clause 1294: Provision or payment out of employee benefit contributions
3314. This clause sets out the rules for allocating the provision of qualifying benefits, or payment of qualifying expenses, by the third party against the employee benefit contributions received. It is based on paragraph 4 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 42 of ITTOIA.

Clause 1295: Profits calculated before end of 9 month period
3315. This clause applies if the company makes its corporation tax return before the end of the nine month period. It is based on paragraph 6 of Schedule 24 to FA 2003. The corresponding rule for income tax is in section 43 of ITTOIA.

Clause 1296: Interpretation of sections 1290 to 1296
3316. This clause interprets and defines terms. It is based on paragraphs 3 and 9 of Schedule 24 to FA 2003. The corresponding rules for income tax are in section 44 of ITTOIA.

Clause 1297: Life assurance business
3317. This clause modifies the operation of clause 1290 where the company in question is charged on the I minus E basis in respect of life assurance business and claims a deduction for expenses under section 76 of ICTA. It is based on paragraph 7 of Schedule 24 to FA 2003.

Clause 1298: Business entertainment and gifts
3318. This clause and the following two clauses deal with expenditure on business entertainment or gifts. It is based on section 577 of ICTA. The corresponding rule for income tax is in sections 45 and 867 of ITTOIA.

3319. Section 577 of ICTA denies a deduction for certain expenses “in computing profits chargeable to corporation tax under Schedule D”. Profits chargeable to corporation tax under Schedule D include profits of a business which is neither a trade nor a property business. And section 577(7)(b) of ICTA indicates that references to a trade, for the purposes of the section, include references to a business.

3320. The exceptions to the general rules are not limited to trades. See *Change 93* in Annex 1.

Clause 1299: Business entertainment: exceptions
3321. This clause provides exceptions to the prohibition in clause 1298 relating to business entertainment in certain circumstances. It is based on section 577 of ICTA. The corresponding rules for income tax are in section 46 of ITTOIA.

Clause 1300: Business gifts: exceptions
3322. This clause provides exceptions to the prohibition in clause 1298 relating to business gifts in certain circumstances. It is based on section 577 of ICTA. The corresponding rules for income tax are in section 47 of ITTOIA.

3323. *Subsection (3)* allows the Treasury to increase the monetary limit in paragraph (b). See *Change 94* in Annex 1.

3324. *Subsection* (5) makes an exception for gifts to charities and named bodies. Section 577(9) of ICTA limits this exception to the computation of profits under Schedule D Cases I and II, that is, to income calculated under rules rewritten in Part 3 of this Bill. It was not intended that the exception should be applied narrowly to the disadvantage of a business other than a trade or property business. This section extends the exception to such businesses. See *Change 93* in Annex 1.

Clause 1301: Restriction of deductions for annual payments
3325. This clause prevents annual payments for which the consideration is either a dividend or not taxable from being deducted in calculating a company's income from any source. It is based on section 125 of ICTA. The corresponding income tax rule is in sections 843 and 904 of ITA.

3326. *Subsections (4)* to *(6)* together set out the conditions that must be met by an annual payment in order for the rule in *subsection (1)* to apply to the payment.

3327. The source legislation specifies that the payment must not be interest (section 125(2)(a) of ICTA). Annual payments within *subsection (2)* do not include interest, so this does not need to be stated explicitly. In addition, no specific reference is made to annuities (also mentioned in the source legislation) as these are simply one type of annual payment.

3328. This clause does not rewrite the exclusion in section 125(3)(a) of ICTA for payments which in the hands of the recipient are income falling within section 627(2)(a) of ITTOIA. Such payments cannot be relevant for corporation tax purposes since such payments can only be made by an individual. Nor does this clause rewrite the commencement provision in section 125(5) of ICTA, which is spent.

Clause 1302: Social security contributions
3329. This clause prevents a deduction for most social security contributions for any corporation tax purpose. It is based on section 617 of ICTA. The corresponding rule for income tax is in section 868 of ITTOIA.

Clause 1303: Penalties, interest and VAT surcharges

3330. This clause contains the general rule that tax penalties and interest are not to be deducted. It is based on section 827 of ICTA. The corresponding rule for income tax is in section 869 of ITTOIA.

3331. This clause refers to "profits" because the rule covers both the calculation of income and deductions (such as expenses of management within Part 16) from total profits.

3332. Section 90(1)(b) of TMA prohibits a deduction for interest payable "under this Part" of TMA. Section 90(2) cancels the prohibition for interest under sections 87 and 87A of TMA. This is because interest under those sections may be taken into account as a loan relationship debit (see Parts 5 and 6 of this Bill). But the prohibition does apply to interest under section 86 of TMA, which applies for corporation tax purposes only for accounting periods ending before 1 October 1993. So that rule is "saved" by Schedule 2 to this Bill and not rewritten in this clause.

3333. The table in *subsection (2)* sets out the specific statutory references because a general description of the penalties etc would not be precise enough. But the second column of the table is a description of the tax to indicate what is involved.

Clause 1304: Crime-related payments

3334. This clause prohibits any deduction for expenses incurred in making a payment:

- the making of which is a criminal offence, or which would be a criminal offence if the payment were made in the United Kingdom; or

- which is made in response to a demand, the making of which is a criminal offence.

3335. The clause is based on section 577A of ICTA. The corresponding rule for income tax is in section 870 of ITTOIA.

3336. The source legislation denies a deduction for certain crime-related payments "in computing profits chargeable to corporation tax under Schedule D". Profits chargeable to tax under Schedule D include profits of a business which is neither a trade nor a property business.

3337. The clause applies to income charged to corporation tax. Some kinds of income are not charged under Schedule D in the source legislation. But the prohibition of a deduction is not thought to have any practical effect on income that is not charged under Schedule D. So the scope of the prohibition is unchanged.

3338. The clause overrides any provision which otherwise allows a deduction to be made in calculating the profits of a trade. See clause 51(1)(b) of this Bill.

Clause 1305: Dividends and other distributions

3339. This clause sets out the prohibition on deducting dividends or other distributions made by a company in computing that company's profits chargeable to corporation tax. It is based on section 337A(1)(a) of ICTA.

Chapter 2: Other general rules

Clause 1306: Losses calculated on same basis as miscellaneous income

3340. This clause is based on numerous provisions, including section 827 of ICTA. The corresponding rule for income tax is in section 872 of ITTOIA.

3341. The application of the clause is limited to "miscellaneous income", defined in *subsection (3)* by reference to section 834A of ICTA (inserted by Schedule 1 to this Bill). The source legislation does not generally limit the scope of the rule. For example, section 827(1) of ICTA says "the payment shall not be allowed as a deduction in computing any income, profits or losses for any corporation tax purposes". But in practice this clause affects only the calculation for corporation tax purposes of amounts, other than profits within Part 3 or 4 of this Bill, chargeable under a provision listed in the table in section 834A of ICTA.

3342. *Subsection (2)* ensures that this rule does not overturn any rules about the calculation of losses. For example, see section 398 of ICTA (which deals with the calculation of losses for the purposes of a claim under section 396 of ICTA).

3343. See the related commentary on clause 47 of this Bill.

Clause 1307: Apportionment etc of miscellaneous profits and losses to accounting period

3344. This clause provides for apportionment of profits and losses when a company's period of account does not coincide with an accounting period. It is based on section 72 of ICTA. The corresponding rule for income tax is in sections 203 and 871 of ITTOIA.

3345. Section 72 of ICTA applies "in the case of any profits or gains chargeable… under Case I, II or VI of Schedule D". Apportionment is therefore not limited to the case of profits or losses of a trade. See the related commentary for section 52.

3346. The clause applies where income is chargeable under a provision to which section 834A of ICTA applies. That section is inserted by Schedule 1 to this Bill. Section 834A of ICTA does not apply to income to which Chapter 8 of Part 10 (income not otherwise charged) applies which arises from a source outside the United Kingdom (see subsection (3) of that section). *Subsection (2)* of this clause qualifies the reference to that section so that the benefit of the apportionment rules extends to such income (that is, to income charged in the source legislation under Schedule D Case V). See *Change 95* in Annex 1.

3347. The only circumstance in which aggregation within *subsection (3)(b)* will occur is when a company is in liquidation and has fixed accounting periods of 12 months in accordance with clause 12 of this Bill.

3348. This clause does not carry over the rewrite change in section 871(5) of ITTOIA whereby apportionment is permitted by a measure of time other than the number of days in the respective periods, as required by section 72(2) of ICTA. HMRC consider that a day cannot fall into more than one accounting period.

3349. See also the paragraph headed “miscellaneous profits and losses: apportionment to accounting periods ending before 1 April 2009” in Part 21 of Schedule 2 to the Bill which provides for a period of account that straddles the end of the financial year 2008 and the beginning of the financial year 2009.

Clause 1308: Expenditure brought into account in determining value of intangible asset

3350. This clause provides that expenditure on research and development, if not of a capital nature, may be taken into account for the purposes of Part 13, even though for accounting purposes it has been brought into account in determining the value of an intangible asset. It is based on section 53 of FA 2004.

Clause 1309: Payments treated as made to visiting performers

3351. This clause provides that some payments made to a company are not to be included in the company’s income. It is based on sections 556 and 558 of ICTA. The corresponding rule for income tax is in sections 13 and 14 of ITTOIA.

3352. Section 966 of ITA requires deduction of tax from certain payments to entertainers and sportsmen and women. The section also applies in some cases to payments made to a person other than the performer. In those cases section 13(5) of ITTOIA treats the payments as made instead to the performer.

Part 21: Other general provisions

Clause 1310: Orders and regulations

3353. This clause sets out how orders and regulations are to be made or may be annulled. It is based on section 828 of ICTA. The corresponding rule for income tax is in section 873 of ITTOIA.

Clause 1311: Apportionment to different periods

3354. This clause sets out how apportionments to different periods are to be made. It is based on section 834 of ICTA.

Clause 1312: Abbreviated references to Acts

3355. This clause provides details of abbreviations used in this Bill. The corresponding list for income tax is in Part 1 of Schedule 4 to ITTOIA.

Clause 1313: Activities in UK sector of continental shelf
3356. This clause sets out how certain activities carried on in the UK sector of the continental shelf are treated for corporation tax purposes. It is based on section 830 of ICTA. The corresponding rule for income tax is in section 874 of ITTOIA.

Clause 1314: Meaning of "caravan"
3357. This clause defines "caravan". It is based on sections 15 and 70A of ICTA, section 29 of the Caravan Sites and Control of Development Act 1960, section 13 of the Caravan Sites Act 1968 and section 8 of the Mobile Homes Act 1975. The corresponding rule for income tax is in section 875 of ITTOIA.

3358. It effects a change in the law in two ways. First it provides a uniform definition of "caravan" for the whole of the United Kingdom. Second it applies that definition to all occurrences of "caravan" in this Bill. See *Change 96* in Annex 1.

Clause 1315: Claims and elections
3359. This clause provides that references to a claim or election are to claims or elections in writing. It is based on paragraphs 57, 58 and 59 of Schedule 18 to FA 1998.

Clause 1316: Meaning of "connected" persons and "control"
3360. This clause defines "connected" persons and "control" by reference to definitions in ICTA.

Clause 1317: Meaning of "farming" and related expressions
3361. This clause defines "farming" and "market gardening" and clarifies the meaning of "forestry" and "woodlands". It is based on section 832 of ICTA and section 154 of FA 1995. The corresponding rules for income tax are in section 996 of ITA.

3362. Section 832(1) of ICTA defines "farm land" and "market garden land". It then goes on to say that "farming" and "market gardening" "shall be construed accordingly". The reasons for this approach are largely historic and date from the time when the charge on farming and market gardening was under Schedule B. "Farm land" and "market garden land" are no longer terms used in the rules concerned with farming and market gardening; they remain only in the definition in section 832(1) of ICTA.

3363. The definitions in this clause take a different approach. They define "farming" and "market gardening" by reference to the nature of the activity, not the land on which the activity is carried out. Farming excludes market gardening.

3364. Farming is an activity which is given differing taxation treatment depending on whether or not the land is situated in the United Kingdom. Section 832(1) of ICTA provides that the definitions of "farm land" and "market garden land" are confined to land occupied in the United Kingdom.

3365. There is no territorial restriction in the definitions in this Bill. Instead the territorial restriction is included in the rewrite of section 53(1) and (2) of ICTA as clause 36 of this Bill and not in the definitions.

3366. *Subsection (1)* provides the definition of “farming”. It requires the land to be occupied wholly or mainly for the purposes of husbandry. This reflects a long-standing distinction in tax law between profits resulting from the taxpayer’s occupation of the land and profits from an activity in which occupation of the land is merely incidental.

3367. In the first case the trader exploits or uses the land, for example, by growing crops or grazing animals. In the second case the trader occupies the land only because a physical location, such as a shop or factory, is needed from which to carry on the trade. Factory farming, that is the intensive rearing of fish or livestock, is not farming for tax purposes. This is because the animals do not live or draw their sustenance from the land.

3368. Husbandry is a fairly old-fashioned term but one that is the subject of a considerable body of case law. The status of any marginal case must be determined in the light of that case law subject to the clarification given in *subsection (2)*.

3369. The definition of “farm land” in section 832 of ICTA excludes “any dwelling or domestic offices”. This clause does not repeat this exclusion of farmhouses.

3370. As originally enacted, the definition of farm land in section 832(1) of ICTA specifically included the farmhouse and farm buildings as part of the farm land. The House of Lords in <u>IRC v Korner and Others</u> (1969), 45 TC 287 HL, held that the effect of this provision was that a farmhouse was an asset of the trade for which a 100% deduction could be obtained. This applies even if the farmhouse is used as a private residence. An amendment was introduced in FA 1969 to reverse the effect of that decision. This is why the definition of “farm land” in section 832(1) of ICTA excludes “any dwelling or domestic offices”.

3371. In practice a farming company is allowed to make deductions in respect of expenditure of a revenue nature on office buildings used purely for business purposes. Such expenditure has always been treated as being incurred wholly and exclusively for the purposes of the trade and not prohibited from being deducted under section 74(1)(a) of ICTA.

3372. Section 74(1)(c) of ICTA deals with the deduction of rent where only part of a dwelling house or domestic offices are used for trade purposes. Again, in practice, a company whose trade is farming is permitted to make deductions in respect of such houses and offices.

3373. In the case of any other expenses of a residential property which is subject to dual private and business use a company is permitted to apportion these and the proportion attributable to trade use is allowed as a deduction. Again this treatment applies to farming companies. See clause 54 of this Bill (expenses not wholly and exclusively for trade and unconnected losses).

3374. A company which wishes to claim a deduction for the proportion of expenses of a farmhouse attributable to trade rather than private purposes can do so through clause 54. Omitting the exclusion of farmhouses and domestic offices from the definition of farming gives statutory effect to what occurs in practice.

3375. *Subsection (2)* identifies two specific types of activity as “husbandry” and therefore farming.

3376. Paragraph (a) is based on the definition of market garden land in section 832(1) of ICTA. Hop growing is generally recognised to be farming but is often spoken of as taking place in a garden. This could bring it within the definition of “market garden land” in section 832(1) of ICTA but for the fact that hop growing is excluded from that definition. Subsection (2)(a) makes clear that hop growing is farming.

3377. Paragraph (b) is based on the ordinary meaning of the word farming. Stud farming has generally been assumed to be farming for income tax purposes. The reference to “the breeding and rearing of horses and the grazing of horses in connection with those activities” makes clear what that activity encompasses for the purposes of this Bill.

3378. *Subsection (5)* defines “market gardening”. It makes it clear that the produce sold must have been grown on the relevant land rather than being bought in for resale.

Clause 1318: Meaning of grossing up
3379. This clause explains what is meant by “grossing up” for the purposes of this Act and provides a formula for calculating the gross amount to be taxed. It is new. The corresponding rule for income tax is in section 998 of ITA.

Clause 1319: Other definitions
3380. This clause defines various terms.

Clause 1320: Interpretation: Scotland
3381. This clause deals with the application to Scotland of certain terms used in the Bill. It is based on section 24 of ICTA. The corresponding rule for income tax is in section 879 of ITTOIA.

3382. *Subsection (2)* is based on *Change 15* in Annex 1 and gives certainty to the meaning of “enactment”.

Clause 1321: Interpretation: Northern Ireland
3383. This clause deals with the application to Northern Ireland of certain terms used in the Bill. It is new. The corresponding rule for income tax is in section 880 of ITTOIA.

3384. It clarifies the meaning of "enactment". See *Change 15* in Annex 1.

Clause 1322: Minor and consequential amendments
3385. This clause introduces Schedule 1. It is new.

Clause 1323: Power to make consequential provision
3386. This clause provides a power for the Treasury to make by order consequential amendments additional to those contained in Schedule 1. It is new.

3387. The power is in substance the same as that in section 1028 of ITA. As with that power, it will not be exercised without the agreement of the Tax Law Rewrite Project's Consultative and Steering Committees to the proposed modifications.

3388. *Subsection (2)* provides that the power may not be used after 31 March 2012. It is sensible to enable additional consequential amendments to be made in this way only over a limited period, and it would in any case become progressively more difficult to do so accurately as subsequent Finance Bills are enacted. The date of 31 March 2012 takes account of this while giving a reasonable amount of time for missed consequential amendments to come to light.

3389. *Subsection (4)* provides that the power may contain provision having retrospective effect. Whether that would be appropriate would need to be considered on a case-by-case basis. As the power can be used only to make provision in consequence of this Act, any retrospective effect is limited to provision having effect from the date the Act comes into force.

Clause 1324: Power to undo changes
3390. This clause provides a power for the Treasury to undo changes in the law made by the Bill for the purpose of restoring the effect of the law to what it was immediately before 1 April 2009. It is new. A corresponding provision is in section 1029 of ITA.

3391. The power will not be exercised without the agreement of the Tax Law Rewrite Project's Consultative and Steering Committees to the proposed modifications. It will make it possible for any errors made in rewriting the source legislation, or in making consequential amendments, to be corrected without recourse to a Finance Bill.

3392. *Subsection (2)* provides that the power may not be exercised after 31 March 2010. As with section 1029 of ITA, it is considered sensible to time-limit the power in this way, especially as successive Finance Acts may make it progressively more difficult to make such amendments. The time limit will provide a reasonable period for missed consequential amendments to come to light.

3393. *Subsection (4)* provides that the power may contain provision having retrospective effect. Whether that would be appropriate would need to be considered on a case-by-case basis.

Clause 1325: Transitional provisions and savings
3394. This clause introduces Schedule 2 and provides for the Treasury to make transitional or savings provisions additional to those contained within the Schedule. It is new. A corresponding provision is in section 1030 of ITA.

3395. The power will not be exercised without the agreement of the Tax Law Rewrite Project's Consultative and Steering Committees.

3396. *Subsection (3)* provides that the power may contain provision having retrospective effect.

Clause 1326: Repeals and revocations
3397. This clause introduces Schedule 3.

Clause 1327: Index of defined expressions
3398. This clause introduces Schedule 4.

Clause 1328: Extent
3399. This clause provides for the Bill to form part of the law of each part of the United Kingdom.

Clause 1329: Commencement
3400. This section provides for the commencement of the Act.

3401. This Bill deals for the most part only with corporation tax. However, it does amend legislation relating to income tax and capital gains tax, mostly consequentially. Separate provision is made about commencement in relation to those amendments.

Clause 1330: Short title
3402. This clause specifies the short title for the Act.

Schedule 1: Minor and consequential amendments
Part 1: Income and Corporation Taxes Act 1988
The charge to corporation tax
3403. See the commentary on Chapter 1 of Part 2 for an explanation of the charges to corporation tax in this Bill. That Chapter deals with the charge to corporation tax on profits.

3404. The charge under clause 2 is on amounts of income and on chargeable gains that together form the "profits pot". The label "the charge to corporation tax on income" is explained in clause 2(2). There are examples of consequential amendments expressed in these terms in the amendments to section 761(1) and section 776(3A) of ICTA.

3405. There are also consequential amendments to charges to an amount of corporation tax. These charges do not fall within the "profits pot" and are provisions of an administrative nature mainly recovering excessive relief. Two examples are the amendment to section 399(3) of ICTA and the amendment to paragraph 27(4) of Schedule 16 to FA 2002.

3406. References to Schedule D Case VI are removed in these consequential amendments: see the commentary on the amendment inserting section 834A of ICTA.

Section 15 of ICTA

3407. Section 15(1A) of ICTA is not rewritten because it is no longer necessary. It is part of a framework in which income tax and corporation tax are, broadly, governed by the same provisions. In that context its purpose is to keep the property income of a non-UK resident company chargeable to income tax separate from that company's property income chargeable to corporation tax. But the provisions governing income tax have been separated from those governing corporation tax in the rewrite. Specifically, Part 3 of ITTOIA deals with property income charged to income tax and Part 4 of this Bill deals with property income charged to corporation tax. Clause 3(1)(b) prevents the provisions in ITTOIA from applying to income of a non-resident within the charge to corporation tax. Together, this is all that is required to achieve the result of dividing a non-UK resident company's property income between separate income tax and corporation tax property businesses.

Section 42 of ICTA

3408. Clauses 240 to 242 of this Bill rewrite the application of section 42 of ICTA for cases within section 42(1)(a) of ICTA (determination of amounts which may be chargeable to corporation tax). So section 42(1)(a) of ICTA is repealed.

3409. Section 42 of ICTA continues to apply for cases within section 42(1)(b) of ICTA (determination of amounts which may be chargeable to income tax).

Section 74 of ICTA

3410. Section 74(1) of ICTA lists various items in respect of which no deduction is allowed in computing profits charged to corporation tax under Schedule D Case I.

3411. Section 74(1)(f) provides that in computing the amount of the profits to be charged to corporation tax under Case I, no sum shall be deducted in respect of:

> (f) any capital withdrawn from, or any sum employed or intended to be employed as capital in, the trade …, but so that this paragraph shall not be treated as disallowing the deduction of any interest

3412. The proposition in the second half of section 74(1)(f) of ICTA that the prohibition of any deduction in respect of capital should not be construed as disallowing the deduction of interest has been overtaken by the loan relationships legislation in Chapter 2 of Part 4 of FA 1996.

3413. The tax treatment of returns from corporate debt now follows accountancy treatment in taxing a profit or allowing a loss at the time the return is credited or debited in the company's accounts. And section 100 of FA 1996 extends the corporate debt regime to include interest arising other than in respect of the lending of money, for example interest on trade debts.

3414. So the second half of section 74(1)(f) is redundant and this Bill repeals it.

3415. Section 74(1)(h) of ICTA prohibits deductions for interest forgone on capital used in the trade or in improving the trade premises. It is unlikely that any accounts drawn up in accordance with generally accepted accounting practice would include a deduction for notional interest. So section 74(1)(h) of ICTA is redundant and this Bill repeals it.

3416. Section 74(1)(k) of ICTA prohibits deductions for "any average loss beyond the actual amount of loss after adjustment".

3417. Generally accepted accountancy practice in such cases is to make a provision in the year of loss and review that provision in subsequent years. Without section 74(1)(k), the tax treatment of the average loss follows generally accepted accountancy practice. See *Change 97* in Annex 1.

3418. Section 74(1)(m) of ICTA prevents a deduction for any annuity and other annual payment "payable out of the profits". Because the rule applies only to amounts payable "out of the profits", it has no application to the calculation of those profits. So section 74(1)(m) of ICTA is redundant and this Bill repeals it.

Sections 76ZA to 76ZO of ICTA

3419. A number of rules about calculating profits apply:

- in calculating the profits of a trade (or property business);
- to the calculation of expenses of management for the purpose of section 75 of ICTA; and
- to the calculation of expenses of insurance companies under section 76 of ICTA.

3420. This Bill rewrites the first set of rules in Part 3 or, in some cases, in Part 20.

3421. This Bill rewrites the second set of rules in Part 16 or, in some cases, in Part 20.

3422. This Bill does not rewrite section 76 of ICTA. Instead, it inserts sections 76ZA to 76ZO into ICTA, to provide a version of the rules adapted to insurance companies to which section 76 of ICTA applies. The new sections follow the corresponding rules in this Bill. So the new sections repeat the changes to the law made by this Bill. See (in the order in which they appear in this Schedule) *Changes 14, 16, 82, 12, 17, 82, 15, 18, 68, 10 and 83* in Annex 1.

3423. In section 76ZN of ICTA subsection (3)(a)(ii) caters for the possibility that the release of a debt for car hire may be a "reversal" within section 76(7) of ICTA. In that case, this rule ensures that the reversal is restricted by the appropriate fraction.

Section 84A of ICTA

3424. Section 84A continues in force for income tax purposes.

Section 86 of ICTA

3425. Section 86 of ICTA allows a company to deduct the cost of an employee seconded to a charity or educational establishment in calculating the profits to be charged to corporation tax.

3426. Section 86(5) of ICTA lists educational establishments in Scotland for the purposes of relief under section 86 of ICTA. Section 86(5)(d) of ICTA refers to "a self-governing school within the meaning of the Self-Governing Schools etc (Scotland) Act 1989". Self-governing schools were abolished on 1 April 2003. So section 86(5)(d) of ICTA is redundant.

Section 89 of ICTA

3427. Section 89 of ICTA is not rewritten for corporation tax purposes. See the commentary on clause 55 and *Change 8* in Annex 1.

Section 92 of ICTA

3428. Section 92 of ICTA applies to regional development grants under Part 2 of the Industrial Development Act 1982. The Industrial Development Act 1982 was repealed by the Statute Law (Repeals) Act 2004 with effect from 22 July 2004. No applications under Part 2 of the 1982 Act could be made after 31 March 1988 and there are no payments outstanding in respect of grants made before that date. So section 92 of ICTA is redundant.

Section 101 of ICTA

3429. The Bill does not cater for a company carrying on a profession. So this section is repealed. See *Change 39* in Annex 1.

Section 116(4) of ICTA

3430. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 119(2) of ICTA

3431. Section 119(2) of ICTA is not rewritten because it is otiose. See *Change 53* in Annex 1.

Section 209(6A) of ICTA

3432. Section 209(6A) of ICTA provides that alternative finance return shall not be treated as a distribution for the purposes of the Corporation Tax Acts. It rewrites section 54(1) and (2) of FA 2006.

Section 337A(2)(b) of ICTA

3433. Section 337A(2)(b) of ICTA is not rewritten because it only duplicates other provisions with the same effect.

3434. Section 337A(2)(b) of ICTA provides that no deduction shall be made in computing income for the purposes of corporation tax in respect of losses from intangible fixed assets which come within Schedule 29 of FA 2002 except in accordance with the rules of that Schedule. However section 337A(2)(b) achieves nothing that is not already achieved by the provisions of Schedule 29. Section 337A(2)(b) is expressed to apply in respect of "losses from intangible assets within Schedule 29". Paragraph 1(2) of Schedule 29 states that the Schedule "also has effect for determining how a company's losses in respect of intangible fixed assets are brought into account for the purposes of corporation tax". And paragraph 1(3) of Schedule 29 states that, apart from specified exceptions, "… the amounts to be brought into account in accordance with this Schedule [29] in respect of any matter are the only amounts to be brought into account for the purposes of corporation tax in respect of that matter".

Section 396 of ICTA

3435. These amendments make the adaptations necessary to this section and its heading as a result of the abolition of Schedule D and its Cases by this Bill.

3436. The main reference in section 396(1) of ICTA to tax charged under Schedule D Case VI has been replaced by a reference to tax charged under or by virtue of "a relevant provision". This ties in with the substituted subsection (2) which, in common with the approach taken generally to replacing references to Schedule D Case VI, refers to the table of provisions in section 834A of ICTA for this purpose but with the exclusion of one provision in that table. The reference to section 761(1)(b)(ii) of ICTA derives from the replaced section 396(2) of ICTA.

3437. Section 834A of ICTA is inserted by this Schedule. It is the equivalent for corporation tax of the income tax provision in section 1016 of ITA. For further information, see the commentary in these notes on section 834A of ICTA.

3438. See also section 436A of ICTA which excludes a loss under that section from relief under section 396 of ICTA and prevents any relief under the latter section being set against profits under section 436A.

3439. The inserted section 396(2A) and (2B) of ICTA preserves relief for losses arising in an accounting period ending on or before 31 March 2009 against any income arising from a relevant provision in later accounting periods. Subsection (2B) reflects the commencement date for the insertion of a reference to Chapter 5 of Part 17 of ICTA in the superseded subsection (2).

Section 399 of ICTA

3440. Section 399(1B) of ICTA is not rewritten for corporation tax purposes. The loss relief provisions it restricts, in particular section 396 of ICTA (losses from miscellaneous transactions), cannot apply. The gains that match the losses in question are not chargeable to tax and so losses are not eligible for relief. This provision is the equivalent for corporation tax purposes of section 399(1) of ICTA. That provision was not rewritten but repealed by ITTOIA for the same reasons.

Section 431 of ICTA

3441. A new label “life assurance trade profits provisions” is inserted into section 431(2) of ICTA. It is used in various consequential amendments to the life assurance provisions of the Corporation Tax Acts. They include the use of the label, instead of “provisions applicable to Case I of Schedule D” (or some variant), in places such as section 434(1) of ICTA, section 83YC(10) of FA 1989 and section 210A(10A) of TCGA.

Section 584 of ICTA

3442. This amendment repeals section 584 of ICTA. Subsection (9) has not been rewritten. See *Change 98* in Annex 1.

Sections 586 and 587 of ICTA

3443. These amendments repeal sections 586 and 587 of ICTA. See *Change 99* in Annex 1.

Section 695 of ICTA

3444. This amendment repeals section 695 of ICTA. Subsection (6) has not been rewritten. See *Change 100* in Annex 1.

Section 779 of ICTA

3445. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 781 of ICTA

3446. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 782 of ICTA

3447. Subsection (9) is concerned with successions. Section 337(1)(b) of ICTA and section 18 of ITTOIA are not concerned with successions. And section 337(1)(a) is not rewritten in this Bill. So the closing words of subsection (9) are no longer needed and this Bill omits them.

Section 785 of ICTA

3448. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

Section 798A of ICTA

3449. Subsection (4)(a) of this section applies to all income chargeable to tax under Schedule D Case V. But the rule in subsection (3) applies only if there are deductions or expenses allowable in the calculation of the income. So the amendments by this Bill identify such foreign income as comprising only:

- foreign trading income (the new subsection (4)(a));
- income from an overseas property business (the new subsection (4)(b)); and
- foreign miscellaneous income (the new subsection (4)(c)).

3450. The new subsection (5) preserves the distinction between post-cessation receipts charged to tax by section 103 of ICTA (to which section 798A does not apply) and those charged to tax by section 104 of ICTA (to which section 798A does apply).

Sections 807B to 807G of ICTA

3451. These amendments insert sections 807B to 807G into ICTA. These sections rewrite double taxation relief provisions in Schedule 9 (loan relationships) to FA 1996 and Schedules 26 (derivative contracts) and 29 (intangible fixed assets) to FA 2002. Those provisions were inserted in those Schedules by The Corporation Tax (Implementation of the Mergers Directive) Regulations (SI 2007/3186) and amended by The Corporation Tax (Implementation of the Mergers Directive) Regulations 2008 (SI 2008/1579).

3452. Because of the similarity of the provisions for each regime (loan relationships, derivative contracts and intangible fixed assets) each section deals with all three regimes.

Section 817 of ICTA

3453. This amendment repeals section 817 of ICTA. See *Change 101* in Annex 1.

Section 826(5A) of ICTA

3454. Section 749A of ITTOIA rewrites the exemption from income tax in section 826(5) of ICTA. Section 826(5A) of ICTA, which states that the exemption from tax does not extend to corporation tax, is repealed with this subsection.

Section 834(1) of ICTA

3455. The partial definition of income inserted into section 834(1) of ICTA provides that income includes anything to which the charge to corporation tax on income applies. It reflects the fact that, where something that is not income by nature is made subject to the charge on income, it is impliedly treated as income for corporation tax purposes. .

3456. The terms of the partial definition assume you know what the charge on income applies to. Therefore, its relevance is confined to contexts other than defining the application of the charge. As with the other definitions in section 834(1), the partial definition does not apply if the context otherwise requires.

Section 834A of ICTA

3457. This amendment provides for the purposes of corporation tax the equivalent of section 1016 of ITA.

3458. This Bill omits the Schedules and the cases of Schedule D under which most income has been charged. There are various places in the Corporation Tax Acts, notably section 396 of ICTA, where there is a need to refer generically to the charging scope of Schedule D Case VI.

3459. This amendment inserts section 834A of ICTA. The section provides a list that replicates the scope of Schedule D Case VI so far as relevant to those generic references in the Corporation Tax Acts to Case VI. As in the income tax equivalent, the list omits those purely administrative uses of Case VI to recover excess relief, over-repayments of tax and the like, to which the generic references of Case VI have no application.

3460. Section 834A(3) of ICTA excludes from the list certain foreign income charged under Chapter 8 of Part 10 of this Bill (which deals with income not otherwise charged, whether the source is in or outside the United Kingdom), as such income is not within Schedule D Case VI.

Section 842 of ICTA

3461. This amendment includes the insertion of subsections (2D) and (2E) in section 842 of ICTA. It is based on paragraph 39 of Schedule 26 to FA 2002.

Section 843C of ICTA

3462. This amendment inserts a new section into ICTA. The explanation of “total profits” follows the use of the expression in section 9(3) of ICTA.

Paragraph 5 of Schedule 30 to ICTA

3463. This amendment repeals paragraph 5 of Schedule 30 to ICTA. See *Change 102* in Annex 1.

Part 2: Other enactments

TMA

Section 12AE of TMA

3464. This Bill legislates the "Crown Option". So this section is not needed and is repealed. See *Change 55* in Annex 1.

Section 19(2) of TMA

3465. This subsection is obsolete because sections 34 to 36 of ICTA have not charged sums under Schedule D Case VI since 1 April 1998.

Section 31(3) of TMA

3466. This Bill legislates the "Crown Option". So this section is not needed and is repealed. See *Change 55* in Annex 1.

Section 42(7) of TMA

3467. A number of trading income rules which require a claim in the source legislation are rewritten without that requirement. As a consequence the references in this section to claims under sections 84, 91B and 101(2) of ICTA and section 43(5) of FA 1989 are removed without replacement. See *Changes 28, 38, 39 and 68* in Annex 1.

Section 109A of TMA

3468. The residence rules in section 66 of FA 1988 and section 249 of FA 1994 apply for the purposes of the Taxes Acts as defined in section 118 of TMA. This Bill rewrites those rules for the purposes of the Corporation Tax Acts (Chapter 3 of Part 2). Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, this new section is introduced into TMA to apply to that Act the rules given in Chapter 3 of Part 2.

IHTA

Section 91 of IHTA

3469. Section 91 of IHTA currently refers to Part 16 of ICTA for the meaning of "charges on residue". This term has not been rewritten in this Bill and therefore the meaning is inserted into section 91 of IHTA. See the commentary on clause 947.

FA 1988

Paragraph 3(1) of Schedule 12 to FA 1988

3470. This Schedule deals with the change of status of building societies. The rule in this paragraph prevents the change of status from being a discontinuance of the building society's trade for the purposes of CAA.

3471. The main rules about what is a discontinuance for the purposes of CAA are in section 577 of CAA (and sections 558 and 559 deal with, respectively, partnership changes and successions). This 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 section 337(1)(a) of ICTA is not specially rewritten and there is no longer any rule that *treats* any event as the equivalent of the setting up, commencement or discontinuance of a trade etc. It follows that paragraph 3(1) of Schedule 12 to FA 1988 is no longer needed and this Bill repeals it.

TCGA

Section 59 of TCGA

3472. This section is amended to rewrite section 115(5) to (5C) of ICTA so far as it applies to chargeable gains of a company. The addition of the words "so far as providing for that relief" make clear that the rule (for both capital gains tax and corporation tax) goes no further than removing any exemption for chargeable gains in a double taxation arrangement. See *Change 87* in Annex 1.

Sections 116A and 116B of TCGA

3473. These amendments insert two new provisions rewriting section 91G(1) of, and (2) and paragraph 5 of Schedule 10 to, FA 1996 respectively. These two provisions within the loan relationships regime (Chapter 2 of Part 4 of FA 1996) are, in essence, capital gains provisions.

Sections 151E to 151G of TCGA

3474. These amendments insert new provisions which rewrite parts of both the loan relationships regime (Chapter 2 of Part 4 of FA 1996) and the rules on alternative finance arrangements in FA 2005 (rewritten as part of the loan relationships regime in Part 6 of the Bill). These provisions are, in essence, capital gains provisions.

3475. Section 151E, which rewrites section 84A(8) of FA 1996, is to be repealed from an appointed day (see Part 8 (loan relationships) of Schedule 2).

Sections 156ZA and 156ZB of TCGA

3476. These amendments insert new provisions which rewrite those parts of the intangible assets regime in Schedule 29 to FA 2002 which are, in essence, capital gains provisions.

3477. This includes those parts of paragraph 132 of Schedule 29 to FA 2002 which have permanent effect. Paragraph 132(2) to (4) provides rules of transition dealing only with a temporary overlap of the capital gains and intangible fixed assets regimes (unless there is an extension under section 152(3) of TCGA of the time limit) and can never be relevant to disposals after 31 March 2003. So they are not rewritten.

Section 158 of TCGA

3478. This 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 section 337(1)(a) of ICTA is not specially rewritten and there is no longer any rule that requires an event to be *regarded* as the equivalent of the setting up, commencement or discontinuance of a trade etc. It follows that the closing words of section 158(2) of TCGA are no longer needed and this Bill omits them.

Section 286A of TCGA

3479. The residence rules in section 66 of FA 1988 and section 249 of FA 1994 apply for the purposes of the Taxes Acts as defined in section 118 of TMA. This Bill rewrites those rules for the purposes of the Corporation Tax Acts (Chapter 3 of Part 2). Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, this new section is introduced into TCGA to apply to that Act the rules given in Chapter 3 of Part 2.

FA 1995

Section 126 of FA 1995

3480. This section no longer applies for corporation tax purposes, following the amendment of it by FA 2003 and the enactment of the scheme of corporation tax for non-United Kingdom resident companies. In subsection (7A)(b) the reference to section 114 of ICTA would need amendment but the whole of paragraph (b) is no longer needed and so is repealed by this Bill.

Section 127 of FA 1995

3481. This amendment is a consequence of removing the term "profit share return" from the provisions covering alternative finance arrangements. Refer to the commentary on clause 513. Sub-paragraph (ca) is amended to include what is currently profit share return under section 49A of FA 2005 and sub-paragraph (cb) can be omitted.

FA 1998

Paragraph 84 of Schedule 18 to FA 1998

3482. Paragraph 84 of Schedule 18 to FA 1998 makes administrative provision for HMRC to operate the "Crown Option" under which they may determine which Case of Schedule D applies if an item falls within more than one Case of that Schedule.

3483. This Bill provides priority rules for all such possible overlaps (see, for example, clause 982 (provisions which must be given priority over Part 10)). These reflect how the Crown Option is applied. So the administrative provisions in paragraph 84 of Schedule 18 to FA 1998 are redundant. See *Change 55* in Annex 1.

FA 1999

Section 63 of FA 1999

3484. Section 63 of FA 1999 provides transitional relief to mitigate the effect on football and other sports clubs of new accounting standards for the treatment of intangible assets.

3485. Section 63 of FA 1999 applies only to contracts entered into before the beginning of the first accounting period in which a club adopts the new accounting standards. The new accounting rules are effective for accounting periods ending on or after 23 December 1998. So section 63 applies only to contracts entered into before 24 December 1999.

3486. It is unlikely that any contract entered into before 24 December 1999 will still be in force when this Bill comes into effect. So section 63 of FA 1999 is considered to be redundant. See *Change 103* in Annex 1.

FA 2000

Section 46 of FA 2000

3487. The amendments to this section include those needed to replace the references to Schedule D Case I or VI, as a result of the omission by this Bill of the Schedules and the cases of Schedule D. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

3488. A number of the references in subsection (2A) have been omitted as unnecessary. These are not within the provisions listed in section 834A of ICTA to which subsection (2) now refers. But they are not in fact relevant to the exemption in this section, which applies to income "applied solely for the purposes of the charitable company" (subsection (3)). The omitted references all provide for a recovery of tax or similar charge and therefore do not represent income of the charity that could be so applied.

CAA

Sections 108, 112, 115, 263 265, 559 and 577 of CAA

3489. This 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. The amendments to these sections reflect this change of approach. See *Change 104* in Annex 1.

FA 2002

Paragraph 141 of Schedule 29 to FA 2002

3490. Paragraph 141 of Schedule 29 to FA 2002 is not rewritten. Paragraph 141(2) provides that references in Schedule 29 to the Inland Revenue are, subject to stated exceptions, references to any officer of the Board. The exceptions mentioned in paragraph 141(1) are in relation to the discretionary extension of the time limits for group relief under Part 6 of Schedule 29 and for reinvestment relief under Part 7 of Schedule 29 and in relation to clearance applications in respect of specified provisions in Part 11 of Schedule 29. In the case of these exceptions "Inland Revenue" means the Board. Matters to be dealt with by the Board are traditionally those requiring the exercise of judgement and discretion in particularly sensitive areas. The "Board" here is stated to mean the Commissioners for Inland Revenue reflecting directly the defined usage of terms in section 1(1) of TMA.

3491. Paragraph 141 of Schedule 29 to FA 2002 provides a way for Schedule 29 to make the necessary references to Revenue officers while preserving the distinction between functions that could be performed at an "ordinary" level in the department and those that could not. The terminology has however been overtaken by the creation of HMRC and the provisions of CRCA. If paragraph 141 were rewritten, it would be necessary to translate there the references to "Board", "Inland Revenue" and "Commissioners for Inland Revenue" into the post-CRCA equivalents while preserving the "special treatment" in respect of the provisions referred to in paragraph 141(1).

3492. However this is not necessary. A general interpretative provision is appropriate when the intangible fixed assets rules are set out in a separate Finance Act Schedule. But in the Bill, these rules are part of the main body of the corporation tax rules. So the appropriate post-CRCA term is simply inserted into each provision.

3493. For intended references to "any officer of the Board" under the general rule in paragraph 141(2) of Schedule 29 to FA 2002, the post-CRCA term is "any officer of Revenue and Customs" (section 50(1) of CRCA).

3494. For intended references to the "Commissioners for Inland Revenue" under the specific rule in paragraph 141(1) and (3) of Schedule 29 to FA 2002, the post CRCA term is the "Commissioners for Her Majesty's Revenue and Customs" (sections 1(1) and 50(1) of CRCA). However, as explained in the notes relating to the clauses involved, changes are proposed in respect of paragraph 35(2) of Schedule 29 to FA 2002 (rewritten as clause 753(2)) and paragraph 39(1)(a) of Schedule 29 to FA 2002 (rewritten as clause 756(1)) to reflect the fact that the power attributed there to the Commissioners for HMRC is, in practice, exercised by an officer of HMRC (see also *Change 1* in Annex 1).

3495. It is not necessary to rewrite the final sentence in paragraph 141(1) of Schedule 29 to FA 2002 which refers to the authority to delegate Board's functions. Under section 13 of CRCA practically all functions of the Commissioners are stated to be delegable to an officer of the Department. The established rewrite approach to denoting a function as proper to the Commissioners for HMRC is to leave section 13 of CRCA to spell out that it need not be carried out by the Commissioners personally.

Paragraph 142 of Schedule 29 to FA 2002

3496. This definitional provision in not rewritten because it is superseded in the Bill.

Paragraph 143 of Schedule 29 to FA 2002

3497. An index of definitions is included in a Bill-wide Schedule so paragraph 143 is not rewritten.

Energy Act 2004

Sections 28 and 44 of the Energy Act 2004

3498. The reference to section 834A of ICTA is to the provision inserted by this Schedule.

ITTOIA

Section 48 of ITTOIA

3499. 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".

3500. The amendments in this paragraph remedy two errors in section 48 of ITTOIA.

3501. Section 578A(4) of ICTA restricts a recovery charge if *any* deduction has been restricted under section 578A(3). Section 48(3) of ITTOIA deals only with a previous restriction under section 48(2). The amendment extends the restriction on the recovery charge to cases where the original restriction was made to any other deduction.

3502. Section 48(4) of ITTOIA refers to a "rebate or release" but neither paragraph of the subsection deals with a rebate. The amendment to paragraph (a) ensures that the subsection applies to rebates as well as to releases of debts.

3503. See *Change 83* in Annex 1.

Section 49 of ITTOIA

3504. 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".

3505. This amendment remedies a small omission in the definition in section 49 of ITTOIA of "qualifying hire car" for the purpose of section 48 of ITTOIA. See *Change 105* in Annex 1.

Sections 79, 79A and 80 of ITTOIA

3506. These amendments clarify the operation of ITTOIA in cases where there is a change in the persons carrying on a trade etc. See *Change 17* in Annex 1.

Sections 155 of ITTOIA

3507. This amendment allows as a deduction all levies and costs under FISMA. See *Change 22* in Annex 1.

Sections 175 to 184 of ITTOIA

3508. These amendments cater for the possibilities that trading stock is transferred to a person carrying on a profession or vocation or that work in progress is transferred to a person carrying on trade. See *Change 39* in Annex 1.

Section 303 of ITTOIA

3509. This amends Rule 1 in section 303 of ITTOIA so that the rule remains the same for income tax as it is for corporation tax. See *Change 50* in Annex 1.

Section 860 of ITTOIA

3510. This amendment makes clear that the section applies to property businesses. See *Change 88* in Annex 1.

Section 749A of ITTOIA

3511. Section 749A of ITTOIA rewrites section 826(5) of ICTA which was overlooked in the preparation of ITTOIA. It exempts from income tax interest on corporation tax repayments.

Sections 861 and 862 of ITTOIA

3512. These amendments make clear how the rules about spreading receipts from the sale of patent rights apply when there is a change in persons carrying on a trade. See *Change 89* in Annex 1.

FA 2005

Section 49(2) of FA 2005

3513. This amendment is a consequence of replacing the term “profit share return” with “alternative finance return”. Refer to the commentary on clause 513. Amendments for the same reason are also required for sections 49A, 51, 52, 56 and 57 of FA 2005.

FA 2006

Sections 46 and 47 of FA 2006

3514. The provisions about film production companies, film tax relief and supporting definitions in sections 31 to 36 of FA 2006 are rewritten. Those definitions are repealed along with the other provisions that are rewritten. But since those FA 2006 definitions also apply for the purposes of sections 46 and 47 of FA 2006 (withdrawal of existing reliefs), this amendment ensures that the rewritten definitions apply for the purposes of sections 46 and 47 of FA 2006.

Section 121 of FA 2006

3515. Section 114(1)(a) of ICTA does not apply to payments received by companies carrying on a trade etc in partnership. So subsection (4) of this section is repealed. See *Change 85* in Annex 1.

Paragraph 28 of Schedule 10 to FA 2006

3516. This paragraph determines a company's share in the profits or losses of a business. Sub-paragraph (2) refers to section 114(2) of ICTA. That reference is replaced by one to clause 1262 of this Bill.

3517. Clauses 1263 and 1264 legislate a non-statutory practice (see *Change 86* in Annex 1). The rules in those clauses would not have been taken into account for the purposes of Schedule 10 to FA 2006. So they are excluded by the amendment.

3518. The reference in sub-paragraph (2)(b) to a share in capital allowances and balancing charges has no effect because such allowances and charges are taken into account in calculating the profits or losses of the business. So paragraph (b) is not reproduced in the amendment.

ITA

Section 835A of ITA

3519. The residence rules in section 66 of FA 1988 and section 249 of FA 1994 apply for the purposes of the Taxes Acts as defined in section 118 of TMA. This Bill rewrites those rules for the purposes of the Corporation Tax Acts (Chapter 3 of Part 2). Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, this new section is introduced into ITA to apply the rules given in Chapter 3 of Part 2 for the purposes of income tax.

Schedule 2: Transitionals and savings

Part 1: General provisions

3520. These paragraphs ensure continuity of the law, despite the fact that this Bill repeals and rewrites provisions.

3521. Paragraph 2 makes clear that the proposition about the continuity of the law in paragraph 1 does not apply to changes in the law made by this Bill.

3522. The paragraphs in this Part stand instead of section 17(2) of the Interpretation Act 1978 and provide a comprehensive set of transitional arrangements.

Part 2: Changes in the law

3523. This paragraph allows anyone affected by a minor change in the law made by this Bill to elect that the change does not apply to events occurring before 1 April 2009. This allows the Bill to be applied as soon as possible without imposing charges retrospectively.

Part 3: Charge to corporation tax on income

Effect of repeal of section 9(1) of ICTA on relevance of case law

3524. The case law to which the saving is relevant is the case law relating to the construction of source legislation rewritten in the Bill whose application for corporation tax purposes depended on section 9(1) of ICTA (which applies income tax principles for corporation tax purposes).

Part 5: Company residence: exceptions to section 14

3525. These paragraphs apply where a company incorporated in the United Kingdom carried on business before 15 March 1988, the commencement date for section 66 of FA 1988 (rewritten in Chapter 3 of Part 2). These paragraphs rewrite parts of paragraphs 1, 2 and 5 of Schedule 7 to FA 1988. Paragraphs 4 and 5 of that Schedule are spent.

3526. United Kingdom incorporated companies which received Treasury consent to migrate from the United Kingdom before the commencement date (paragraph 1) and those with an application in the pipeline before the commencement date (paragraph 2) retain their foreign residence (despite clause 14) until they cease to carry on business or become resident in the United Kingdom under other rules. The provision for the Treasury to consent to company migrations (most recently section 765 of ICTA) was repealed with effect from the commencement date for section 66 of FA 1988.

Part 6: Trading income

Reserves of marketing authorities etc

3527. This paragraph makes clear that the status of schemes or arrangements approved by or made with the National Assembly for Wales before 26 May 2007 is preserved. See *Change 15* in Annex 1.

Part 7: Property income

Lease premiums: time limits for claims for repayment of tax

3528. This paragraph provides that the time limit for claims for repayment of tax under clause 238 or 239 is six years after the events described in those clauses. This preserves the period of six years mentioned in section 36(2)(b) of ICTA (charge on sale of land with right to reconveyance) until the Treasury make an order under this paragraph.

Part 8: Loan relationships

Exemption for interest on tax overpaid for accounting periods ending before 1 July 1999

3529. Section 34 of FA 1998 removed the exemption from corporation tax for interest under section 826(1) of ICTA (interest on tax overpaid) for payments made in accounting periods ending on or after 1 July 1999. Section 826(5A) of ICTA, which provides that the exemption does not apply for corporation tax purposes, is not rewritten in this Bill as the interest naturally falls to be charged as income by Part 5 of this Bill.

5½% Treasury Stock 2008-2012 not redeemed before 6 April 2009

3530. Because this Treasury Stock may be redeemed within a maximum of three years the exemption from charge under Part 5 for amounts other than interest (section 96(2) of FA 1996) is rewritten in this Schedule. See the commentary in the overview of Chapter 12 of Part 5.

Part 10: Derivative contracts

Extended meaning of reference in section 591(6)(b)

3531. This paragraph extends the list of provisions relevant to condition E in clause 591 (conditions A to E mentioned in section 589(5)). It is based on paragraph 4(2D) of Schedule 26 to FA 2002.

Disapplication of section 645

3532. This paragraph disapplies clause 645 (creditor relationships: embedded derivatives which are options) to a derivative contract if paragraph 9(2) of Schedule 10 to FA 2004 has effect in relation to the asset representing the creditor relationship which hosts the derivative contract. It is based on paragraphs 12(11C) and 45D(2) and (4) of Schedule 26 to FA 2002.

3533. That provision of FA 2004 deems an asset representing a creditor relationship no longer to be such if the asset was in existence at a date not later than 31 December 2005. See the following paragraphs for the rules that apply if a derivative contract would be within clause 645 if this paragraph did not apply.

Existing assets representing creditor relationships: options

3534. This paragraph, supplemented by the next two, disapplies clause 574 (non-trading credits and debits to be brought into account under Part 5) in respect of a derivative contract and modifies the application of TCGA in respect of the "original creditor relationship" mentioned in clause 645 (creditor relationships: embedded derivatives which are options), if that clause would have applied to the derivative contract but for the disapplication in the preceding paragraph. This paragraph is based on paragraphs 12(11C) and (11D), 45A(2) and 45FA(1), (3), (4), (6) and (8) of Schedule 26 to FA 2002.

3535. *Sub-paragraph (2)* disapplies clause 574 in respect of the "relevant credits and debits" arising on the option. Any gain or loss on the exercise or abandonment of the option is dealt with under the provisions of TCGA, as those provisions apply to the creditor relationship. "Relevant credits and debits" are defined in clause 659.

3536. The first modification of TCGA in respect of the original creditor relationship, in *sub-paragraph (3)*, is the same as that made by clause 645(8). The creditor relationship is not treated as a "qualifying corporate bond" although section 117(A1) of TCGA would otherwise treat it as such.

3537. The second modification, in *sub-paragraph (4)*, is to the amount or value of the consideration applicable to the asset representing the creditor relationship on a disposal of that asset. So much of any interest in respect of the creditor relationship as is brought into account under Part 5 (loan relationships) but, because of the terms of the disposal, is not paid or payable to the company to which it accrues, is deducted from the consideration. In effect, the charge under that Part is given priority over the charge to corporation tax on chargeable gains.

3538. The third modification, in *sub-paragraph (6)*, also affects the amount of that consideration. It adjusts that amount for any “relevant exchange gains” and “relevant exchange losses”, as those terms are defined in the paragraph below. The consideration is first increased by any such losses and then reduced by any such gains. If that reduction would exceed the amount of the consideration, that amount becomes nil and, under *sub-paragraph (7)*, the excess is added to incidental costs of acquisition under section 38 of TCGA.

3539. The definition of “relevant exchange gains” and “relevant exchange losses” refers to such gains and losses in respect of the asset representing the creditor relationship as are brought into account under Part 5 (loan relationships) for an accounting period throughout which the company holds the asset. Gains and losses are apportioned as necessary if the company only holds the asset for part of an accounting period. The effect of the adjustments to the consideration is to reverse the application of that Part to exchange gains and losses in respect of the asset in question so that those exchange adjustments are taken into account only in the chargeable gains arising in respect of the asset representing the creditor relationship.

3540. The second of these paragraphs provides definitions for the purposes of the first paragraph. It is based on paragraphs 12(11C) and 45FA(7) of Schedule 26 to FA 2002.

3541. The third of these paragraphs provides for the meaning in the first paragraph of the asset representing the creditor relationship if there has been a reorganisation of share capital. It is based on paragraphs 12(11C) and 45FA(5) of Schedule 26 to FA 2002.

Disapplication of section 648

3542. This paragraph disapplies clause 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences) to a derivative contract if paragraph 11(2) of Schedule 10 to FA 2004 has effect in relation to the asset representing the creditor relationship. It is based on paragraphs 12(11C) and 45F(2) and (7) of Schedule 26 to FA 2002.

3543. That provision of FA 2004 deems an asset representing a creditor relationship linked to the value of assets no longer to be such if the asset was in existence at a date not later than 31 December 2005. See the following paragraphs for the rules that apply if a derivative contract would be within clause 648 if this paragraph did not apply.

Existing assets representing creditor relationships: contracts for differences

3544. This paragraph and the next one make, with one exception, corresponding provision in respect of a derivative contract and its host contract, if clause 648 (creditor relationships: embedded derivatives which are exactly tracking contracts for differences) would apply to the derivative contract but for the disapplication in the preceding paragraph, to that made by the paragraphs above for “existing assets representing creditor relationships: options”. The exception is that these paragraphs do not provide specially for exchange gains and losses ("relevant exchange gains" and "relevant exchange losses" in the earlier paragraphs). These paragraphs are based on paragraphs 12(11C) and (11D) and 45FA(1), (2), (3), (4) and (5) of Schedule 26 to FA 2002.

Disapplication of section 658

3545. This paragraph disapplies clause 658 (chargeable gain or allowable loss treated as accruing when certain debtor relationships come to an end) to a derivative contract (and makes a consequential provision) if the liability representing the debtor relationship that hosts the derivative contract was owed before a date that is usually in 2005. It is based on paragraphs 45K(2) and 45KA(1) of Schedule 26 to FA 2002.

3546. The consequential provision is that, if clause 658 would apply to a derivative contract but for this paragraph, this paragraph disapplies clause 574 (non-trading credits and debits to be brought into account under Part 5) in respect of the relevant credits and debits arising on the derivative contract. Any gain or loss arising on the contract for differences is dealt with under the provisions of TCGA, as those provisions apply to the liability representing the debtor relationship. "Relevant credits" and "relevant debits" are defined in clause 659.

Disapplication of section 661

3547. This paragraph disapplies clause 661 (contract which became derivative contract) if the time when the relevant contract became a derivative contract was before 30 December 2006 (the date by reference to which the amendments made by the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006 (SI 2006/3269) have effect.). It is based on paragraph 43A(4) of Schedule 26 to FA 2002.

Disapplication of section 666

3548. This paragraph disapplies clause 666 (allowable loss treated as accruing where amount paid in discharge of obligations under debtor relationship) if the liability representing the debtor relationship was owed before a date which is usually in 2005. It is based on paragraph 45JA(1) and (2) of Schedule 26 to FA 2002.

Contracts which became derivative contracts on 16 March 2005

3549. This paragraph brings into account as a chargeable gain or allowable loss, when a company ceases to be a party to the contract, the gain or loss latent in a contract that became a derivative contract from 3.00pm on 16 March 2005 (the time at which the 2005 Budget announced proposed changes to the definition of what is a derivative contract). It is based on paragraph 4A(1), (2) and (3) of Schedule 26 to FA 2002.

3550. A contract that was not a derivative contract before that time but became one after that time is commonly one that formerly met the conditions for its underlying subject matter to be "excluded property" (see the commentary on clause 589 (contracts excluded because of underlying subject matter: general)). The Finance

Act 2002, Schedule 26, Parts 2 and 9 (Amendment) Order 2005 (SI 2005/646) amended the conditions for that purpose from that time to cut down the range of excluded property (see the conditions in clause 591 (conditions A to E mentioned in section 589(5))). Rather than covering most cases where the underlying subject matter of the contract is shares, either by themselves or in conjunction with holdings in shares, the excluded property rule now focuses on contracts used to hedge assets which are shares on which chargeable gains arise.

3551. The paragraph only applies if the contract was a "chargeable asset" immediately before it became a derivative contract (see the definition of that term in clause 703).

3552. *Sub-paragraph (5)* requires a chargeable gain or allowable loss to be brought into account on the assumption the company disposed of the contract immediately before it became a derivative contract and did so for consideration equal to the book value of the contract (if any) at the end of the last accounting period of the company before that to which the changes made by SI 2005/646 apply.

3553. Paragraph (b) of *sub-paragraph (6)* defines that period. In the source legislation, the words used are "the company's accounting period immediately before its first new period". The term "new period" is not otherwise used in SI 2005/646. But a "new period" cannot predate the first period to which the amendments made by those regulations apply (as set out in article 1 of SI 2005/646). The paragraph has therefore been aligned with the commencement terms of SI 2005/646. See *Change 106* in Annex 1.

Contracts which became derivative contracts on 28 July 2005

3554. This paragraph treats a relevant contract to which it applies as a derivative contract entered into by a company on 28 July 2005 and determines the value of the consideration given for the contract. It also brings into account as a chargeable gain or allowable loss when the company ceases to be a party to the contract the gain or loss latent in the contract at 28 July 2005. It is based on paragraph 4B(1), (2), (3) and (4) of Schedule 26 to FA 2002.

3555. The Finance Act 2002, Schedule 26, Parts 2 and 9 (Amendment No 2) Order 2005 (SI 2005/2082) extends the scope of the amendments made by SI 2005/646 to the "excluded property" rules (see clause 589 (contracts excluded because of underlying subject matter: general)). See the comments on the amendment of the "excluded property" rules in connection with the preceding paragraph.

3556. A contract to which this paragraph applies is one that was not a derivative contract immediately before 28 July 2005 (although it was a "chargeable asset" at that point). But it would have been a derivative contract had an accounting period of the company begun on that date, that is, when the amendments made by SI 2005/2082 came into force. Because of the rule in this case, it is immaterial when the actual accounting period of the company began in which 28 July 2005 falls.

3557. The definition of “chargeable asset” in clause 703 applies.

3558. *Sub-paragraph (6)* brings into account the chargeable gain or allowable loss latent in the contract at the time it is treated as becoming a derivative contract. It does so in the same way as the preceding paragraph with one exception. This is that the consideration for the disposal is equal to the fair value of the contract on 28 July 2005 (that is, the same figure as is taken to be the consideration for the deemed derivative contract in the subsequent application of Part 7 to the contract).

Plain vanilla contracts which became derivative contracts before 30 December 2006

3559. This paragraph modifies the amounts otherwise allowable as acquisition costs under section 38 of TCGA on the disposal of a plain vanilla contract if the disposal occurs because the company ceases to be a party to the contract. It is based on paragraph 4D of Schedule 26 to FA 2002.

3560. There are two conditions to be met. The first is that the plain vanilla contract was previously not a derivative contract but became one at a date before 30 December 2006. Although the paragraph does not specify in what circumstances the contract became a derivative contract, it is likely to be the case that it had ceased to satisfy the conditions in clause 589 (contracts excluded because of underlying subject matter: general) under which the underlying subject matter of the contract was “excluded property”.

3561. The second condition is that neither of the two preceding paragraphs applies on the company ceasing to be a party to the contract.

3562. 30 December 2006 is the date by reference to which the amendments made by the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006 (SI 2006/3269) have effect.

3563. *Sub-paragraph (2)* disapplies clause 699 (priority of Part 7 for corporation tax purposes) in respect of a disposal to which this paragraph applies (that is, the provisions of this paragraph do not exhaust the application of the Corporation Tax Acts to this disposal).

3564. The adjustments made by this paragraph to the acquisition costs allowable under section 38 of TCGA are similar to those made by a number of provisions in Chapter 8 of Part 7. As with those clauses, this paragraph in effect reverses the treatment of credits and debits in respect of the derivative contract so that double counting is avoided when the contract is disposed of.

3565. And similarly again to those clauses, if the adjustment to be made under *sub-paragraph (3)* is a reduction that exceeds the amounts otherwise allowable under section 38 of TCGA, the excess is added to the consideration for the disposal.

3566. “Plain vanilla contract” is defined in clause 708.

Issuers of securities with embedded derivatives: deemed options

3567. This paragraph disapplies clauses 653 and 655 and varies the application of clause 654 in a case where the company was a party to the debtor relationship in question immediately before its first accounting period to begin on or after 1 January 2005. It is based on paragraph 45J(4) of Schedule 26 to FA 2002.

3568. The paragraph preserves the commencement rules that apply on the insertion of paragraph 45J of Schedule 26 to FA 2002.

Contract becoming derivative contract on 12 March 2008

3569. This paragraph determines the consideration treated as given for a relevant contract that became a derivative contract on 12 March 2008 by virtue of certain provisions of FA 2008. It is based on paragraph 20 of Schedule 22 to FA 2008.

3570. Paragraph 20 of Schedule 22 to FA 2008 amends the source legislation for clauses 579(1) and 589(5) with effect from 12 March 2008, the effect of which is that a number of relevant contracts became derivative contracts. This paragraph determines the consideration treated as given for such a derivative contract so that the provisions setting out the credits and debits to be brought into account under Part 7 may be applied.

Avoidance relying on continuity of treatment provisions: transactions before 16 May 2008

3571. This paragraph preserves the commencement rules applying on the introduction of the source legislation for clause 629. It is based on paragraph 5(3) of Schedule 22 to FA 2008.

Disposals for consideration not fully recognised by accounting practice: disposals before 16 May 2008

3572. This paragraph preserves the commencement rules applying on the introduction of the source legislation for clause 698. It is based on paragraph 4(3) of Schedule 22 to FA 2008.

References to Companies Act 2006

3573. This paragraph provides for the interpretation of references to section 286 of the Companies Act 2006 until such time as that section is brought into force. It is based on regulation 6 of The Corporation Tax (Implementation of the Mergers Directive) Regulations 2008 (SI 2008/1579).

3574. The paragraph applies the equivalent provision in the predecessor Companies Act until an order brings section 658 of the Companies Act 2006 into force.

Repeal of provisions concerning exchange gains and losses from derivative contracts

3575. This paragraph preserves the prospective repeal by F(No 2)A 2005 of some provisions dealing with exchange gains and losses. It is based on paragraph 9(1) of Schedule 6 to F(No 2)A 2005.

Part 14: Other relief for employee share acquisitions

Accounting periods beginning before 1 January 2003

3576. This paragraph preserves the transitional provision in paragraph 33 of Schedule 23 to FA 2003. This transitional might be required to prevent a double deduction in the case of an option granted before 1 January 2003 but exercised after 30 March 2009.

Part 17: Film production

Application of Part 15 etc to films that commenced principal photography before 1 January 2007 but were not completed before that date

3577. Section 52 of FA 2006 contains powers to make transitional provisions relating to films that started principal photography before 1 January 2007 but which were not completed before that date. The Corporation Tax (Taxation of Films) (Transitional Provisions) Regulations 2007 (SI 2007/1050) have been made under section 52 of FA 2006.

3578. Some of the tax provisions which are modified, for transitional purposes, by SI 2007/1050 are rewritten in Part 15 but others (such as the withdrawal of existing film reliefs for both income tax and corporation tax purposes) are not rewritten or are, effectively, rewritten elsewhere (in the Part dealing with intangible fixed assets).

3579. These paragraphs adapt the transitional provisions in SI 2007/1050 so that they refer to the appropriate places in FA 2006, Part 15 of this Bill or elsewhere in this Bill.

Part 19: Unremittable income

Unremittable income that arose in an accounting period ending before 1 April 2009

3580. This paragraph ensures that the relief given by Part 18 of this Bill, and any withdrawal of that relief by virtue of clause 1276 or 1277, is not restricted to income that arose in an accounting period ending on or after 1 April 2009 or, as regards withdrawal of relief, to claims under that Part.

3581. See also sub-paragraph (7) of the paragraph headed “tribunal reform” in Part 21 of this Schedule.

Part 21: Other provisions

Miscellaneous profits and losses: apportionment to accounting periods ending before 1 April 2009

3582. Clause 1307 applies to various sources of income that are taxed under Schedule D Case VI in the source legislation. It rewrites section 72 of ICTA which allows the profits of a period of account to be apportioned.

3583. The basis of assessment for such income is the full amount of the profit arising in the accounting period (clause 8). If accounts are prepared for any of these sources it may be necessary to apportion the profits of accounts made up to a period which is not itself an accounting period to arrive at the figure of profit that arises in each relevant accounting period.

3584. Clause 1329 provides that the Bill when enacted takes effect for corporation tax purposes for accounting periods ending after 31 March 2009. This paragraph provides that the rewritten legislation applies to a period of account that straddles 1 April 2009 even though an accounting period or periods ending before 1 April 2009 are affected. This Bill includes a number of minor changes in the law. Without this paragraph it would be necessary for taxpayers to take account of those changes only for the accounting period ending on or after 1 April 2009.

3585. If the taxpayer does not want the new law to apply to a transaction that occurred before 1 April 2009 it can elect for the old legislation to continue to apply (see Part 2 of this Schedule).

Charge to tax under Case VI of Schedule D in subordinate legislation

3586. These paragraphs preserve the effect of references to Schedule D Case VI in subordinate legislation. Where a provision such as section 396 of ICTA refers to something "within the charge to corporation tax under Case VI of Schedule D", that reference is sufficient to pick up any such part of the charge as is applied in secondary legislation. For an example of this, see paragraph 58 of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).

3587. Such references to Schedule D Case VI are replaced by references to provisions in the table in section 834A of ICTA (which is inserted by Schedule 1 to this Bill). The first paragraph ensures that such parts of the charge to corporation tax that are in secondary legislation are treated as within the table in that section. The second paragraph ensures that any such secondary legislation that had effect for the purposes of loss relief in respect of a transaction to which Schedule D Case VI applied continues to have equivalent effect.

Tribunal reform

3588. This paragraph makes provision for a number of rules to apply by reference to the functions of General or Special Commissioners until those functions are transferred to the First-tier Tribunal or Upper Tribunal in accordance with an order made under section 30 (1) of the Tribunals, Courts and Enforcement Act 2007.

3589. A draft of such an order ("the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2008") has been laid before Parliament for approval by resolution of each House of Parliament in accordance with section 49(5) of the Tribunals, Courts and Enforcement Act 2007. The order proposes the transfer of the functions of the General Commissioners and Special Commissioners to the First-tier Tribunal or Upper Tribunal by means of amendments of references to General Commissioners and Special Commissioners in primary and secondary legislation. It also proposes the repeal of various provisions including sections 31B to 31D of TMA and section 584(9) of ICTA as well as the insertion of appropriate replacement appellate procedures where needed. The draft order proposes coming into force on 1 April 2009.

3590. The drafting of the Bill assumes the proposals in the draft order will be in force on 1 April 2009, the date on which the Bill itself comes into force. This paragraph preserves the position under the law as it stood before that date, for the clauses rewriting provisions that refer to procedures before General or Special Commissioners, in the event that the draft order comes into force later than 1 April 2009. It also preserves a transitional rule, under which the right of appeal to the Special Commissioners, in section 584(9) of ICTA, is retained for cases involving questions on the operation of that section or Part 18 of the Bill that refer to income arising in an accounting period ending before 1 April 2009. See *Change 98* in Annex 1.

Schedule 3: Repeals and revocations

3591. This Schedule contains repeals and revocations of enactments including some spent enactments.

Schedule 4: Index of defined expressions

3592. This Schedule lists expressions defined in this Act or in other Acts.

3593. The definition of "registered industrial and provident society" is inserted into section 834(1) of ICTA by Schedule 1 to this Bill.

FINANCIAL EFFECTS OF THE BILL

3594. The Bill will not require any additions to previously planned expenditure. Revision of guidance for users and for staff will be undertaken as part and parcel of the process of improving such material and keeping it up to date in response to new legislation and other changes. The minor changes in the law in the Bill are expected to have negligible effect on tax revenues.

EFFECTS OF THE BILL ON PUBLIC SERVICE MANPOWER

3595. The Bill will not require any increase in the number of staff in HMRC or other departments.

SUMMARY OF THE IMPACT ASSESSMENT

3596. An implementation stage impact assessment of the effects of the Bill is available at http://www.hmrc.gov.uk/ria/index.htm#full or from Jackie Bartlett, Tax Law Rewrite Project, HMRC, 8th Floor, SW Wing, Bush House, Strand, London WC2B 4RD (Telephone 020 7438 7606).

3597. In summary, the Bill is expected to benefit companies, external tax professionals and agents as well as HMRC staff. The benefits are broadly summarised as:

- greater ease of use of the legislation with fewer disputes or errors concerning the meaning of the law; and

- less time spent navigating, understanding and applying the legislation correctly.

3598. In addition:

- tax professionals new to the legislation will find it easier to understand and learn; and

- greater ease of use of the legislation will result in lower costs.

3599. There will be some one-off costs to business: there will be retraining costs for users in familiarising themselves with the new legislation and commercial publishers and software suppliers will need to update their products.

EUROPEAN CONVENTION ON HUMAN RIGHTS

3600. Section 19 of the Human Rights Act 1998 requires the Minister in charge of a Bill in either House of Parliament to make a statement, before second reading, about the compatibility of the provisions of the Bill with the Convention rights (as defined in section 1 of that Act).

3601. The Chancellor of the Exchequer has made the following statement:

> In my view the provisions of the Corporation Tax Bill are compatible with the Convention rights.

3602. The provisions of the Bill have been the subject of careful consideration in order to ensure that they are compatible with the Convention rights. The following provisions have received closest scrutiny. Articles referred to below are Articles of the Convention.

Clause 245

3603. This clause provides that an officer of HMRC may by notice require a person, thought by the officer to have information about the effective duration of a lease, to provide information on matters specified in the notice. In relation to a solicitor acting for a client, the scope of the information is limited to whether the solicitor was acting on behalf of the client and that client's name and address.

3604. The solicitor/client relationship is in principle protected by Article 8. Nevertheless, this clause has a legitimate aim and is a proportionate means of obtaining the information, since it is discretionary in nature and therefore allows the officer to use alternative, less intrusive means if available. It does not offend the limits of legal professional privilege, since it does not result in the disclosure of legal advice itself. It is therefore compatible with the Article 8 rights of both the taxpayer and the solicitor.

Clauses 333, 334, 609 and 610

3605. These clauses rewrite Paragraph 10A of Schedule 9 to FA 1996 (loan relationships) and Paragraph 22A of Schedule 26 to FA 2002 (derivative contracts). They apply where a United Kingdom resident company asset holder ceases to be resident or where the asset ceases to be held for the purposes of a permanent establishment in the United Kingdom. In either case the relevant event causes the asset to be taxed at fair (market) value.

3606. The apparent difference in treatment, between resident and non-resident companies, does not engage Article 14 (in conjunction with Article 1 of Protocol 1). There is no use of a personal characteristic as a ground for the difference in treatment.

Clauses 792 and 793

3607. These clauses rewrite part of Paragraph 66 of Schedule 29 to FA 2002, relating to intangible fixed assets. That paragraph allows the reallocation of a chargeable realisation gain (described in clause 741) between members of a group of companies, on certain conditions. The main condition is that the transferee company must be resident in the United Kingdom or trading through a permanent establishment not exempt from corporation tax under double taxation rules.

3608. The apparent different treatment of non-resident group companies not trading here is not incompatible with Article 14 (prohibition of discrimination), taken in conjunction with Article 1 Protocol 1 (protection of property), because such a company is not in a comparable situation to resident group companies, not having the same economic connection with the United Kingdom. Nor is the difference in treatment based upon a personal characteristic. Further, in so far as the condition is intended to prevent reallocation of charges outside the United Kingdom tax net, it is an anti-avoidance provision which pursues a legitimate aim in a proportionate manner.

Clause 1207

3609. The offence created in this clause consists of unlawful disclosure of private taxpayer information by officials acting for the Secretary of State for Culture, Media and Sport and officials of the United Kingdom Film Council. A defence is available if the official shows that he or she reasonably believed that the disclosure was lawful or that the information was already available to the public. Disclosure is "lawful" if it is made in accordance with one of the six exceptions listed in clause 1206(3) (for example, if disclosure is authorised by an enactment, under an order of a court or with the consent of the person to whom the information relates).

3610. The reverse onus in this provision does not offend the presumption of innocence in Article 6(2), since it does not remove the presumption, but merely allows a specific defence which, when weighed against the taxpayer confidentiality rights, is both appropriate and fair.

Part 2 of Schedule 2

3611. The Bill makes minor changes to the law in the interests of simplification and to bring the legislation into line with current practice. These changes have either no practical effect or only small effects. A small number may make small increases in the amount of tax payable for a small group of taxpayers. In addition, the wording of the Bill differs from the wording of the legislation it replaces in very many detailed particulars. Although the contents of the Bill have been examined with great care, it is still possible that some of these detailed changes will operate to change the law in ways that cannot now be foreseen. Some of the changes arising in this way may have effect so as to impose a charge to tax in respect of events occurring before the respective provisions have effect.

3612. Part 2 of Schedule 2, therefore, addresses the possibility of an unfair adverse effect upon a taxpayer, and possibly upon the taxpayer's Convention rights. A corresponding provision was included in ITA. If there is an action or event prior to the coming into force of the Bill which has certain tax consequences, and the effect of the Bill is that those tax consequences change when the Bill comes into force, the taxpayer may opt that the tax consequences after the Bill comes into force are to be the same as they were under the "old" law. While Article 1 of Protocol 1 is engaged, the provision satisfies the fair balance test in that Article.

TERRITORIAL EXTENT

3613. The Bill extends to the whole of the United Kingdom.

3614. Because the Sewel Convention provides that Westminster will not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament, if there are amendments relating to such matters which trigger the Convention, consent of the Scottish Parliament will be sought for them.

COMMENCEMENT

3615. The substantive provisions of this Bill will come into force on 1 April 2009. Clause 1329 provides for it to have effect:

- for corporation tax purposes, for accounting periods ending on or after that day; and

- for income tax and capital gains tax purposes, for the tax year 2009-10 and subsequent tax years.

CORPORATION TAX BILL

EXPLANATORY NOTES

[VOLUME III]

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

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