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 I]

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 1
(INTRODUCTION AND SECTIONS 1 TO 476)

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INTRODUCTION

1. These explanatory notes relate to the Corporation Tax Bill as introduced in the House of Commons on 4 December 2008. They have been prepared by the Tax Law Rewrite project at HMRC to assist readers of the Bill and to help inform debate on it. They do not form part of the Bill and have not been endorsed by Parliament.

2. The notes need to be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of its contents. So if a clause or part of a clause does not seem to require explanation or comment, none is given.

3. The commentary on each clause indicates the main origin or origins of the clause. A full statement of the origins of each clause is contained in the Bill's Table of Origins.

4. At the end of the commentary there is supporting material in two annexes.

- *Annex 1* contains details of the minor changes in the law made by the Bill.
- *Annex 2* contains lists of:
    - the Extra-Statutory Concessions to which the Bill gives effect;
    - the minor changes made by the Bill which involve giving statutory effect to principles derived from case law; and
    - provisions not included in the Bill on the grounds of redundancy.

Summary

5. The main purpose of the Corporation Tax Bill is to rewrite the charge to corporation tax and the primary corporation tax legislation used by companies in computing their income.

6. The Bill does not generally change the meaning of the law when rewriting it. The minor changes which it does make are within the remit of the Tax Law Rewrite project and the Parliamentary process for the Bill. In the main, such minor changes are intended to clarify existing provisions, make them consistent or bring the law into line with well established practice.

Background

The Tax Law Rewrite project

7. In December 1995 the Inland Revenue presented a report to Parliament on the scope for simplifying the United Kingdom tax system (*The Path to Tax Simplification*). The main recommendation was that United Kingdom direct tax legislation should be rewritten in clearer, simpler language.

8. This recommendation was warmly welcomed, both in Parliament and in the tax community. In his November 1996 Budget speech the then Chancellor of the Exchequer (the Rt Hon Kenneth Clarke QC MP) announced that the Inland Revenue would propose detailed arrangements for a major project to rewrite direct tax legislation in plainer language.

9. The project team has been carrying out this work. The aim is that the rewritten legislation should use simpler language and structure than previous tax legislation. The members of the project are drawn from different backgrounds. They include longstanding HMRC employees, former private sector tax professionals and parliamentary counsel including (as head of the drafting team) a senior member of the Parliamentary Counsel Office.

Steering Committee

10. The work of the project is overseen by a Steering Committee, chaired by the Rt Hon the Lord Newton of Braintree OBE DL. The membership of the Steering Committee as at 31 October 2008 was:

The Rt Hon the Lord Newton of Braintree OBE DL (Chairman)
Dr John Avery Jones CBE
Adam Broke
Baron Christopher of Leckhampton CBE
Nicholas Dee
Dave Hartnett CB
The Rt Hon Michael Jack MP
Eric Joyce MP
District Judge Rachel Karp
Professor John Tiley CBE
John Whiting CBE

Consultative Committee

11. The work is also reviewed by a Consultative Committee, representing the accountancy and legal professions and the interests of taxpayers. The membership of the Consultative Committee as at 31 October 2008 was:

Robina Dyall	Chairman
Brian Atkinson	100 Group
Adam Broke	Special Committee of Tax Law Consultative Bodies
Colin Campbell	Confederation of British Industry
Russell Chaplin	London Chamber of Commerce & Industry
Mary Fraser	Association of Chartered Certified Accountants
Malcolm Gammie CBE QC	The Law Society of England and Wales
Julian Ghosh QC	Revenue Bar Association
Keith Gordon	Chartered Institute of Taxation

Terry Hopes	Institute of Chartered Accountants in England and Wales
Bob McInerney	Federation of Small Businesses
Isobel d'Inverno	Law Society of Scotland
Amy Jones	Institute of Chartered Accountants of Scotland
Simon McKie	Institute of Chartered Accountants in England and Wales
Lakshmi Narain	Chartered Institute of Taxation
Francis Sandison	The Law Society of England and Wales
Michael Templeman	Institute of Directors
Professor David Williams	Office of the Social Security Commissioners
Mervyn Woods	Confederation of British Industry

Consultation

12. The work produced by the project has been subject to public consultation. This has allowed all interested parties an opportunity to comment on draft clauses.

13. This consultation took the form of a series of papers which published clauses in draft. There were 20 of these, published between July 2006 and November 2008 and a draft Bill was published for consultation in February 2008. All these documents are available on the Tax Law Rewrite website.

14. The project also held detailed informal discussions and workshops with leading private sector tax professionals and HMRC specialists to consider the drafting of the more complex areas of rewritten tax legislation, for example, loan relationships and derivative contracts.

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

Alma Consulting Group
Chartered Institute of Taxation
Confederation of British Industry
Deloitte & Touche LLP
Ernst & Young LLP
Institute of Chartered Accountants in England and Wales
International Swaps and Derivatives Association, Inc.
KPMG LLP
Law Society
London Investment Banking Association
London Society of Chartered Accountants
PricewaterhouseCoopers LLP

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

This Bill

The end of the Schedules

16. ITTOIA completed the abolition of Schedules for charging income for income tax. This Bill repeals the Schedules so far as they remain for corporation tax and therefore marks the end of the Schedules.

Features of the Bill

17. The Bill:

- contains the basic corporation tax provisions including the charge to tax, accounting periods and provisions relating to residence;
- contains provisions relating to trading and property income and income from other sources;
- contains special provisions for companies affecting the calculation of income, such as those for loan relationships, derivative contracts and intangible fixed assets;
- contains provisions governing particular types of expenditure, for example, expenditure on research and development and films; and
- will take the place of many provisions within ICTA, FA 1996, FA 2001 and FA 2002 as the main Act for the areas of corporation tax covered by this Bill.

18. The Bill has 1330 clauses and four Schedules.

19. The clauses are arranged as follows:

Part 1: Introduction
Part 2: Charge to corporation tax: basic provisions
Part 3: Trading income
Part 4: Property income
Part 5: Loan relationships
Part 6: Relationships treated as loan relationships etc
Part 7: Derivative contracts
Part 8: Intangible fixed assets
Part 9: Intellectual property: know-how and patents
Part 10: Miscellaneous income
Part 11: Relief for particular employee share acquisition schemes
Part 12: Other relief for employee share acquisitions
Part 13: Additional relief for expenditure on research and development
Part 14: Remediation of contaminated land
Part 15: Film production
Part 16: Companies with investment business
Part 17: Partnerships

Part 18: Unremittable income
Part 19: General exemptions
Part 20: General calculation rules
Part 21: Other general provisions

20. The Schedules are:

Schedule 1: Minor and consequential amendments
Schedule 2: Transitionals and savings
Schedule 3: Repeals and revocations
Schedule 4: Index of defined expressions

21. Tables of Origins and Destinations have also been prepared. The Table of Destinations shows the destination not only of repealed provisions but of all provisions rewritten in the Bill.

Glossary

22. The commentary uses a number of abbreviations. They are listed below.

CAA	the Capital Allowances Act 2001
CAA 1990	the Capital Allowances Act 1990
CRCA	the Commissioners for Revenue and Customs Act 2005
ESC	Extra-statutory concession
HMRC	Her Majesty's Revenue and Customs
FA 1989	Finance Act 1989 (and similarly for other Finance Acts)
F(No 2)A	Finance (No 2) Act
FISMA	the Financial Services and Markets Act 2000
ICTA	the Income and Corporation Taxes Act 1988
IHTA	the Inheritance Tax Act 1984
ITA	the Income Tax Act 2007
ITEPA	the Income Tax (Earnings and Pensions) Act 2003
ITTOIA	the Income Tax (Trading and Other Income) Act 2005
NIC	national insurance contributions
PAYE	Pay As You Earn
R&D	research and development
TCGA	the Taxation of Chargeable Gains Act 1992
TMA	the Taxes Management Act 1970
VAT	value added tax

COMMENTARY ON CLAUSES

Part 1: Introduction

Clause 1: Overview of Act

23. This clause describes the content of the Bill. It is new.

24. *Subsections (1)* and *(2)* make it clear that that a large part of the Bill is directly concerned with the application of the charge to corporation tax on income.

25. *Subsection (3)* notes that Part 7 also includes provision for the charge to corporation tax on chargeable gains in relation to derivative contracts.

26. *Subsection (4)* notes that Parts 5 to 8 have a role in relation to the treatment of deficits and losses in connection with the matters to which the Parts relate.

27. *Subsections (5)* and *(6*) describe the particular cases covered by Parts 11 to 18 and *subsection (7)* the provisions of general application in Parts 19 to 21.

28. *Subsection (8)* notes where abbreviations and defined expressions used in the Bill can be found.

Part 2: Charge to corporation tax: basic provisions
Chapter 1: The charge to corporation tax
Overview

29. The process of separating income tax and corporation tax began with ITTOIA and continued with ITA, which substantially completed the rewrite of income tax legislation for income tax purposes. Following that there were two parallel sets of income tax principles. Those in rewrite style apply only for income tax purposes and, for example, no longer include Schedules such as Schedule D and its Cases.

30. Prior to this Bill corporation tax has been dependent on the continuing existence of the income tax rules in unrewritten style so that, for example, those Schedules and Cases continue to be applied for the purposes of corporation tax.

31. This Bill continues and finalises the separation process so that the relevant principles apply separately for corporation tax. The adoption of this approach means that section 9 of ICTA (computation of income: application of income tax principles) is repealed by this Bill (apart from section 9(5) which theoretically could have a continuing effect). Some of the provisions of section 9 of ICTA are rewritten in clause 969 and there is a transitional provision in Schedule 2.

32. This Chapter deals with the charge to corporation tax on profits. The approach retains the principle of a single charge, currently under section 6 of ICTA. The charge under clause 2 is on amounts of income and on chargeable gains that together form the "profits pot".

33. This contrasts with the multiple charges to income tax in the Income Tax Acts, primarily ITTOIA, and reflects the different history of the two taxes.

34. The way the charge on profits operates is explained in the commentary on clause 2. This clause rewrites both section 6(1) and (4) of ICTA and section 9(1) and (4) of that Act. In the light of the separation of corporation tax from income tax it is

necessary to find a different way of expressing the relationship between the general charge to corporation tax on income and the provisions that deal with its application.

35. There are also other charges to corporation tax. These are charges to an amount of corporation tax and they do not feature in the "profits pot". There is an example of this kind of charge in this Bill – in clause 75{j032704}(2) (retraining courses: recovery of tax).

36. These are provisions of an administrative nature mainly recovering excessive relief. In some of the charges of this kind there are references to the assessment being made under Schedule D Case VI. The Case VI label will disappear along with Schedule D and the other Cases with the repeal of section 18 of ICTA. The references are removed by consequential amendments in Schedule 1. An example is the amendment to paragraph 27(4) of Schedule 16 to FA 2002.

Clause 2: Charge to corporation tax

37. This clause provides the charge to corporation tax on profits. It is based on section 6(1) and (4) and section 9(1) and (4) of ICTA.

38. *Subsection (1)* states that corporation tax on profits is charged for a financial year for which an Act provides. It is based on the two overlapping propositions in section 6(1) of ICTA.

39. Under *subsection (2)* "profits" in Part 2 means "income and chargeable gains, except in so far as the context otherwise requires". This interpretation derives from section 6(4) of ICTA. The Bill amends section 6(4) of ICTA in Schedule 1.

40. Chargeable gains are defined in section 1(1) of TCGA. In *subsection (3)* " the charge to corporation tax on income" is introduced as a label. The expression is defined for corporation tax purposes as a result of an amendment to section 834(1) of ICTA made by Schedule 1 to the Bill.

41. *Subsection (4)* provides that the charge to corporation tax on income in effect depends on there being another provision of the Corporation Tax Acts that applies it.

42. This subsection is based on section 9(1) and (4) of ICTA. Section 9(1) in effect controls the meaning of "income" in section 6 of ICTA. As noted in the overview the Bill will complete the split between income tax and corporation tax and the formulation in section 9(1) of ICTA is no longer apposite since its wording is *adapted to the circumstances of applying one body of tax law (income tax principles) for the purposes of another tax (corporation tax).*

43. The effect of section 9 of ICTA is that the scope of the charge to income tax determines what is income for corporation tax purposes (except as otherwise provided by the Tax Acts). *Income tax, although primarily a charge to tax on things which would be regarded as income in its ordinary* sense, is not exclusively a charge on such

things. Section 9(4) provides that anything that is within the charge to income tax is within the charge to corporation tax on income "whether expressed to be income or not and whether an actual amount or not".

44. So the effect of section 9 of ICTA is that (subject to the provisions of the Corporation Tax Acts) the charge to corporation tax on income is driven by the particular heads of the charge to income tax.

45. The purpose of this clause is to achieve an equivalent effect, so that the charge to corporation tax on income is driven by the particular heads of the charge to corporation tax on income. In this way the clause substitutes the provisions of the Corporation Tax Acts for the income tax provisions. For example clause 35 applies the charge to corporation tax on income to the profits of a trade.

Clause 3: Exclusion of charge to income tax

46. This clause ensures that income of a company within the charge to corporation tax is not chargeable to income tax as well as corporation tax. It is based on section 6(2) of ICTA.

Clause 4: Exclusion of charge to capital gains tax

47. This clause ensures that chargeable gains of a company within the charge to corporation tax are not chargeable to capital gains tax as well as corporation tax. It is based on section 6(3) of ICTA.

Clause 5: Territorial scope of charge

48. This clause sets out the territorial scope for the charge to corporation tax. It is based on section 8(1) and section 11(1) and (2) of ICTA.

49. *Subsection (1)* deals with the position of companies resident in the United Kingdom. It restates section 8(1) of ICTA which, although expressed in general terms, only has effect in relation to UK resident companies (because of the exception under section 11 for non-UK resident companies).

50. Chapter 3 of this Part sets out the statutory rules for company residence. Chapter 4 explains what are chargeable profits in the case of non-UK resident companies.

Clause 6: Profits accruing in fiduciary or representative capacity

51. This clause deals with profits accruing directly to the company where it is acting in a fiduciary or representative capacity, for example as a nominee. It is based on section 8(2) of ICTA.

52. In this case the charge under clause 2 only applies where the company has a beneficial interest in the profits.

53. When a company goes into liquidation it ceases to be the beneficial owner of its assets. The exception in *subsection (2)* means that in this case the company's profits remain within the charge to corporation tax.

Clause 7: Profits accruing under trusts

54. This clause sets out the treatment of profits that do not accrue to the company directly but in which the company has a beneficial interest under a trust. It is based on section 8(2) of ICTA.

55. The words "in any case in which it would be so chargeable if the profits accrued to it directly" are not reproduced because the treatment for which the clause provides makes them unnecessary. Profits which are treated as accruing to a company directly are chargeable to corporation tax in the same circumstances that they would have been had they in fact accrued directly to the company.

56. There is no reference to profits arising under a partnership in contrast to section 8(2) of ICTA. Provisions for the charge to corporation tax on the profits of corporate partners are set out elsewhere in the Bill and in particular in Part 17.

Clause 8: How tax is charged and assessed

57. This clause sets out how corporation tax is charged and assessed. It is based on section 8(3) and section 12(1) of ICTA.

58. The reference to deductions in section 8(3) and section 12(1) of ICTA and the words in brackets in section 12(1) "(whether or not received in or transmitted to the United Kingdom)" have not been rewritten since they do not add anything substantive to these provisions. There are rules elsewhere about what deductions can be made and this clause together with clause 5 make it clear that the charge is on profits wherever arising.

59. Section 70(1) is not rewritten in the Bill but is reflected in *subsection (3)* of this clause which contains the general rule about the basis of assessment.

Chapter 2: Accounting periods

Overview

60. This Chapter gives the definition of accounting period. It is based on section 12 of ICTA.

61. The accounting period is a basic building block of corporation tax because corporation tax is charged by reference to accounting periods. For nearly all established UK resident companies the accounting period coincides with the 12 month period for which it makes up its accounts. Most of the Chapter is taken up with rules explaining what happens outside the usual case.

62. The Chapter does not rewrite section 12(8) of ICTA. Section 12(8) is an administrative provision that deals with the validity of assessments. The Chapter is

concerned with when accounting periods begin and end, and not with the circumstances in which an officer of Revenue and Customs may make an assessment or determination.

Clause 9: Beginning of accounting period

63. This clause identifies when an accounting period begins. It is based on section 12 and section 342A of ICTA.

64. *Subsection (1)(a)* deals with the case in which a company comes within the charge to corporation tax. Subsection (1)(a) states an important general rule. This Bill does not reproduce the two examples given in section 12(2)(a) of ICTA of circumstances in which this general rule would apply (becoming UK resident, acquiring a source of income). The examples add nothing useful and might obscure the general rule.

65. *Subsection (1)(b)* deals with the usual case of a company that is already within the charge to corporation tax so that a new accounting period begins when the previous accounting period ends.

66. *Subsection (4)* disapplies this clause in the case of a company being wound up. Clause 12, which makes special provision about companies being wound up, applies instead.

67. *Subsection (6)* is a general signpost that, in certain circumstances, the rules in this clause are modified by rules in other provisions of the Corporation Tax Acts that deal with particular cases. The implications for accounting periods will be clear when considering the cases in question (for example, paragraph 3 of Schedule 10 to FA 2006 (sale of lessor companies) and paragraph 52 of Schedule 22 to FA 2000 (tonnage tax)).

Clause 10: End of accounting period

68. This clause identifies the end of an accounting period. It is based on section 12 of ICTA.

69. The starting point for the clause to apply is that the company has an existing accounting period. The occurrence of any one of the listed events brings that accounting period to an end. In many cases clause 9(1)(b) then applies to start a new accounting period.

70. The opening words of *subsection (1)* provide that an accounting period ends "on the first occurrence of any of" the events listed in paragraphs (a) to (j). These words fall to be read in relation to each accounting period which is commenced. The effect of these words is not that the first event on that list to occur settles how all subsequent accounting periods of that company are to end. Rather, the effect is that each accounting period may be ended by the occurrence of a different event, depending on what happens in that particular accounting period.

71. The rules applying to companies in administration have been integrated into the general rules. The case is different from where a company is being wound up. In that case (see clause 12) there is a self-contained set of rules about when a company's accounting periods end. In the case of a company in administration, the general rules about when an accounting period of a company end continue to apply, but there are two additional circumstances in which an accounting period ends. These are the circumstances mentioned in subsection (1)(i) and (j).

72. The legislation rewritten by subsections (1)(i) and (j), (2), (3) and (4) only applies to companies that enter administration on or after 15 September 2003. This limitation is preserved in Schedule 2 (transitionals and savings).

Clause 11: Companies with more than one accounting date

73. This clause allows a company carrying on more than one trade to nominate the accounting date which marks the end of the accounting period. It is based on section 12 of ICTA.

74. The clause is most likely to apply to a non-UK resident company carrying on more than one trade in the United Kingdom through a permanent establishment. If a UK resident company carries on more than one trade it prepares a single set of accounts to cover all the company's activities. A non-UK resident company may not be subject to these regulatory requirements. Without this clause an accounting period would end at each separate accounting date.

75. The company is allowed to choose which accounting date is used for the purposes of the test in clause 10(1)(b). The company's choice is subject to review by HMRC. In the source legislation this power is exercised by the Commissioners for HMRC. In practice it is exercised by an officer. *Subsection (3)* reflects that. See *Change 1* in Annex 1.

76. The source legislation does not provide for the situation where a company has one or more businesses in addition to its trades, or several businesses but no trade. The effect is that the company's choice and the officer of Revenue and Customs' discretion is limited to selection of an accounting date relating to one of the company's trades. In other words, neither the company nor the officer can choose as the accounting period end date an accounting date of one of the company's businesses which is not a trade.

Clause 12: Companies being wound up

77. This clause identifies the beginning and end of an accounting period if a company is being wound up. It is based on section 12 of ICTA.

78. Although the rules applying to companies in administration have been integrated into the general rules (see clause 10(1)(i) and (j)), the separate exposition of the rules applying to companies being wound up have been preserved. This is because the scheme of section 12(7) of ICTA is to provide for a self-contained set of rules

about when an accounting period ends. It follows that the accounting period of a company being wound up does not end on the occurrence of any of the events listed in clause 10(1)(b) to (j). Accordingly, it is not appropriate to add the termination events listed in clause 12 to the list of termination events in clause 10(1).

79. *Subsection (5)* is new. It makes provision for when a new accounting period of a company being wound up begins. Section 12(7) of ICTA provides for an accounting period to begin on the commencement of winding up, but does not provide for the commencement of any subsequent accounting period. The rule in section 12(2)(b) of ICTA, now clause 9(1)(b), continues to apply for that purpose. It is preferable to make separate provision for the commencement of a new accounting period after the end of 12 months, rather than rely on clause 9(1)(b) for this purpose.

80. The reason for this is that the rule in clause 9(1)(b) is that a new accounting period only begins at the end of 12 months if the company is still within the charge to corporation tax. However, section 12(7) of ICTA does not make the company's remaining within the charge to corporation tax a condition of a new accounting period starting on the company beginning to be wound up. Also, that provision states that "an accounting period shall not end otherwise than by the expiration of 12 months from its beginning". Given that, section 12(2)(b) of ICTA must necessarily be modified in its application to companies being wound up.

Chapter 3: Company residence

Overview

81. This Chapter gives the statutory rules for company residence outside double taxation conventions.

82. The rules on company residence are both statutory and non-statutory. The oldest of the company residence rules ("central management and control") is based on common law.

83. The central management and control test is generally considered to be best expressed in <u>De Beers Consolidated Mines v Howe</u> (1905), 5 TC 198 HC. "A company resides, for the purposes of Income Tax, where its real business is carried on … I regard that as the true rule; and the real business is carried on where the central management and control actually abides". This has been endorsed by subsequent decisions and was described by Lord Radcliffe in <u>Bullock v Unit Construction Company</u> (1959), 38 TC 712 HL as being "as precise and unequivocal as a positive statutory injunction".

84. Residence may also be determined by the tie-breaker in a double taxation convention. When a company is resident in the territory of both parties a tie-breaker generally awards residence to the country where the effective management of the company is situated.

85. The two main statutory rules are found in section 66 of FA 1988 and section 249 of FA 1994. These two tests are rewritten in this Chapter.

86. Under section 66 of FA 1988 a company incorporated in the United Kingdom is, with some exceptions, regarded as resident here for all tax purposes. This overrides the rule in common law given above, although the common law test continues for companies outside section 66, that is to say companies which are not incorporated in the United Kingdom.

87. Section 249 of FA 1994 treats a company resident in the United Kingdom under the common law test or section 66 of FA 1998 as being non-UK resident if the tie-breaker in the double taxation treaty between the United Kingdom and that other territory would make the company resident outside the United Kingdom.

88. Both these statutory rules apply for the purposes of the Taxes Acts as defined in section 118 of TMA (see section 66(1) and 66A(2) of FA 1988 and section 249(1) of FA 1994). This Bill rewrites the rules for the purposes of the Corporation Tax Acts only. Because the Corporation Tax Acts are defined more narrowly (Schedule 1 to the Interpretation Act 1978) than the Taxes Acts, Schedule 1 to this Bill inserts new sections into TMA, TCGA and ITA to apply the rules given in this Chapter to those Acts.

Clause 13: Overview of Chapter

89. This clause sets out which residence rules are dealt with in this Chapter. It is new.

90. Although this Chapter does not legislate the common law test on residence (see above), *subsection (3)* makes clear that clause 15 applies where a company has been resident in the United Kingdom under that test.

Clause 14: Companies incorporated in the United Kingdom

91. This clause provides that a company incorporated in the United Kingdom is resident here for corporation tax purposes and, under clause 5, is within the charge to corporation tax on all its income and chargeable gains. It is based on section 66(1) of FA 1988.

92. *Subsection (2)* makes it clear that a company which is resident in the United Kingdom under *subsection (1)* is not resident in any other territory.

93. Although section 66 of FA 1988 and section 249 of FA 1994 refer to a company being “regarded as” resident it is not considered necessary to adopt that or similar wording. A company is simply resident somewhere.

Clause 15: Continuation of residence established under common law

94. This clause gives rules on residence for companies which are not incorporated in the United Kingdom. Companies which were UK resident immediately before they

ceased business or came under the control of a foreign liquidator continue to be treated as UK resident. The clause is based on section 66(2) of FA 1988.

95. This clause clarifies that the provision applies only to companies which are not incorporated in the United Kingdom. That is less clear in the source legislation. Any United Kingdom incorporated company which ceases business or is being wound up outside the United Kingdom is already UK resident under the rule in the previous clause.

96. The purpose of the rule in this clause is to provide that a company which is resident in the United Kingdom through central management and control (see above) remains resident here. Such a company could otherwise become non-UK resident if central management and control left the United Kingdom.

97. Section 66(4) of FA 1998 gives effect to Schedule 7 to that Act, the commencement and transitional provisions. Paragraphs of that Schedule which are not spent are rewritten in Schedule 2 (transitionals and savings) to this Bill.

Clause 16: SEs which transfer registered office to the United Kingdom

98. This clause provides that once an SE ("Societas Europaea" – see clause 1319) has transferred its registered office to the United Kingdom it becomes and remains resident there, notwithstanding its residence elsewhere under overseas law or the subsequent transfer of its office abroad. The clause is based on section 66A of FA 1988.

99. This clause applies only to SEs which transfer their registered office to the United Kingdom since SEs that are formed here are resident in the United Kingdom in any event under clause 14.

100. Once the registered office is moved to the United Kingdom the SE is effectively treated as if it were incorporated there. It cannot cease to be resident at any time simply by transferring its registered office.

Clause 17: SCEs which transfer registered office to the United Kingdom

101. This clause provides the same rule for SCEs (European Cooperative Societies – see clause 1319) that clause 16 provides for SEs. It is based on section 66A of FA 1988.

Clause 18: Companies treated as non-UK resident under double taxation arrangements

102. Under this clause a company which is resident in the United Kingdom, but treated under a double taxation convention as resident in a territory outside the United Kingdom, is resident outside the United Kingdom for corporation tax purposes. The clause is based on section 249 of FA 1994.

103. Section 250 of FA 1994 is spent. It is repealed by this Bill.

Chapter 4: Non-UK resident companies: chargeable profits

Overview

104. This Chapter sets out which profits of a non-UK resident company are liable to corporation tax. It is based on sections 11 and 11AA of, and Schedule A1 to, ICTA.

105. The Schedules themselves contain rules on territorial scope. Section 18(1)(a)(i) and (ii) of ICTA brings within the charge to tax under Schedule D annual profits or gains accruing to a *UK resident* from (a) any kind of property whatever wherever situated and (b) from any trade wherever carried on. Section 18(1)(a)(iii) brings within the same charge to tax annual profits or gains accruing to a *non-UK resident* from any property in the United Kingdom or from any trade or profession exercised there. Section 18 of ICTA is not itself a charge but a method of computing and marshalling under a Schedule income that is charged to tax under section 6 of ICTA.

106. Section 9 and section 18(4A) of ICTA apply section 18(1) (Schedule D) of ICTA for corporation tax purposes. But section 11 of ICTA sets out another rule on the scope of the corporation tax charge on a non-UK resident company.

107. The scope of Schedule D in section 18 of ICTA is narrower than the charge in section 11 of ICTA. Under section 18 non-UK residents are only liable to tax in respect of annual profits or gains from property in the United Kingdom or from trades exercised there. Under section 11 a non-UK resident company is chargeable to corporation tax on all profits wherever arising that are attributable to its permanent establishment in the United Kingdom and on income from property or rights held by or for the permanent establishment through which it trades. There is no requirement that that property should be in the United Kingdom.

108. The seventh edition (1999) of *Taxation of Companies and Company Reconstructions* by Bramwell *et al* (footnote to page 421) says of section 11(2):

> These words appear to be rather wider than the income tax “profits or gains arising from any trade exercised within the United Kingdom”. It is possible that the corporation tax charge on trading profits extends beyond the income tax charge, perhaps, for example, in the area of overseas activities connected with a United Kingdom branch.

109. Section 70(3) of ICTA enables a non-UK resident company to be charged to corporation tax under Schedule D Case V.

110. Prior to the removal of Case IV for corporation tax purposes in FA 1996, section 70(3) of ICTA extended Schedule D Cases IV and V to non-UK residents. (The replacement of “Case IV” by “Case III” as a consequential amendment in FA 1996 made little sense since section 18(3A) of ICTA already brought income arising outside the United Kingdom into Schedule D Case III for corporation tax purposes.)

111. The FA 1965 Notes on Clauses for the section on which section 70(3) of ICTA is based read:

> (This clause) provides machinery for charging any overseas income attributable to the branch in the United Kingdom of a non-resident company trading here through the branch. Such a branch may have funds which are recognisably attributable to branch operations but deposited abroad and earning interest whilst still held to the branch's account. The machinery selected is that of Cases IV and V (which applies to overseas income of residents of the United Kingdom).

112. Section 70(3) of ICTA would seem to confirm that non-UK resident companies can be charged on income arising outside the United Kingdom and thus confirm the wider scope and precedence of section 11 of ICTA over section 18(1)(a)(iii) of ICTA (see above).

113. Section 18(1)(a)(iii) of ICTA is therefore redundant for corporation tax purposes because it adds nothing to section 8 of ICTA, which deals with the scope of corporation tax generally, and section 11 of ICTA.

114. Section 70(3) is not rewritten. The section adds nothing to the basic position of a non-UK resident company under clauses 5(3) and (4) and 19. Moreover the parenthetical words in section 70(3) ("but without prejudice to any provision of the Tax Acts especially exempting non-residents from tax on any particular description of income") apply on first principles to income falling within the definition of "chargeable profits".

115. A reordering of the clauses on permanent establishments in this Chapter is intended to clarify the relationship between the various provisions. First comes the charge on the profits attributable to the permanent establishment followed by an introductory clause explaining how the clauses are set out and how they apply.

116. This is followed by the clauses on the separate enterprise principle. Those that apply this principle specifically to banks are at the end of this group of clauses. The special rules on deductions then appear at the end of the Chapter.

117. Much of the terminology employed in sections 11 and 11AA of, and Schedule A1 to, ICTA is shared in common with the Model Tax Treaty and Commentary of the Organisation for Economic Cooperation and Development (OECD). Indeed the legislation is intended to reflect to a considerable degree the Model Treaty and Commentary. This terminology is retained so that the relationship between the two is not lost.

Clause 19: Chargeable profits

118. This clause sets out what profits of the non-UK resident company are charged to tax. It is based on sections 11(1) to (2A) and 11AA(1) of ICTA.

119. *Subsection (2)* provides that income and chargeable gains form part of the non-UK resident company's chargeable profits only if they are of a type specified in *subsection (3)* and are attributable to the company's permanent establishment. This is a rather different approach to that in section 11(2A) of ICTA but, read with section 11AA(1) of ICTA, it seems that section 11(2A) of ICTA is merely identifying

the types of income and gains that are capable of being attributed to the permanent establishment and not giving the amount of those income and gains.

120. Subsection (3)(c) brings into the chargeable profits of a company chargeable gains falling within section 10B of TCGA. The chargeable gains falling within that section are those accruing to a company on the disposal of assets situated in the United Kingdom. Such gains are relevant in this context if the assets in question are connected with the trade carried on by the company through the permanent establishment or are for use by or for the purposes of the establishment.

121. "Permanent establishment" is defined in section 148 of FA 2003 and appears in Schedule 4 (index of defined expressions).

122. Neither the words "subject to any exceptions provided for by the Corporation Tax Acts" nor the second sentence of section 11(2) of ICTA are rewritten as they are considered unnecessary.

Clause 20: Profits attributable to permanent establishment: introduction

123. This clause describes how the clauses that follow are set out and how they apply. It is based on section 11AA(1) of ICTA.

Clause 21: The separate enterprise principle

124. This clause sets out the basic rule of the separate enterprise principle. It is based on section 11AA(2) and (3) of, and paragraph 1(2) of Schedule A1 to, ICTA.

125. The terms "distinct and separate enterprise" and "credit rating" in this clause are unique to section 11AA of ICTA. The former term is taken from Article 7 of the Model Treaty and the latter from the commentary on that article. The meaning of the former is well understood from its use in double taxation conventions while the latter takes its normal commercial meaning, a meaning that is well established through credit ratings given by agencies such as Moody's or Standard and Poor.

Clause 22: Transactions treated as being on arm's length terms

126. This clause provides the rule for dealing with transactions between the permanent establishment and the rest of the non-UK resident company. It is based on paragraph 2 of Schedule A1 to ICTA.

Clause 23: Provision of goods or services for permanent establishment

127. This clause sets out the rule for goods and services provided by the non-UK resident company to the permanent establishment. It is based on paragraph 6(1) to (3) of Schedule A1 to ICTA.

128. Although this clause deals with both a deduction (expense) – see *subsection (3)* – and the separate enterprise principle, it is grouped with other clauses dealing with the separate enterprise principle as that is the main rule here and to separate these elements would be unhelpful.

Clause 24: Application to insurance companies

129. This clause provides the power for the making of regulations in respect of the application of clause 21 to insurance companies. It is based on section 11AA(5) of ICTA.

Clause 25: Non-UK resident banks: introduction

130. This clause introduces clauses 26 to 28 which contain particular provisions applying the separate enterprise principle to banks. It is based on paragraph 7(1) and (2) of Schedule A1 to ICTA.

131. While these provisions are an application of the separate enterprise principle with particular relevance to banks, the principles behind them are applicable to companies other than banks and *subsection (2)* clarifies this point.

Clause 26: Transfer of financial assets

132. This clause applies the separate enterprise principle to loans or financial assets transferred between the permanent establishment and any other part of the company. It is based on paragraphs 7(1) and 8(1) and (2) of Schedule A1 to ICTA.

133. Each of the clauses applying the separate enterprise principle to banks contains the phrase "in accordance with the separate enterprise principle" to clarify that the provisions given are all within the general principle in clause 21 and not expressing new principles.

134. *Subsections (3)* and *(4)* retain the term "valid commercial reasons" in paragraph 8(2) of Schedule A1 to ICTA notwithstanding that the usual phrase adopted in rewrite Bills is either "commercial reason" or "genuine commercial reason". This is because "valid commercial reason" is the term used in the Commentary (paragraph 15.2) to Article 7(2) of the treaty.

135. Subsection (4) also contains the term "tax advantage". The term is undefined (as in the source legislation) although its use elsewhere in the Taxes Acts refers to the definition in section 709 of ICTA. The absence of a definition in paragraph 8(2) of Schedule A1 is intentional. It was considered that any attempt to define all possible and future forms of tax advantage in this context would have added complexity for no good purpose.

Clause 27: Loans: attribution of financial assets and profits arising

136. This clause explains how a financial asset (eg a loan) made by the non-UK resident company and the profits arising from it should be attributed (whether to the permanent establishment or another part of the company). It is based on paragraphs 7(1) and 9(1) and (3) to (5) of Schedule A1 to ICTA. An example would be where a permanent establishment in the United Kingdom obtains new business and passes that business back to the overseas part of the company. Resulting loans, derivatives etc can be attributed to the permanent establishment under this clause notwithstanding that they have been issued by an overseas office.

Clause 28: Borrowing: permanent establishment acting as agent or intermediary

137. This clause applies the separate enterprise principle where a permanent establishment of a non-UK resident bank acts as an agent or intermediary in borrowing funds for another part of the company. It is based on paragraphs 7(1) and 10(1) and (2) of Schedule A1 to ICTA.

Clause 29: Allowable deductions

138. This clause brings together some general rules on deductions allowable in arriving at the profits of a permanent establishment. It is based on section 11AA(4) of, and paragraph 3(1) and (2) of Schedule A1 to, ICTA.

139. "Executive and general administrative expenses" in *subsection (2)* are not defined. The term is borrowed from Article 7(3) of the OECD Model Treaty. The Commentary on the Model Treaty does not define the term further but "executive expenses" would seem to cover the expenses of higher management of the permanent establishment.

Clause 30: Restriction on deductions: costs

140. This clause is the first of three clauses which restrict deductions in arriving at the attributable profits of a permanent establishment. It provides that no deduction for costs should exceed what would be payable under the separate enterprise principle. It is based on section 11AA(3) of ICTA.

Clause 31: Restriction on deductions: payments in respect of intangible assets

141. This clause disallows a deduction for inter-company payments for the use of intangibles where the intangible assets are held by the company. The reasoning here is that it is difficult to allocate ownership of intangibles to any one part of a company as if it were an independent enterprise. The clause is based on paragraph 4(1) to (3) of Schedule A1 to ICTA.

Clause 32: Restriction on deductions: interest or other financing costs

142. This clause applies the same principle as the previous clause but to interest payments. An exception is, however, made for companies dealing in loans, debts commodities and futures. It is based on paragraph 5(1) to (3) of Schedule A1 to ICTA.

Chapter 5: Supplementary

Clause 33: Trade includes office

143. This clause provides that trade includes an office in Part 2 of the Bill, subject to context. It is based on section 6(4) of ICTA which applies the definition of "trade" in paragraph (b) of that subsection to various provisions of ICTA, except in so far as the context otherwise requires.

144. The reference to "carrying on a trade" in *paragraph (b)* is new. It reflects one of the usages of "trade" in Part 2.

145. The interpretation does not refer to employment or vocation. The treatment of vocations is discussed in *Change 2* in Annex 1. A company does not hold an employment but it is not uncommon for a company to hold an office such as that of company secretary and the charge to corporation tax on income from an office is set out in clause 969.

146. Clause 969 applies the charge to corporation tax on income under clause 2 to income from the holding of an office.

Part 3: Trading income
Overview
147. This Part contains the rules relating to trading income. The Part charges:

- the profits of a trade (charged in the source legislation under Schedule D Case I or V); and

- post-cessation receipts (charged in the source legislation under Schedule D Case VI).

148. The structure of the Part is to:

- identify the income taxed as profits of a trade (Chapter 2);

- calculate the profits of the trade (Chapters 3 to 7);

- apply the rules for particular trades (Chapters 8 and 9);

- apply other rules affecting the calculation of profits of the trade (Chapters 10 to 14); and

- identify the other component of trading income – post-cessation receipts – (Chapter 15).

149. This Part is not an exhaustive statement of the rules for the calculation of trading income. Other regimes may affect that calculation. In particular, Parts 5 to 8 and 11 to 15 of this Bill contain rules that may affect trade profits.

150. References to “profits or gains” in the source legislation which relate only to income are rewritten in this Part omitting the reference to “gains”. This continues the tidying up of such references started in section 46(3) of, and Schedule 7 to, FA 1998.

Chapter 1: Introduction
Clause 34: Overview of Part
151. This clause provides an overview of this Part. It is new. The corresponding income tax rule is in section 3 of ITTOIA.

152. In contrast to section 3 of ITTOIA, this clause makes no reference to adjustment income. This is because for corporation tax purposes adjustments on a change of basis of accounting are brought into account in computing trading profits rather than being treated as a distinct category of income.

Chapter 2: Income taxed as trade profits

Overview

153. This Chapter explains what is taxed as profits of a trade. It identifies a number of activities and receipts and sets out how they are treated.

Clause 35: Charge to tax on trade profits

154. This clause applies the corporation tax charge on income to the profits of a trade. It is based on section 18 of ICTA. The corresponding rule for income tax is in section 5 of ITTOIA.

155. The clause does not rewrite the reference to "profession or vocation" in Schedule D Case II. See *Change 2* in Annex 1.

156. Section 832(1) of ICTA provides that "trade" includes "every trade, manufacture, adventure or concern in the nature of trade". This brings within the meaning of trade an isolated transaction (or a small number of transactions) which, while in the nature of trade, is not sufficiently extensive to amount to a trade.

Clause 36: Farming and market gardening

157. This clause has two functions. First, it treats all farming or market gardening carried on in the United Kingdom as a trade. Second, it treats all farming carried on in the United Kingdom by a particular person as a single trade. It is based on section 53 of ICTA. The rules for income tax are rewritten in section 9 of ITTOIA.

158. *Subsection (1)* deals with the first function. In most cases there will be no doubt that farming is a trade on first principles. Like clause 38 of this Bill this clause can trace its origins back to the time when there was a charge to income tax under Schedule B on the occupation of land. Farming was originally charged under Schedule B. The purpose of section 53 of ICTA and its predecessor provisions was to take the charge on farming out of Schedule B and into Schedule D. With the abolition of Schedule B that function is now spent.

159. But section 53 of ICTA does make clear that even uncommercial farming is treated as a trade. This clause preserves that effect.

160. *Subsection (2)* deals with the second function of the clause. It provides that all farming carried on by a company in the United Kingdom is treated as a single trade. It makes clear that farming carried on as part of another trade is not included in the single trade of farming.

161. The restriction of subsection (2) to farming in the United Kingdom is derived from the definition of “farming” in section 832(1) of ICTA.

162. Section 53(2) of ICTA uses the expression “particular company or partnership” to make clear that the single trade rule applies also to a firm. It follows that farming carried on by a company as a member of a firm is separate from any farming carried on by that company alone. This rule is dealt with in clause 1270 in Part 17 (Partnerships). The corresponding provision for income tax is section 859 of ITTOIA.

163. The definition of “farming” and “market gardening” is given in clause 1317 in Part 21 (Other general provisions). The corresponding provision for income tax is section 996 of ITA.

Clause 37: Commercial occupation of woodlands

164. This clause provides that the commercial occupation of woodlands is not treated as a trade for any corporation tax purpose. It is based on section 53 of ICTA and paragraph 3 of Schedule 6 to FA 1988. The corresponding rule for income tax is in section 11 of ITTOIA.

165. *Subsection (3)* makes clear that when this clause is read together with related clauses any profits and losses arising from the commercial occupation of woodlands are wholly outside the corporation tax code.

166. This clause prevents any charge to tax as trading income and denies any claim for relief for a trade loss. Clause 208(b) of this Bill performs a similar function in relation to property income. Clause 980 prevents there being any charge to tax under Chapter 8 of Part 10 (income not otherwise charged). The corresponding rule for income tax is in section 768 of ITTOIA.

Clause 38: Commercial occupation of land other than woodlands

167. This clause deals with the commercial occupation of land for purposes other than farming or woodlands. It is based on section 53 of ICTA. The corresponding rule for income tax is in section 10 of ITTOIA.

168. The clause treats the commercial occupation of land in the United Kingdom as the carrying on of a trade. It provides certainty of treatment if land is occupied on a commercial basis in circumstances that do not amount to the carrying on of a trade on first principles.

169. The origins of section 53 of ICTA go back to the time when there was a charge to income tax under Schedule B on the occupation of land. The purpose of the Schedule B charge was to tax the profit that an occupier of the land could earn from the land itself, for example, by farming it. The tax was charged whether or not the occupier actually exploited the land.

170. The Schedule B charge was calculated by reference to the annual value of the land. This amount could be considerably less than the amount of profit an occupier could in fact derive from the land. For this reason the basis of charge was switched from Schedule B to Schedule D Case I if the land was farmed or otherwise managed on a commercial basis.

171. The last remnant of Schedule B was repealed by FA 1988. Schedule 6 to FA 1988 exempted any profits and losses from the occupation of commercial woodlands from corporation tax.

172. The provisions of section 53 of ICTA relating to farming are rewritten as clause 36 of this Bill. The provisions relating to the occupation of commercial woodlands are rewritten as clause 37 of this Bill.

Clause 39: Profits of mines, quarries and other concerns

173. This clause treats the profits and losses of certain concerns as if they were the profits and losses of a trade. It is based on section 55 of ICTA. The corresponding rule for income tax is in section 12 of ITTOIA.

174. The feature that most of these concerns have in common is that they exploit land for its natural resources. The clause applies only if the activity carried on by the concern does not amount to a trade on first principles. If the activity is a trade on first principles the profits and losses will be taxed in accordance with clause 35 of this Bill.

175. The clause does not deem the concern to be carrying on a trade. The company will not qualify for roll-over relief under section 152 of TCGA on any chargeable gain. That section requires the taxpayer to be carrying on a trade as defined in section 158(2) of TCGA. If the concern is operated by a company not resident in the United Kingdom that company does not become liable to corporation tax through the application of clause 5(2). Clause 5(2) requires a trade to be carried on in the United Kingdom.

176. *Subsections (1)* and *(2)* provide that the profits and losses of the concern are calculated and charged to tax as if the concern were a trade. The source legislation was not explicit in this regard. See Part A of *Change 3* in Annex 1. This change reproduces Change 2 in ITTOIA and so brings the income tax and corporation tax codes back into line.

177. *Subsection (3)* provides that the normal loss rules apply. See Part B of *Change 3* in Annex 1.

178. *Subsection (4)* lists the concerns to which the clause applies. It updates the reference to “fishings” to “rights of fishing”.

179. *Subsection (5)* makes clear that clause 38 of this Bill has priority over clause 39. This is because clause 38 treats the activity as if it were a trade. This contrasts

with the approach of this clause, which is to treat the profits and losses as trade profits and losses. Clause 38 may be more beneficial for the company. For example, the activity would qualify as a trade for chargeable gains purposes. See section 158(2) of TCGA.

Clause 40: Credit unions

180. This clause ensures that most credit unions are not treated as carrying on a trade for tax purposes. It is based on section 487 of ICTA.

181. Credit unions are profit-sharing financial co-operatives, owned and managed by their own members, which offer a convenient way of saving and loans to their members.

182. The members make regular savings, as little or as much as they wish. These savings then form a common pool of money from which loans are made to members. When members have been saving for a certain period of time (usually about 12 weeks) they can apply for a loan from the pool. Interest on the loan is charged at about 1% per month on the monthly reducing balance.

183. There are other rules about credit unions:

- in Part 5 (loan relationships);
- in clause 133; and
- in clause 1218.

184. *Subsection (1)* is the rule that the usual activities of a credit union are not to be treated as a trade. The rule applies only in the calculation of the credit union's income. So, if the carrying on of a trade is relevant for some other purpose (for instance, the taxation of chargeable gains), and the credit union is in fact carrying on a trade, the position is not disturbed by this rule.

Clause 41: Effect of company starting or ceasing to be within charge to corporation tax

185. This clause treats a company as starting or ceasing to carry on a trade in particular circumstances. It is based on section 337 of ICTA. The corresponding rule for income tax is in section 18 of ITTOIA.

186. Section 337 of ICTA requires the company's trade or property business income to be calculated as though it had started or ceased to carry on a trade or a property business in two cases. Clause 41 deals with trades and clause 289 with property businesses.

187. The first trade case is when the company begins or ceases to carry on the trade (section 337(1)(a) of ICTA). Then its profits from that trade are calculated as though

the trade had, at that time, begun or ceased. It is not necessary to rewrite this case. It is dealt with automatically in the rewritten rules because they are "person-based" and do not assume that a particular trade can continue independently of the person actually carrying it on.

188. The second case involves movement by the company into or out of the corporation tax regime (section 337(1)(b) of ICTA). Non-UK resident companies are within the charge to corporation tax only if they are trading, are trading in the United Kingdom, and through a permanent establishment in the United Kingdom. Then they are chargeable to corporation tax on all the profits attributable to that permanent establishment. First meeting or ceasing to meet those conditions can result in a change of taxing regime from income tax to corporation tax or vice versa.

189. Clause 41 says what happens when a company enters or leaves the corporation tax regime in respect of the trade: then its trade profits are calculated as though it had started or ceased to carry on the trade. The corresponding income tax rule in section 18 of ITTOIA is a complementary, mirror-image rule which applies when the company enters or leaves the income tax regime in respect of the trade.

Clause 42: Tied premises

190. This clause treats rent received by a company carrying on a trade, for premises let to persons to whom the company supplies goods sold or used on those premises, as a receipt of the trade rather than a receipt of a property business. It is based on section 98 of ICTA. The corresponding rule for income tax is in section 19 of ITTOIA.

191. Section 98 of ICTA is expressed in general terms. But it most commonly applies to rent received by a brewing company which lets premises to tied tenants.

Clause 43: Caravan sites where trade carried on

192. This clause allows a company which carries on a trade associated with the operation of a caravan site to include in the receipts of that trade income from letting pitches or caravans where the letting does not itself constitute a trade. It is based on ESC C36. The corresponding rule for income tax is in section 20 of ITTOIA. See *Change 4* in Annex 1.

193. See clause 1314 and *Change 96* in Annex 1 for the definition of "caravan".

Clause 44: Surplus business accommodation

194. This clause allows income from letting surplus business accommodation to be treated as a trade receipt instead of as rent. It is based on the practice known as "Revenue Decision 9" set out in the HMRC publication *Tax Bulletin* of 15 February 1994. The corresponding rule for income tax is in section 21 of ITTOIA. See *Change 5* in Annex 1.

Clause 45: Payments for wayleaves

195. This clause applies if a trader receives rent from a wayleave granted in respect of land on which a trade is carried on. It is based on section 120 of ICTA. The corresponding rule for income tax is in section 22 of ITTOIA.

196. Rent received in respect of a wayleave is normally taxed as property income either by Chapter 2 of Part 4 of this Bill (property businesses) or by clause 277 (charge to tax on rent receivable for a UK electric-line wayleave). But if the rent is received in respect of land on which a trader carries on a trade and the trader receives no other rent in respect of the same land the rent, and any associated expenses, can be included in the calculation of the trade profits. See *Change 6* in Annex 1. This change enacts a non-statutory practice, and also makes changes to both practice and the law. It reproduces Change 5 in ITTOIA and so brings the income and corporation tax codes back into line.

197. *Subsection (4)* defines “rent”. Section 120 of ICTA uses the definition of “rent” in section 119(3) of ICTA (rent etc. payable in connection with mines, quarries and similar concerns). Section 119 of ICTA is rewritten in Chapter 7 of Part 4 of this Bill. The definition of rent in that Chapter and in this clause must be the same. See the commentary on clause 271 of this Bill for a fuller description of the rewrite of the word “rent” in Chapter 7 of Part 4 of this Bill.

198. *Subsection (5)* defines “wayleave”. Section 120 of ICTA uses the word “easement” as defined in section 119(3) of ICTA to describe the nature of the right for which the rent is paid. This clause uses “wayleave” as that is how most of the payments covered by this clause are usually described in practice. The definition of “easement” in section 119(3) of ICTA gives that word a meaning that is much wider than its usual legal meaning. See the comments of Uthwatt J at pages 329 and 330 of Mosley v George Wimpey & Co Ltd (1945), 27 TC 314 CA.

199. The definition of “wayleave” preserves the generality of the words in section 119(3) of ICTA and includes a reference to the Scottish equivalent, “servitude”.

200. The definition has no territorial limitation. So the clause covers services other than UK electric-line wayleaves.

201. The clause does not rewrite the reference to “profession or vocation” in Schedule D Case II. See *Change 2* in Annex 1.

Chapter 3: Trade profits: basic rules

Clause 46: Generally accepted accounting practice

202. This clause sets out the starting point for the calculation of trade profits. It is based on section 42 of FA 1998. The corresponding rule for income tax is in section 25 of ITTOIA.

203. *Subsection (1)* is the general rule that requires profits to be calculated "in accordance with generally accepted accounting practice", an expression defined in section 50 of FA 2004. In particular, such practice generally requires account to be taken of debtors and creditors and of the value of stock. The general rule is subject to any special rule of law whether expressed in statute or explained by the courts.

204. The relevant statutory laws are mainly those that are rewritten in this Part. But there are also provisions not included in Part 3 of this Bill which may affect the calculation of profits: for example, the pension contributions deductions provisions in FA 2004 and some anti-avoidance provisions in ICTA that apply to all income types.

205. *Subsection (2)* makes clear that subsection (1) does not bring with it any of the other accounting requirements, such as a formal audit.

206. *Subsection (3)* sets out exceptions to the general rule in subsection (1). Lloyd's underwriters have their own special rules (mostly in Chapter 3 of Part 2 of FA 1993); there are special rules for insurance companies (mostly in Chapter 1 of Part 12 of ICTA and Chapter 1 of Part 2 of FA 1989); and tonnage tax companies (see Schedule 22 to FA 2000) are subject to "special rules" for the calculation of profits.

Clause 47: Losses calculated on same basis as profits

207. This clause ensures that profits and losses are calculated on a consistent basis. It is based on section 46 of FA 1998. The corresponding rule for income tax is in section 26 of ITTOIA.

Clause 48: Receipts and expenses

208. This clause is based on section 46 of FA 1998. The corresponding rule for income tax is in section 27 of ITTOIA.

Clause 49: Items treated as receipts and expenses

209. This clause signposts rules affecting trade profits that are elsewhere in the Corporation Tax Acts. It is new. The corresponding rule for income tax is in section 28 of ITTOIA.

210. In particular the CAA rules override the rules against the inclusion of capital items in clauses 53 and 93 of this Bill.

Clause 50: Animals kept for trade purposes

211. This clause contains the basic rule for the corporation tax treatment of animals. It is based on paragraphs 1, 7 and 9 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 30 of ITTOIA. The animals are treated as trading stock unless a herd basis election is made under Chapter 8 of this Part.

Clause 51: Relationship between rules prohibiting and allowing deductions

212. This clause makes clear the interaction between those provisions that allow a deduction and those provisions that prohibit a deduction. It is new. See *Change 7* in Annex 1. The corresponding rule for income tax is in section 31 of ICTA.

213. The general principle is that a rule allowing a deduction takes priority over a rule prohibiting a deduction. But this is subject to a number of exceptions.

Clause 52: Apportionment etc of profits and losses to accounting period

214. 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. That section is rewritten for income tax purposes in sections 203 and 871 of ITTOIA.

215. This clause does not carry over the rewrite change in sections 203(4) and 871(5) of ITTOIA whereby apportionment is permitted by a measure of time other than the days permitted by section 72(2) of ICTA. HMRC has a long-established view that days cannot be split into accounting periods. That helps prevent exploitation of the wider range of reliefs available in the rather different context of corporation tax.

Chapter 4: Trade profits: rules restricting deductions

Overview

216. This Chapter contains provisions prohibiting various deductions in calculating the profits of a trade or restricting the extent to which such deductions can be made.

Clause 53: Capital expenditure

217. This clause prohibits deductions for capital expenditure and is based on section 74(1)(f) of ICTA. The corresponding rule for income tax is in section 33 of ITTOIA.

218. It is a long-established and generally accepted principle that capital items are ignored in calculating the profits of a trade and the question whether a sum is income or capital is ultimately a question of law, not accountancy. For judicial authority for this proposition, see, for example the words of Brightman J on page 173 of <u>ECC Quarries Ltd v Watkis</u> (1975), 51 TC 153 ChD[1]:

> …unchallenged evidence, or a finding, that a sum falls to be treated as capital or income on principles of correct accountancy practice is not decisive of the question whether in law the expenditure is of a capital or an income nature.

219. A sum which is of a capital nature may however be allowed as a deduction in calculating the profits of a trade because of a statutory exception to the general rule on the deduction of such items in this clause. See, for example, clause 89 (expenses connected with patents).

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[1] STC [1975] 578

220. In the absence of general agreement on what constitutes capital expenditure "items of a capital nature" is not defined.

221. Section 74(1)(g) of ICTA is redundant as the deduction of capital employed in the improvement of premises is covered by the general prohibition on the deduction of "items of a capital nature". So this Bill repeals section 74(1)(g) of ICTA without rewriting it.

Clause 54: Expenses not wholly and exclusively for trade and unconnected losses

222. This clause contains rules for the deduction of expenses and losses in calculating the profits of a trade. It is based on section 74(1)(a) (expenses) and (e) (losses) of ICTA. The corresponding rules for income tax are in section 34 of ITTOIA.

223. Section 74(1)(a) of ICTA provides that in calculating the profits of a trade no deduction is allowed for expenditure which is not incurred "wholly and exclusively" for the purposes of that trade. This could be construed to mean that if expenditure is incurred partly for trade purposes and partly for some other purposes, no part of that expenditure can be deducted in arriving at the trade profits.

224. But section 74(1)(c) of ICTA, which prohibits any deduction in respect of the rent of premises used for residential or "domestic" purposes, provides for the *apportionment* of rent paid for premises used partly as residential accommodation and partly for the purposes of a trade. And in practice a deduction is allowed for any expenditure which can be apportioned between trade and non-trade expenditure – for example, expenditure on a car used partly for trade and partly for private purposes.

225. There is judicial support for allowing a deduction where expenditure incurred for more than one purpose can reasonably be apportioned between expenditure incurred for the purpose of the trade and non-trade expenditure. See, for example, Lochgelly Iron and Coal Company Ltd v Crawford (1913), 6 TC 267 CS, in which a deduction was allowed for part of a subscription to a trade association and Copeman v William Flood & Sons Ltd (1941), 24 TC 53 KB, in which the High Court remitted the case to the Commissioners to find as a fact whether the remuneration paid to certain directors who were also shareholders in the family company was wholly and exclusively expended for the purpose of the Company's trade, and if not, how much of the remuneration was so expended.

226. Conversely, the courts have held that if it is not possible to identify any part of the expenditure that is incurred wholly and exclusively for the purposes of the trade, no apportionment is possible. See, for example, Mallalieu v Drummond (1983), 57

TC 330 HL[2] in which no deduction was allowable for clothing worn for warmth and decency as well as being required by the taxpayer's profession.

227. So *subsection (2)* of this clause provides for the deduction of any part or proportion of expenses incurred partly for the purposes of the trade and partly for some other purpose that can be identified as incurred wholly and exclusively for the purposes of the trade. Rent on dual purpose accommodation can be apportioned under subsection (2) of this clause. So this Bill repeals section 74(1)(c) of ICTA without rewriting it.

Clause 55: Bad debts

228. This clause is based on the rule restricting relief for some debts in section 88D of ICTA. It also rewrites the relief in section 89 of ICTA for debts proved irrecoverable after a trade is treated as having ceased. See *Change 8* in Annex 1. The corresponding rule for income tax is in section 35 of ITTOIA.

229. *Subsection (2)(a)* refers to a deduction "by way of impairment loss". That expression is not defined for the purpose of this clause. But clause 476(1) defines "impairment loss" for the purposes of the loan relationships legislation as "a debit in respect of the impairment of a financial asset". "Impairment" includes "uncollectability".

230. *Subsection (2)(b)* deals with debts released as part of a "statutory insolvency arrangement", which is defined in section 834(1) of ICTA.

231. *Subsection (3)* provides a definition that clarifies the scope of the clause. All money debts (see clause 303) arising in a trade that produce an impairment loss are within the loan relationships rules (see clause 479). Even if a money trade debt is released as part of a statutory insolvency arrangement any loss on the debt is within the extended meaning of "impairment" in clause 476(1).

232. There is a corresponding rule for income from holding an office in clause 970.

Clause 56: Car or motor cycle hire

233. 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 restriction increases in line with the retail price. The clause is based on sections 578A and 578B of ICTA. The corresponding rule for income tax is in section 48 of ITTOIA.

234. Section 578B(1) of ICTA says that for the purposes of section 578A of ICTA "car" includes a motor cycle. So this clause and clause 57 refer to a "car or motor cycle" throughout.

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[2] STC [1983] 665

235. Section 578A(4) of ICTA provides for amounts in respect of hire charges brought into account as a receipt of the trade under section 94 of ICTA (see clause 94 of this Bill) to be reduced in the same proportion as the deduction in respect of those charges is reduced under section 578A(3) of ICTA. *Subsection (4)* of this clause extends the same treatment to amounts in respect of hire charges taxed as a post-cessation receipt under clause 193 (debts released after cessation). See *Change 9* in Annex 1.

Clause 57: Car or motor cycle hire: supplementary

236. This clause defines various terms and is based on section 578B of ICTA. The corresponding rule for income tax is in section 49 of ITTOIA.

237. Section 578B(2) of ICTA defines “qualifying hire car” for the purposes of section 578A of ICTA as a car hired under a hire-purchase agreement subject to an option to purchase which is exercisable for a nominal amount.

238. Not all hire-purchase agreements require the hirer to exercise an option at the end of the hire period. Under some types of agreement, ownership of the vehicle passes automatically to the hirer at the end of the hire period. So *subsection (2)(a)* of this clause extends the definition of “qualifying hire car or motor cycle” to include a car or motor cycle where ownership passes without the exercise of an option to purchase. See *Change 10* in Annex 1.

Clause 58: Hiring cars (but not motor cycles) with low CO_2 emissions before 1 April 2013

239. This clause excludes certain cars hired before 1 April 2013 under a contract entered into before that date from the restriction in clause 56. It is based on section 578A(2A) and (2B) of ICTA and section 60 of FA 2002. The corresponding rule for income tax is in section 50 of ITTOIA.

240. *Subsection (2)* defines low emissions by reference to section 45D of CAA. A transitional rule in Schedule 1 to the Bill provides that, for a car hired on or before 31 March 2008, the carbon emissions limit in section 45D(4) of CAA remains 120 grams instead of the new limit of 110 grams.

Clause 59: Patent royalties

241. This clause prohibits a deduction for patent royalties. It is based on section 74(1)(p) of ICTA.

242. For most patent royalties this rule is overridden by the rules of the intangible fixed assets regime (rewritten in Part 8 of this Bill) which provide relief for trades as well as other commercial activities (see, in particular, clause 728(5) and Chapter 6 of Part 8 of this Bill). But for a minority of cases, this clause will remain relevant and will continue to prevent a deduction. That includes, for example, cases where the royalty is in respect of an intangible asset that is not a fixed asset of the payer’s trade.

Clause 60: Expenditure on integral features

243. This clause draws attention to the rule in section 33A(3) of CAA. There is a signpost to that rule in section 74(1)(da) of ICTA. That subsection is repealed. The signpost is not formally rewritten but it is replaced in this clause (and in the property income clause 263).

Chapter 5: Trade profits: rules allowing deductions

Overview

244. This Chapter contains provisions allowing various deductions in calculating the profits of a trade.

Clause 61: Pre-trading expenses

245. This clause gives relief for expenses incurred before a trade starts. It is based on section 401 of ICTA. The corresponding rule for income tax is in section 57 of ITTOIA.

246. *Subsection (1)* sets the scene. Consistent with other rules in this Part, it refers to the “date” on which (instead of the “time” when) a company starts to trade.

Clause 62: Tenants under taxed leases: introduction

247. This clause provides for the following five clauses to apply where a tenant, under a taxed lease, uses land for the purposes of a trade. It is based on section 87(1), (2), (8) and (9A) of ICTA. The corresponding provision for income tax is in section 60 of ITTOIA.

248. Chapter 4 of Part 4 (profits of property businesses: lease premiums etc) contains provisions (in clauses 217 to 222) treating certain premiums, and other amounts, relating to a lease (“the taxed lease”) as giving rise to receipts of a property business (of amount X). Chapter 4 of Part 4 also provides that in certain cases a tenant under the taxed lease obtains relief in respect of all, or part, of X:

- by reducing the amount of another property business receipt (clauses 227 to 230), or

- by being treated as an expense of a property business (clauses 231 to 234).

249. Clauses 62 to 67 provide for certain cases in which a tenant under the taxed lease obtains relief as a trading expense in respect of all, or part, of X.

250. *Subsection (1)* extends relief to cases in which X arose in relation to a lease of land outside the United Kingdom. See *Change 11* in Annex 1. This is in accordance with the policy of treating UK and overseas property businesses in the same way as far as possible.

251. The amount which a tenant can deduct in respect of rent which it is treated as paying under section 87(2) of ICTA is qualified by:

- the general rules as to deductions not allowable in computing the profits of a trade in section 74(1) of ICTA; and

- rules prohibiting or restricting the deduction of specific expenditure elsewhere in ICTA.

252. In this Bill, the rules restricting deductions are in Chapter 4 of this Part and section 74(1)(a) of ICTA is rewritten in that Chapter in clause 54. *Subsection (3)* preserves the interaction of section 87(2) of ICTA and the general and specific rules restricting deductions in ICTA by providing that a deduction for an expense which a tenant is treated as incurring under clause 63 is subject to the application of any provision of Chapter 4 of this Part.

Clause 63: Tenants occupying land for purposes of trade treated as incurring expenses

253. This clause treats a tenant under a lease, in respect of which an amount is brought into account by the landlord, (a "taxed lease") as incurring an expense for each day on which the property held under the lease is occupied for the purposes of the tenant's trade. It is based on section 87(2), (3) and (9) of ICTA. The corresponding rule for income tax is in section 61 of ITTOIA.

254. Clauses 217 to 222 provide for a company to bring an amount into account as a receipt of a property business in cases where the company has granted a short-term lease at a premium (or in certain other cases).

255. Sections 277 to 282 of ITTOIA make corresponding provision for a person to bring an amount into account as a receipt of a property business for income tax.

256. *Subsection (1)* treats a tenant which, for a qualifying day, occupies land for the purposes of a trade as incurring an expense. This corresponds to the treatment of the landlord who has been, or would have been (see clause 227(4)), treated as receiving a receipt ("taxed receipt") of the landlord's property business.

257. The formula in *subsection (4*) calculates the expense for each qualifying day by spreading an amount in respect of the taxed receipt evenly over the receipt period of that receipt. Defining "A" in that formula as "the unreduced amount of the taxed receipt" makes clear that the amount of the expense which the tenant is treated as incurring for each qualifying day is calculated by reference to the amount of the taxed receipt *before* any reductions or deductions.

258. *Subsection (5)* modifies that formula for a qualifying day on which the tenant occupies only part of the land subject to the taxed lease for the purposes of a trade. The subsection requires the fraction of the land which is occupied by the tenant for the

purposes of the trade to be calculated "on a just and reasonable basis", where section 87(3) of ICTA requires a "just apportionment". See *Change 12* in Annex 1.

Clause 64: Limit on deductions if tenant entitled to mineral extraction allowance
259. This clause prevents a double deduction where a tenant is entitled under section 403 of CAA to an allowance in respect of qualifying expenditure on acquiring a mineral asset. It is based on section 87(7) of ICTA. The corresponding rule for income tax is in section 62 of ITTOIA.

Clause 65: Tenants dealing with land as property employed for purposes of trade
260. This clause applies to a tenant which, while not occupying a property, uses the property for the purposes of a trade – for example a company which lets premises held under a taxed lease to a person who sells only goods supplied by that company. It is based on section 87(4) and (6) of ICTA. The corresponding rule for income tax is in section 63 of ITTOIA.

261. *Subsection (2)* treats the tenant as if it occupied the property, or part of it, for the purposes of relief under clause 63.

262. *Subsection (3)* prevents the tenant obtaining relief under clause 63 to the extent that relief for the same day is allowed in calculating the profits of the tenant's property business under clause 232.

Clause 66: Restrictions on section 63 expenses: lease premium receipts
263. This clause restricts the expenses that clause 65 treats a tenant as incurring, under clause 63, by reference to the unreduced amount of a taxed receipt under a taxed lease if:

- a sublease has been granted out of the taxed lease; and
- in respect of the sublease, the unreduced amount of the taxed receipt reduces an amount which is brought into account as a receipt under Chapter 4 of Part 4 of this Bill or the corresponding provisions in ITTOIA (the "lease premium receipt").

This clause is based on sections 87(5) and 87A of ICTA. The corresponding rule for income tax is in section 64 of ITTOIA.

264. The restriction in this clause extends to cases where the unreduced amount of the taxed receipt reduces a lease premium receipt of an overseas property business. See *Change 11* in Annex 1.

265. Clause 63 treats the tenant as incurring an expense for each qualifying day in the receipt period of the taxed receipt relating to the taxed lease. The expense is calculated by reference to the unreduced amount of the taxed receipt.

266. If, in respect of the sublease, the unreduced amount of the taxed receipt is used to reduce:

- under clause 228, the amount brought into account as a lease premium receipt under Chapter 4 of Part 4 of this Bill; or

- under section 288 of ITTOIA, the amount brought into account as a lease premium receipt under Chapter 4 of Part 3 of ITTOIA,

this clause makes a corresponding reduction to the amount of the expense which clause 63 treats as incurred by the tenant for a qualifying day in the receipt period of the lease premium receipt.

267. *Subsections (3)* to *(5)* treat the tenant as incurring an expense for a qualifying day of the amount, if any, by which the "daily amount" of the taxed receipt exceeds:

- the "daily reduction" of the lease premium receipt; or

- if the qualifying day falls within the receipt period of more than one lease premium receipt, the "*total* of the daily reductions" of those lease premium receipts.

268. This corresponds to the treatment in clause 233 of cases where lease premium receipts, with overlapping receipt periods, are reduced by reference to the unreduced amount of a single taxed receipt. See *Change 13* in Annex 1.

269. *Subsection (6)* contains formulas for calculating the "daily amount" of a taxed receipt and the "daily reduction" of a lease premium receipt. The subsection provides that the "daily reduction" only takes account of the taxed receipt in question. This corresponds to the treatment in clause 233 of cases where more than one taxed receipt reduces a single lease premium receipt. See *Change 13* in Annex 1.

Clause 67: Restrictions on section 63 expenses: lease of part of premises

270. This clause adapts clause 63 if clause 66 applies but the sublease does not extend to the whole of the premises subject to the taxed lease. It is based on sections 87(5) and 87A of ICTA. The corresponding rule for income tax is in section 65 of ITTOIA.

271. *Subsection (4)* deals with the case where, for a qualifying day, there is more than one lease premium receipt, relating to subleases that do not extend to the whole of the premises, that has been reduced by the taxed receipt. This corresponds to the treatment in clause 234(5) of expenses under clauses 232 and 233 where more than one lease premium receipt falls to be reduced by reference to the same taxed receipt. See *Change 13* in Annex 1.

272. *Subsection (5)* adapts the formulas in clauses 63(4) and 66(6) by multiplying the unreduced amount of the taxed receipt in those formulas ("A") by the fraction of the premises to which the sublease relates.

273. *Subsection (6)* requires the fraction in subsection (5) to be calculated "on a just and reasonable basis", where section 87(5) of ICTA, which applies section 37(6) of ICTA, is not explicit about the necessary basis of apportionment. See *Change 12* in Annex 1.

Clause 68: Replacement and alteration of trade tools

274. This clause allows a deduction for the cost of replacing or altering trade tools if the *only* reason a deduction would not be allowed is that the expenditure is of a capital nature. It is based on that part of section 74(1)(d) of ICTA which relates to deductions in respect of the replacement ("supply") or alteration of implements, utensils or other articles employed for the purposes of the trade. The corresponding rule for income tax is in section 68 of ITTOIA.

275. Expenditure on repairing trade premises or tools is revenue under the normal rules. And following the Special Commissioners decision in Jenners Princes Street Edinburgh Ltd v CIR (1998), SpC000166[3], it is generally accepted that the reference in section 74(1)(d) of ICTA to expenditure "beyond the sum actually expended" does not prohibit the deduction of a provision for repairs if the cost of the repairs would be allowable. So that part of section 74(1)(d) of ICTA which deals with repairs is redundant and is not rewritten.

Clause 69: Payments for restrictive undertakings

276. This clause allows a company to deduct certain amounts paid to employees for restrictive undertakings. Such amounts might not otherwise be deductible to the extent that they are capital in nature or fall foul of the "wholly and exclusively" rule. The clause is based on section 73(2) of FA 1988. The corresponding rule for income tax is in section 69 of ITTOIA.

277. Section 73(2) of FA 1988 applies only to amounts brought into charge on the employee as earnings under section 225 of ITEPA. The former cross-refers to the latter where the definition of the amounts concerned is set out:

> In this section "restrictive undertaking" means an undertaking which restricts the individual's conduct or activities.
>
> For this purpose it does not matter whether or not the undertaking is legally enforceable or is qualified.

278. *Subsection (1)* provides for the deduction. In so doing it focuses on the key element for the rule to apply: the fact of payment.

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[3] STC [1998] (SCD) 196

279. *Subsection (2)* provides a timing rule. The deduction allowed by section 73 of FA 1988 is taken in the accounting period in which the payment is made and no deduction is allowed in any other period. Similar words are used in clauses 77 and 88. This ensures that the timing rules for deductions in this Chapter which depend on payment are explicit and consistent.

Clause 70: Employees seconded to charities and educational establishments

280. This clause allows a company carrying on a trade to deduct the cost of an employee seconded to a charity or educational establishment in calculating the trade profits. It is based on section 86 of ICTA. The corresponding rule for income tax is in section 70 of ITTOIA.

281. Section 86 of ICTA allows a company which seconds an employee to a charity or educational establishment to deduct the cost of employing the seconded person *to the extent that* those costs would have been deductible if the employee continued to be employed for the purposes of the employer's trade. 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 71: Educational establishments

282. This clause defines "educational establishment" for the purposes of clause 70. It is based on section 86 of ICTA. The corresponding rule for income tax is in section 71 of ITTOIA.

283. Section 86(4)(c) of ICTA refers to an independent school registered under section 465 of the Education Act 1996. Section 465 of the Education Act 1996 was repealed by the Education Act 2002. So *subsection (1)(c)* of this clause refers instead to an independent school registered under section 161 of the 2002 Act.

284. Schedule 1 to this Bill makes corresponding amendments to section 71 of ITTOIA.

Clause 72: Payroll deduction schemes: contributions to agents' expenses

285. This clause allows an employer a deduction for expenses incurred in operating a payroll deduction scheme. It is based on section 86A of ICTA. The corresponding rule for income tax is in section 72 of ITTOIA.

286. The main rules for payroll deduction schemes are found in Part 12 of ITEPA. Under such a scheme an employer deducts charitable donations from employees' salaries and pays them to an agent, who distributes them to the employees' chosen charities.

287. The agent's administrative costs may be deducted from the donations. But many employers voluntarily pay the costs themselves so that the employees' full donations can go to the chosen charities.

288. Normally, payments made voluntarily to meet someone else's expenses are not made wholly and exclusively for the purposes of a trade and therefore would not be deductible. Employers might get relief for donations to charitable agencies under the Gift Aid scheme. But there are restrictions on the operation of that scheme and relief would not be available if the agent was not itself a charity.

289. This clause gives relief for the expenses as a trading deduction.

290. The clause does not rewrite the reference to "profession or vocation" in Schedule D Case II. See *Change 2* in Annex 1.

Clause 73: Counselling and other outplacement services

291. This clause allows a deduction for certain expenses of counselling provided for employees. It is based on sections 589A and 589B of ICTA. The corresponding rule for income tax is in section 73 of ITTOIA.

292. *Subsection (3)* cross-refers to ITEPA for the conditions that need to be met for the deduction to be allowed (section 310 of ITEPA exempts the employee from tax in respect of counselling received).

Clause 74: Retraining courses

293. This clause allows a deduction for certain expenses of retraining provided for employees. It is based on section 588 of ICTA. The corresponding rule for income tax is in section 74 of ITTOIA.

294. *Subsection (2)* cross-refers to ITEPA for the conditions that need to be met for the deduction to be allowed (section 311 of ITEPA exempts the employee from tax in respect of qualifying retraining courses).

295. The clause does not rewrite section 588(3)(b) of ICTA. That provision makes a deduction in calculating the employer's trade profits 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 rewritten in clause 73 and does not serve any material purpose. See *Change 16* in Annex 1.

Clause 75: Retraining courses: recovery of tax

296. This clause allows the recovery of tax when a deduction under clause 74 proves to have been wrongly allowed. It is based on section 588 of ICTA. The corresponding rule for income tax is in section 75 of ITTOIA.

297. *Subsection (2)*, like clause 74(2) of this Bill, cross-refers to the relevant provisions in ITEPA to refer to the conditions that have not been met.

Clauses 76 to 81: Redundancy payments etc

Overview

298. These six clauses are based on the trading income rules relating to redundancy payments in sections 90, 579 and 580 of ICTA. The rules that deal with the employee's liability are in section 309 of ITEPA. The corresponding rules for income tax are in sections 76 to 80 of ITTOIA.

299. The trading income rules were introduced to reverse the decisions in CIR v Anglo Brewing Co Ltd (1925), 12 TC 803 and Godden v A Wilson's Stores (Holdings) Ltd (1962), 40 TC 161. In those cases the courts held that certain payments to employees on the closing down of a trade were not deductible in arriving at trading profits. In neither case was the payment made in accordance with a pre-existing obligation.

300. In 1999 HMRC announced (Tax Bulletin 39G, February 1999) that they would be guided by the decision in Commissioner of Inland Revenue v Cosmotron Manufacturing Co Ltd (1997), 70 TC 292[4].

301. In that Hong Kong case the Privy Council decided that redundancy payments made under a pre-existing obligation are deductible. Although that decision is merely persuasive in the United Kingdom, HMRC do not argue that payments made under a pre-existing obligation (including a statutory obligation) are covered by the Anglo Brewing and Wilson's Stores decisions. The announcement in Tax Bulletin means that it may not be necessary to give the employer a statutory right to a deduction in calculating trading profits. But these clauses put the matter beyond doubt.

Clause 76: Redundancy payments and approved contractual payments

302. This clause sets out the circumstances in which the following three clauses apply and explains the terms used in the main provisions. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 76 of ITTOIA.

303. The clauses retain the label "redundancy payment" (from section 579 of ICTA) and the expression "additional payment" (from section 90 of ICTA). This clause also introduces the label "approved contractual payment" to describe the payments that may replace redundancy payments in some cases.

Clause 77: Payments in respect of employment wholly in employer's trade

304. This clause sets out the main rule governing redundancy payments made by an employer. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 77 of ITTOIA.

305. If a payment is otherwise allowable (possibly as a result of the Cosmotron decision – see the overview for this group of clauses), this clause does not interfere

[4] STC [1997] 1134

with the accountancy treatment of the payment. In that case, the normal accounting basis applies.

306. The deduction allowed by section 579 of ICTA is for "a redundancy payment ... made". It is clear that a deduction is allowed only if a payment has been made. It follows that the deduction is to be taken in the accounting period in which the payment is made and that no deduction is allowed in any other period.

307. Section 579(2)(b) of ICTA sets out the rule that applies if a redundancy payment is made after the discontinuance of the employer's trade. The rule applies if the company ceases to carry on a trade or to be within the charge to corporation tax (see clause 41 of this Bill).

308. In the case of a trade carried on by a company in partnership, section 114(1)(c) of ICTA deals with a change of membership of a partnership. The profits of the trade are calculated as if there is a transfer of the trade from one deemed company to another, unless a particular company carries on the trade before and after the change. Such a transfer means that the first deemed company ceases to carry on the trade. This brings it within the rule in section 579(2)(b) of ICTA.

309. *Subsection (5)* of the clause sets out the partnership rule.

310. *Subsection (6)* has a timing rule expressed in words similar to those used in clauses 69 and 88 of this Bill. This ensures that the timing rules for deductions in Chapter 5 of Part 3 of this Bill which depend on payment are explicit and consistent. This special timing rule applies if the payment is allowable only as a result of this clause.

Clause 78: Payments in respect of employment in more than one capacity

311. This clause deals with the case where the employee is employed in more than one capacity. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 78 of ITTOIA. The clause covers the case where there is a non-trade element in the employment and makes clear what part of the payment is allowed as a deduction in calculating trade profits.

312. Section 579(5) of ICTA does not specify the basis on which to apportion the payment. This clause adopts the "just and reasonable" apportionment that is used consistently in this Bill. See *Change 12* in Annex 1.

Clause 79: Additional payments

313. This clause deals with any voluntary payments that an employer makes in addition to the statutory (or approved) payments dealt with in clause 77. It is based on section 90 of ICTA. The corresponding rule for income tax is in section 79 of ITTOIA.

314. Unlike the payments in clause 77, these additional payments are allowable only if the sole reason for their disallowance is the cessation of the trade.

315. The clause applies to payments in connection with the cessation of *part* of a trade in the same way as it applies to payments in connection with the cessation of a whole trade. See *Change 17* in Annex 1.

Clause 80: Application of section 79 in cases involving partnerships

316. This clause clarifies what happens on a change of partnership. It is based on sections 90 and 114 of ICTA. The corresponding rule for income tax is in section 79A of ITTOIA (inserted by Schedule 1 to this Bill).

317. Section 90(3) of ICTA refers to the "discontinuance" of a trade. That word has to be interpreted in the light of sections 114 and 337 of ICTA: the trade is not treated as discontinued unless there is a complete change in the companies carrying it on.

318. A redundancy payment is not disallowable solely on account of a partial change of companies carrying on a trade. This clause puts it beyond doubt that a partial change of companies carrying on a trade does not count as a cessation.

Clause 81: Payments made by the Government

319. This clause sets out what happens if it is not the employer who makes the redundancy payment to the employee. It is based on section 579 of ICTA. The corresponding rule for income tax is in section 80 of ITTOIA.

320. In some cases the Government makes the payment and is reimbursed by the employer. This clause ensures that the employer is allowed a trading deduction.

321. The references in ICTA to section 166 of the Employment Rights Act 1996 and Article 201 of the Employment Rights (Northern Ireland) Order 1996 (SI 1996/1919 (NI 16)) are corrected to section 167 and Article 202.

322. *Subsection (1)(b)* reflects the effect of the devolution settlements. See *Change 15* in Annex 1.

Clause 82: Contributions to local enterprise organisations or urban regeneration companies

323. This is the first of five clauses that allow deductions for contributions to local enterprise agencies, training and enterprise councils, local enterprise companies in Scotland, business links and urban regeneration companies. The clauses are based on sections 79, 79A and 79B of ICTA. The corresponding rules for income tax are in sections 82 to 86 of ITTOIA.

324. Contributions to these bodies are generally donations and are likely to be made for benevolent reasons, rather than wholly and exclusively for the purposes of the trade (see clause 54 of this Bill).

325. *Subsection (3)* is an anti-avoidance rule. It prevents a company using the clause to obtain a deduction for non-trade 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.

326. *Subsections (5)* and *(6)* set out what happens if the company (or a connected person) receives a benefit in connection with the contribution. The charge on the benefit applies if the benefit is received by a person "connected with" the company. That expression is explained in clause 1316.

327. Subsection (6)(b) deals with the case where the recipient's trade has ceased before the benefit is received. It treats the benefit explicitly as a post-cessation receipt. See *Change 19* in Annex 1.

328. *Subsection (7)* makes clear the extent of the disallowance under subsection (3) or charge under subsection (6).

329. The subsection limits the "disqualifying benefit" in accordance with HMRC practice. See *Change 18* in Annex 1.

Clause 83: Meaning of "local enterprise organisation"

330. This clause lists some of the organisations that qualify for deductions to be allowed under clause 82. It is based on the definitions in sections 79(4) and 79A(5) of ICTA. The corresponding rule for income tax is in section 83 of ITTOIA.

331. *Subsection (2)* deals with local enterprise agencies. These agencies may take a number of forms and do not have an approval procedure for any other purpose. So the tax legislation specifies that they must be approved for this purpose.

332. The subsection introduces the expression "relevant national authority". The expression is used also in clauses 84 and 85.

333. The subsection reflects the effect of the devolution settlements. See *Change 15* in Annex 1. The National Assembly for Wales (Transfer of Functions) Order 1999 (SI 1999/672) devolves the functions of the Secretary of State under section 79 of ICTA to the National Assembly for Wales. So the "relevant national authority" may be the Assembly. But the Order does not refer to section 79A of ICTA. So the equivalent functions in subsections (3) and (5) of this clause are still exercised only by the Secretary of State.

334. *Subsections (3)* to *(5)* deal with other bodies to which clause 82 applies. These other bodies have to be set up in a particular way for other reasons and the tax legislation merely follows the existing procedures.

Clause 84: Approval of local enterprise agencies
335. This clause and clause 85 set out the detailed rules that apply for the approval of local enterprise agencies and the withdrawal of such approval. They are based on section 79 of ICTA. The corresponding rule for income tax is in section 84 of ITTOIA.

336. The clause sets out the basic procedure for approving a local enterprise agency. The references to “relevant national authority” are explained in clause 83(2).

Clause 85: Supplementary provisions with respect to approvals
337. This clause and clause 84 set out the detailed rules that apply for the approval of local enterprise agencies and the withdrawal of such approval. They are based on section 79 of ICTA. The corresponding rule for income tax is in section 85 of ITTOIA.

338. The references to “relevant national authority” in this clause are explained in clause 83(2).

Clause 86: Meaning of “urban regeneration company”
339. This clause sets out the detailed rules that apply for the designation of urban regeneration companies. It is based on section 79B of ICTA. The corresponding rule for income tax is in section 86 of ITTOIA.

Clause 87: Expenses of research and development
340. This clause gives relief for the cost of research and development undertaken by or on behalf of a company carrying on a trade. It is based on section 82A of ICTA. The corresponding rule for income tax is in section 87 of ITTOIA.

Clause 88: Payments to research associations, universities etc
341. This clause gives relief for payments by a company carrying on a trade to various bodies engaged in scientific research. It is based on section 82B of ICTA. The corresponding rule for income tax is in section 88 of ITTOIA.

342. The amendments to section 82B of ICTA in section 15 of F(No 2)A 2005 have effect in relation to sums paid to an association within *subsection (1)(a)* of this clause during any accounting period of the association beginning on or after a day to be appointed by the Treasury under section 13(6) of F(No 2)A 2005.

343. Section 82B(1) of ICTA allows a deduction for “the sum paid”. So *subsection (2)* allows a deduction for the accounting period in which the payment is made. The wording is similar to that used in clauses 69 and 77. This ensures that the timing rules for deductions in Chapter 5 of this Part of this Bill which depend on payment are explicit and consistent.

344. Section 82B(4) of ICTA provides that “the Board” shall refer any question as to whether, or to what extent, activities constitute scientific research for the purposes

of section 82B to the Secretary of State. Section 832(1) of ICTA defines "the Board" as "the Commissioners of Inland Revenue".

345. In practice, the function in section 82B of ICTA is exercised by an officer of Revenue and Customs. So s*ubsection (6)* of this clause provides that any question as to what constitutes scientific research must be referred to the Secretary of State by "an officer of Revenue and Customs". This Change corresponds to Part B of Change 149 in ITTOIA (as amended by CRCA) and so brings the income tax and corporation tax codes back into line. See *Change 1* in Annex 1.

Clause 89: Expenses connected with patents

346. This clause allows a deduction for expenses connected with patents. It is based on section 83 of ICTA. The corresponding rule for income tax is in section 89 of ITTOIA.

347. The clause sets out the expenses that are allowable. The deduction 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. See *Change 20* in Annex 1.

348. For most expenses connected with patents this rule is overridden by the rules of the intangible fixed assets regime (rewritten in Part 8 of this Bill) which provide relief for trades as well as other commercial activities (see Chapter 6 of that Part). But, for a minority of cases, this clause remains relevant and allows a deduction.

Clause 90: Expenses connected with designs or trade marks

349. This clause allows a deduction for expenses connected with designs or trade marks. It is based on section 83 of ICTA. The corresponding rule for income tax is in section 90 of ITTOIA.

350. The clause sets out the expenses that are allowable. The deduction 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. See *Change 20* in Annex 1.

351. For most expenses connected with designs or trade marks this rule is overridden by the rules of the intangible fixed assets regime (rewritten in Part 8 of this Bill) which provide relief for trades as well as other commercial activities (see Chapter 6 of that Part). But, for a minority of cases, this clause remains relevant and allows a deduction.

Clause 91: Payments to Export Credits Guarantee Department

352. This clause allows a company carrying on a trade to deduct the cost of certain payments to the Export Credits Guarantee Department ("ECGD"). It is based on section 88 of ICTA. The corresponding rule for income tax is in section 91 of ITTOIA.

353. Section 88 of ICTA refers to payments made under arrangements made by the Secretary of State in pursuance of section 11 of the Export Guarantees and Overseas Investment Act 1978. This clause refers instead to arrangements made under section 2 of the Export and Investment Guarantees Act 1991 which replaced the 1978 Act.

354. Section 13(1) of the Export and Investment Guarantees Act 1991 delegates the functions of the Secretary of State under section 2 of the 1991 Act to the ECGD. So the reference to the Secretary of State in section 88 of ICTA is not rewritten in this clause.

355. Section 88 of ICTA allows a trader to deduct "sums paid" to the ECGD. This clause instead allows a deduction for any "sum payable" by the trader. See *Change 21* in Annex 1.

Clause 92: Levies etc under FISMA 2000

356. This clause provides for the inclusion, in a calculation of trading profits, of certain payments arising from FISMA. It is based on section 76A of ICTA. The corresponding rule for income tax is in section 155 of ITTOIA.

357. *Subsection (1)* applies the clause to any company that pays a "levy" and removes three minor restrictions.

- Section 76A of ICTA applies only to an "authorised person". This clause removes that restriction.
- The clause does not reproduce the restriction in section 76A(2)(e) of ICTA for some "costs".
- A trading company that also has investment business may qualify for a deduction under this clause which is denied by section 76A(1)(b) of ICTA.

See *Change 22* in Annex 1.

358. Subsection (1) provides for a deduction. Most FISMA levies would be allowable expenses under the basic trade profit calculation rules. The purpose of this provision is to deal with the exceptional case where deduction of a levy would otherwise be prevented by a prohibitive rule.

359. The expenses allowable are determined by reference to FISMA. *Subsections (2)* and *(3)* provide the links with FISMA.

360. There is a similar rule about FISMA repayments in clause 104.

Chapter 6: Trade profits: receipts

Overview

361. This Chapter contains provisions on how various receipts are to be treated in calculating the profits of a trade.

Clause 93: Capital receipts

362. This clause is the mirror image of clause 53 (capital expenditure). It is new. The corresponding rule for income tax is in section 96 of ITTOIA.

363. *Subsection (1)* sets out the general rule that items of a capital nature are not to be treated as receipts of a trade.

364. It is a long-established principle that capital receipts are ignored in calculating tax on income.

365. *Subsection (2)* disapplies the general rule in subsection (1) where there is statutory provision for a capital sum to be taken into account as a receipt in calculating the profits of a trade. See, for example, clause 103 (sums recovered under insurance policies etc) and the rules in Part 5 (loan relationships), Part 7 (derivative contracts) and Part 8 (intangible fixed assets).

Clause 94: Debts incurred and later released

366. If an amount owed by a company is released, this clause treats the amount released as a trading receipt. The clause is based on section 94 of ICTA. The corresponding rule for income tax is in section 97 of ITTOIA.

367. *Subsection (1)(c)* sets out the exception that applies if the debt is released as part of a "statutory insolvency arrangement", which is defined in section 834(1) of ICTA.

368. The source legislation treats the sum as a receipt "in the period in which the release is effected". The clause makes it clear that the period in question is an accounting period. If the company is no longer carrying on the trade when the debt is released, the amount released is charged to tax as a post-cessation receipt (see clause 193 of this Bill).

Clause 95: Acquisition of trade: receipts from transferor's trade

369. This clause sets out what happens if a successor to a trade receives a sum that arose from the trade when it was carried on by the predecessor. It is based on section 106 of ICTA. The corresponding rule for income tax is in section 98 of ITTOIA.

370. If a sum arises from a trade that has ceased, the usual rule is that the sum is a post-cessation receipt (see Chapter 15 of this Part). But, if the right to receive the sum is transferred with the trade to a company which takes over the trade, this clause applies instead.

371. *Subsection (1)* refers to a "person" ceasing to carry on a trade. That person may be one of the partners in a firm. If a firm ceases to carry on a trade, all its partners must also cease. So the clause applies in either case.

372. *Subsection (2)* treats the sum as a receipt of the successor's trade. It is not charged on the predecessor. The source legislation treats the sum as a receipt "in the period in which it is received". The clause makes it clear that the period in question is an accounting period.

373. Different rules apply if the right to receive sums is transferred to a person who does not take over the trade (see clause 194 of this Bill).

Clause 96: Reverse premiums

374. This is the first of a group of five clauses based on section 54 of, and Schedule 6 to, FA 1999. This legislation was introduced following the decision of the Privy Council in <u>Commissioner of Inland Revenue v Wattie and another</u> (1998), 72 TC 639[5]. An inducement (a "reverse premium") paid to a tenant to take a lease of land is taxed as income in the hands of the tenant. The corresponding rules for income tax are in sections 99 to 103 of ITTOIA.

375. *Subsection (2)* introduces the term "the recipient", which is used throughout this group of clauses.

376. *Subsection (3)* identifies the transaction which gives rise to a reverse premium.

377. *Subsection (4)* refers to an interest in land being "granted". This distinguishes such a transaction from one in which an interest is assigned. The general rule is that a charge to tax on a reverse premium arises on the grant of an interest in land but not on its assignment. But assignment can give rise to a charge if the assignor is connected with the grantor.

378. The meaning of "reverse premium" in this clause is applied for the purpose of clause 250 by subsection (6) of that clause.

379. Schedule 2 to this Bill rewrites the transitional provision in section 54(2) of FA 1999. These clauses do not apply to pre-1999 reverse premiums.

Clause 97: Excluded cases

380. This clause brings together the various exclusions from the charge on reverse premiums. It is based on paragraphs 5 and 7 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 100 of ITTOIA.

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[5] [1998] STC 1160

381. *Subsection (2)* rewrites the rule in paragraph 6 of Schedule 6 to FA 1999 as it was before it was repealed by ITTOIA. It is possible for a company to receive a reverse premium in connection with a property transaction entered into by an individual involving the individual's only or main residence. The income tax relief is rewritten in section 100(2) of ITTOIA. It was not intended that ITTOIA should withdraw this relief from a company. So this subsection restores the position as it was before ITTOIA. See *Change 23* in Annex 1.

Clause 98: Tax treatment of reverse premiums

382. This clause treats a reverse premium as a revenue receipt, rather than a capital item. It is based on paragraph 2 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 101 of ITTOIA.

383. If the transaction giving rise to the reverse premium is at arm's length there is no statutory timing rule; the normal accountancy treatment applies. If the transaction is not at arm's length, there is a timing rule in clause 99.

Clause 99: Arrangements not at arm's length

384. If a property transaction is not at arm's length there is a special timing rule. This clause provides that the whole of the reverse premium is taxed when the property transaction is entered into. It is based on paragraph 3 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 102 of ITTOIA.

385. *Subsection (1)* refers to "connected persons". That expression is defined for the purpose of this clause in clause 100.

386. *Subsection (5)* deals with the case where the recipient enters into a property transaction for the purposes of a trade but the trade has not yet started. In that case, the reverse premium is brought into account when the trade starts.

Clause 100: Connected persons and property arrangements

387. This clause sets out the special meaning of "connected persons" that applies for the group of clauses on reverse premiums. The basic definition is in clause 1316, which imports the definition of "connected persons" in section 839 of ICTA. The clause is based on paragraph 8 of Schedule 6 to FA 1999. The corresponding rule for income tax is in section 103 of ITTOIA.

Clause 101: Distribution of assets of mutual concerns

388. This clause deals with the consequences for a trader of receiving a distribution from a mutual concern that is a corporate body. It is based on section 491 of ICTA. The corresponding rule for income tax is in section 104 of ITTOIA.

389. *Subsection (1)* sets out the circumstances in which a distribution may give rise to a tax charge. It refers to a distribution out of assets that "represent profits" of the concern. This is not quite the same as "assets of a body corporate, other than assets representing capital", as identified in section 491(1) of ICTA. The difference is that

the clause excludes assets that represent capital gains of the concern. See *Change 24* in Annex 1.

390. *Subsection (2)* is the general rule: the distribution is treated as a receipt of the trade.

391. *Subsection (3)* deals with the case where the distribution is received after the trade has ceased. The clause treats the distribution explicitly as a post-cessation receipt. See *Change 19* in Annex 1.

392. In this Part the rules apply to the company carrying on a trade rather than to the trade itself. So section 337(1)(a) of ICTA is not needed to treat a trade as ceasing when there is a change of company carrying it on. Subsection (3) of this clause reproduces the combined effect of section 491(3)(b) and (4) of ICTA.

393. *Subsection (5)* is a special rule that applies if the right to receive a distribution is transferred other than at arm's length. Market value is substituted for the actual amount received.

394. The clause omits the references to mutual insurance and industrial and provident societies in section 491(9) and (11) of ICTA. Those examples were intended to help readers but there is no comprehensive definition of "mutual business". The subsections were intended to deal with particular doubts which were common when the provision was enacted in 1964. Those doubts do not exist today.

Clause 102: Industrial development grants

395. 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 income tax is in section 105 of ITTOIA.

396. This clause does not rewrite the references in section 93(2)(a) of ICTA to section 7 or 8 of the Industry Act 1972 or in section 93(2)(b) to section 1 of the Industries Development Act (Northern Ireland) 1966 and section 4 of the Industries Development Act (Northern Ireland) 1971. These enactments were repealed or replaced in 1982 and there are no outstanding instalments under the old enactments.

397. Section 93(3) of ICTA disapplies section 93(1) of ICTA in the case of grants towards the payment of all or part of a corporation tax liability made under Article 7 of the Industrial Development (Northern Ireland) Order 1982. Grants in respect of corporation tax liabilities cannot be made under any of the enactments listed in *subsection (1)* of this clause other than Article 7 of the Industrial Development (Northern Ireland) Order 1982. So *subsection (2)* excludes *all* grants in respect of corporation tax liabilities.

Clause 103: Sums recovered under insurance policies etc

398. This clause concerns insurance recoveries. It is based on section 74(1)(l) of ICTA. The corresponding rule for income tax is in section 106 of ITTOIA.

399. Section 74(1)(l) of ICTA prohibits the deduction in computing a trader's profits of "any sum recoverable under an insurance or contract of indemnity". This is regardless of whether the sum is revenue or capital in nature.

400. When a sum is recovered under an insurance policy or contract of indemnity in an accounting period *other than* the accounting period in which the event in respect of which it is received occurs, section 74(1)(l) of ICTA requires any deduction made in respect of that event to be adjusted to reflect the recovery.

401. This clause provides instead that a capital sum recovered by a trader under an insurance policy or a contract of indemnity is brought into account as a receipt in calculating the profits of the trade to the extent that the loss or expense has been deducted in calculating those profits. This means that the timing of the receipt will follow the accountancy treatment. See *Change 25* in Annex 1.

402. No special provision is needed for sums of a revenue nature.

Clause 104: Repayments under FISMA 2000

403. This clause provides for the inclusion in a calculation of trading profits of certain receipts arising from FISMA. It is based on section 76A of ICTA. The corresponding rule for income tax is in section 155 of ITTOIA.

404. *Subsection (2)* provides for a repayment under FISMA to be treated as a trade receipt. Most FISMA repayments would be charged to tax under the basic trade profit calculation rules. The purpose of this provision is to deal with the exceptional case where the FISMA repayment would not otherwise be a trade receipt.

405. The receipts chargeable are determined by reference to FISMA. *Subsections (3)* and *(4)* provide the links with FISMA.

406. There is a similar rule about FISMA levies etc in clause 92.

Chapter 7: Trade profits: gifts to charities etc

Clause 105: Gifts of trading stock to charities etc

407. This clause sets out the main rule for gifts of trading stock. It is based on sections 83A and 84 of ICTA, which give relief for gifts to charities and educational establishments respectively. The corresponding rule for income tax is in section 108 of ITTOIA.

408. When a company disposes of trading stock other than in the course of a trade the general rule is that the market value of the stock is taken into account in calculating the profits of the trade (see Chapter 10 of this Part of this Bill). This clause

sets out an exception to this general rule and applies if the company disposes of trading stock by way of gift to a charity etc.

409. There is a test for gifts to educational establishments in section 84(1)(a) of ICTA concerning the use to which the gift is put in the business of the educational establishment. There is no equivalent test in the rules for the relief for gifts to charities, in section 83A of ICTA. This clause does not reproduce the condition in section 84(1)(a) of ICTA. See *Change 26* in Annex 1.

410. *Subsection (1)* combines the ICTA reliefs for gifts to charities and gifts to educational establishments. It includes the extension of the relief to registered clubs in Part 3 of Schedule 18 to FA 2002. The relief covers gifts "for the purposes of" charities etc. See *Change 27* in Annex 1.

411. The clause does not require a claim by the company. In this respect, the clause is different from section 84(3) of ICTA (but not from section 83A). See *Change 28* in Annex 1.

412. *Subsection (4)* does not reproduce the references to the British Museum and the Natural History Museum. These bodies are charities within subsection (1)(a) of the clause.

Clause 106: Meaning of "designated educational establishment"

413. This clause defines "designated educational establishment" for the purpose of clause 105. It is based on section 84 of ICTA. The corresponding rule for income tax is in section 110 of ITTOIA.

414. Section 84(6) of ICTA provides that "the Board" shall refer any question as to whether a particular establishment is a designated educational establishment for the purposes of the section to the Secretary of State or the Department of Education for Northern Ireland. Section 832(1) of ICTA defines "the Board" as "the Commissioners of Inland Revenue" (to be taken as a reference to the Commissioners for Her Majesty's Revenue and Customs, in accordance with section 50(1) of CRCA).

415. In practice, the function in section 84 of ICTA is exercised by an officer of Revenue and Customs. So s*ubsection (3)* of this clause provides that any question as to whether a particular establishment is a designated educational establishment must be referred to the Secretary of State by "an officer of Revenue and Customs". See *Change 1* in Annex 1.

416. The National Assembly for Wales (Transfer of Functions) Order 1999 (SI 1999/672) devolves the functions of the Secretary of State under section 84 of ICTA to the Welsh Ministers. So this clause refers to the Welsh Ministers (and the Assembly).

Clause 107: Gifts of medical supplies and equipment

417. This clause sets out the main rule for gifts of medical supplies and equipment. It is based on section 55 of FA 2002. It also gives a trading deduction for expenses connected with such gifts.

418. As in clause 105, this clause overrides the rule in Chapter 10 of this Part of this Bill that the market value of a gift should be treated as a trade receipt.

419. *Subsection (3)* is the special rule that the costs of getting the medical supplies and equipment to the recipient are allowed as a deduction.

420. *Subsection (5)* is based on section 55(6) of FA 2002. The power of the Treasury to exclude certain medical supplies and equipment has not been used.

421. There is no corresponding rule for income tax. So section 55 of FA 2002 is repealed by Schedule 1 to this Bill. See *Change 29* in Annex 1.

Clause 108: Receipt of benefits by donor or connected person

422. This clause sets out what happens if a company receives a benefit in connection with a gift of trading stock or plant and machinery. It is based on sections 83A and 84 of ICTA and section 55 of FA 2002. The corresponding rule for income tax is in section 109 of ITTOIA.

423. *Subsection (1)* applies the clause if a benefit is received by the company or a connected person. Clause 82 of this Bill (contributions to local enterprise organisations or urban regeneration companies) uses the same approach. The benefit must be in connection with a gift for which relief has been given under clause 105, clause 107 or the corresponding capital allowances rule.

424. *Subsection (2)* extends the recovery charge to a benefit attributable to the costs associated with making a gift of medical supplies and equipment.

425. If the donor is still carrying on the trade when the benefit is received the value of the benefit is treated as a trading receipt.

426. If the donor has ceased to carry on the trade when the benefit is received the value of the benefit is treated as a post-cessation receipt. This treatment replaces the general charge under Schedule D Case VI. See *Change 19* in Annex 1.

Chapter 8: Trade profits: herd basis rules

Overview

427. This Chapter gives the rules for what is commonly known as the “herd basis”. It is based on Schedule 5 to ICTA. The corresponding rules for income tax are in Chapter 8 of Part 2 of ITTOIA.

428. The object of the herd basis is to treat a herd of animals in a similar fashion to a capital asset. Without the election the individual animals in the herd would be treated as separate items of trading stock. With the election:

- there is no tax allowance for the initial cost of, or any subsequent increase in the size of, the herd;
- the net cost of replacing animals in the herd is allowable;
- any profit or loss on the sale of a single animal or a small number of animals from the herd without replacement is included in the profits of the trade; and
- if the whole, or a substantial part, of the herd is sold and not replaced the resulting profit or loss is not included in the profits of the trade.

429. An election can be made only in respect of animals kept for their produce.

Clause 109: Election for application of herd basis rules

430. This clause allows a taxpayer to elect for the "herd basis rules" to apply and introduces some basic concepts. It is based on paragraphs 1, 2, 3 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 111 of ITTOIA.

431. *Subsection (1)* allows a company or firm of which a company is a member to make a "herd basis election" if it keeps, or has kept, a "production herd". "Production herd" is defined in clause 110(1)(c). The effect of a "herd basis election" is that the "herd basis rules" apply. These rules are set out in clauses 112 to 121. The time limits for making the election are set out in clauses 122 to 124.

Clause 110: Meaning of "animal", "herd", "production herd" etc

432. This clause provides various definitions used in the Chapter. It is based on paragraphs 8 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 112 of ITTOIA.

433. This clause would be the natural home for the rule in paragraphs 7 and 9(5) of Schedule 5 to ICTA that prevents the herd basis rules applying to working animals. Paragraphs 7 and 9(5) of Schedule 5 to ICTA exclude certain animals from being part of a production herd. These are animals kept for the work they do in connection with the trade or those kept for public exhibition, or racing or other competitive purposes. This rule is unnecessary because animals in a production herd must be kept wholly or mainly for the sake of their produce. So the exclusions are not rewritten.

434. *Subsection (1)(a)* rewrites the definition of "animal" in paragraph 9 of Schedule 5 to ICTA. Most of the definitions in paragraph 9 of Schedule 5 to ICTA refer to "animals and other living creatures". The main reason for the reference to "other living creatures" is to make clear that the Schedule applies to birds.

435. Subsection (1)(c) rewrites the definition of "production herd" in paragraph 8(5) of Schedule 5 to ICTA. Herd basis elections are made by reference to classes of production herd. See clause 122. Clause 111(2) identifies when different production herds are treated as being of the same class.

436. *Subsection (6)* makes clear that an immature animal can be treated as added to the herd when it becomes mature. There is a definition of maturity for female animals in clause 111(5).

Clause 111: Other interpretative provisions

437. This clause provides further definitions. It is based on paragraphs 3, 8 and 9 of Schedule 5 to ICTA. The corresponding rules for income tax are section 113 of ITTOIA.

438. *Subsection (2)(a)* applies if production herds of animals of different species are kept for the same product; for example, a herd of cows and a herd of goats both kept for milk production. Each herd satisfies the definition of production herd. Subsection (2)(a) prevents them being treated as of the same class.

439. Subsection (2)(b) prevents animals of the same species being treated as of the same class if they are kept for different products; for example, one herd of cows kept for milk production and another herd of cows kept for its calves.

440. *Subsection (6)* clarifies what is meant by "a substantial part of the herd". This is a question of fact depending on the circumstances. But 20% of the herd is always regarded as substantial. This change clarifies this practice. This change reproduces Change 32 in ITTOIA. See *Change 30* in Annex 1.

441. The following clauses refer to "a substantial part of the herd".

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

Clause 112: Initial cost of herd and value of herd

442. This clause sets out the treatment of the initial cost, and value, of the herd. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 114 of ITTOIA.

Clause 113: Addition of animals to herd

443. This clause sets out the treatment of additions to the herd. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 115 of ITTOIA.

444. *Subsection (1)* makes clear that there is a difference between additions, to which this clause applies, and replacements dealt with in clause 114.

445. *Subsection (2)* prevents a deduction for the cost of the additional animal. It is a similar rule to clause 112(1).

Clause 114: Replacement of animals in herd

446. This clause sets out the treatment if an animal in the herd is replaced. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 116 of ITTOIA.

447. *Subsection (1)* introduces the terms “old animal” to describe an animal leaving the herd and “new animal” to describe the animal that replaces it. The circumstances in which an animal is treated as sold and the meaning of “sale proceeds” are extended by the definitions in clause 111(3) and (4).

448. *Subsection (4)* deals with the deduction due for the replacement animal. The basic principle in paragraph 3(4)(b) of Schedule 5 to ICTA is that the cost of the second animal is deducted as a trading expense. But paragraph 3(4)(b) of Schedule 5 to ICTA provides for an exception - “in so far as that cost consists of such costs as are allowable apart from the provisions of this Schedule as deductions in computing profits of farming under Case I of Schedule D”.

449. It is not clear from ICTA what these costs are. In fact the exception is aimed at the case where the replacement animal comes from trading stock. Here the costs of breeding or acquiring it and, if relevant, rearing it to maturity have already been allowed. The farmer is not allowed a double deduction for costs that have already been allowed.

450. This clause does not reproduce that part of paragraph 3(4)(b) of Schedule 5 to ICTA which refers to the cost of the new animal being subject to paragraph 3(6) of Schedule 5 to ICTA. This reference appears to be an error made in the 1988 consolidation of ICTA. It is generally accepted that it is the rule in paragraph 3(4)(a), and not paragraph 3(4)(b), of Schedule 5 to ICTA which should be qualified by paragraph 3(6) of Schedule 5 to ICTA.

Clause 115: Amount of receipt if old animal slaughtered under disease control order

451. This clause limits the amount of the receipt taxed under clause 114 if the old animal is slaughtered under a disease control order. It is based on paragraph 3 of

Schedule 5 to ICTA. The corresponding rule for income tax is in section 117 of ITTOIA.

452. Paragraph 3(6) of Schedule 5 to ICTA restricts the amount of the receipt to "the amount allowable as a deduction". It is not immediately clear what this amount is. This clause makes clear that it is the amount allowable as a deduction in respect of the new animal. This is called "the equivalent amount for the new animal".

453. *Subsections (4)* and *(5)* define "the equivalent amount for the new animal". Subsection (4) deals with the case in which the replacement animal comes from the farmer's trading stock. Subsection (5) deals with all other cases.

Clause 116: Sale of animals from herd

454. This clause sets out the rules that apply if an animal is sold from the herd and not replaced. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 118 of ITTOIA.

Clause 117: Sale of whole or substantial part of herd

455. This is the first of three clauses that set out the rules relating to the sale of all or a substantial part of the herd within 12 months. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 119 of ITTOIA.

456. The clause merges the rules in paragraph 3(7) to (9) of Schedule 5 to ICTA. This Change reproduces Change 33 in ITTOIA. See *Change 31* in Annex 1.

Clause 118: Acquisition of new herd begun within 5 years of sale

457. This clause sets out the rules that apply if, following the sale of the herd (either all at once or within 12 months), the farmer begins to acquire a new herd within five years. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 120 of ITTOIA.

458. *Subsection (4)* applies if the number of animals in the new herd is smaller than the number of animals in the old herd but the difference is not substantial. See *Change 31* in Annex 1.

459. *Subsection (7)* clarifies what is meant by a "substantial difference". See *Change 30* in Annex 1.

Clause 119: Section 118: sale for reasons outside farmer's control

460. This clause limits the amount taxed as a trade receipt under clause 118 if the sale is for reasons outside the farmer's control and the replacement animal is of a worse quality. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 121 of ITTOIA.

461. The clause is similar to clause 115 although it is not limited, as that clause is, to disposals under a disease control order. The source legislation for both clauses refers to the amount of the trading receipt being restricted to “the amount allowable as a deduction”. It is not immediately clear what this amount is.

462. *Subsection (2)* makes clear that it is the amount allowable as a deduction in respect of the new animal. The clause calls this “the equivalent amount for the new animal”.

463. *Subsections (3)* and *(4)* define “the equivalent amount for the new animal”. Subsection (3) deals with the case in which the replacement animal comes from the farmer’s trading stock. Subsection (4) deals with all other cases.

Clause 120: Replacement of part sold begun within 5 years of sale

464. This clause sets out the rules that apply if, following the sale of a substantial part of a herd (either all at once or within a year), the farmer begins to replace it within five years. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 122 of ITTOIA.

Clause 121: Section 120: sale for reasons outside farmer’s control

465. This clause limits the amount taxed as a trade receipt under clause 120 if the sale is for reasons outside the farmer’s control and the new animal is of a worse quality. It is based on paragraph 3 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 123 of ITTOIA.

466. The clause is similar to clause 115 although it is not limited, as that clause is, to disposals under a disease control order. The source legislation for both clauses refers to the amount of the trading receipt being restricted to “the amount allowable as a deduction”. It is not immediately clear what this amount is.

467. *Subsection (2)* makes clear that it is the amount allowable as a deduction in respect of the new animal. The clause calls this “the equivalent amount for the new animal”.

468. *Subsections (3)* and *(4)* define “the equivalent amount for the new animal”. Subsection (3) deals with the case in which the replacement animal comes from the farmer’s trading stock. Subsection (4) deals with all other cases.

Clause 122: Herd basis elections

469. This clause sets out the rules for the making of herd basis elections. It is based on paragraph 2 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 124 of ITTOIA.

470. Paragraph 2 of Schedule 5 to ICTA requires that the election must be made “in writing” and to an officer of Revenue and Customs. The general rules in Part 7 of

Schedule 18 to FA 1998 that apply to claims and elections mean it is not necessary to repeat these requirements.

471. *Subsection (2)* sets out the time limits for making the election. The election is made by the farmer. The farmer can be a company or a firm in which one of the partners is a company. The time limits are different depending on whether the farmer is a company or a firm.

472. If the farmer is a firm the same time limit applies whether the partners are all income tax payers, all corporation tax payers or a combination of the two. Because of the possible involvement of income tax payers the time limit is set by reference to income tax years. The time limit in clause 122(2)(b) is the same as that in section 124(2)(a) of ITTOIA.

473. The different time limits for a company or a firm are reflected in the other two clauses that deal with herd basis elections, clauses 123 and 124. Those clauses identify the difference by referring to the "accounting period" (company) or the "period of account" (firm).

474. *Subsection (4)* expands on *subsection (1)*, which provides that an election must specify the class of production herd to which it relates. This means separate elections must be made for each class of production herd and that an election may not relate to more than one class of production herd. Separate elections may be made for different classes.

475. *Subsection (7)* identifies the period for which the herd basis election has effect. This depends on whether the farmer is a company (accounting period) or firm (period of account).

476. *Subsection (8)* deals with the case in which the farmer is a firm and there is a change in the partners in the firm. Paragraph 2 of Schedule 5 to ICTA refers to "the farmer making the election". If the farming trade is carried on in partnership, the "farmer" means the firm. If there is a change in the members of a firm, the question arises whether there is a new "farmer". Subsection (8) makes clear that there is.

Clause 123: Five year gap in which no production herd kept

477. This clause deals with the case where there is a period of at least five years when the farmer does not keep a production herd of the particular class for which a herd basis election has been made. It is based on paragraph 4 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 125 of ITTOIA.

478. *Subsection (2)* explains the consequences for the herd basis rules if the farmer starts to keep another production herd of the same class after the end of the five year period. Subsection (2) enacts an extra-statutory practice. See *Change 32* in Annex 1. This Change reproduces Change 36 in ITTOIA.

Clause 124: Slaughter under disease control order
479. This clause sets out the rules for making an election outside the normal time limits following slaughter under a disease control order. It is based on paragraph 6 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 126 of ITTOIA.

Clause 125: Preventing abuse of the herd basis rules
480. This clause provides anti-avoidance rules that may apply if a farmer transfers the whole or part of a production herd in a transaction that is not an open market sale. It is based on paragraph 5 of Schedule 5 to ICTA. The corresponding rules for income tax are in section 127 of ITTOIA.

481. Clause 164(3) in Chapter 11 of this Part (trade profits: valuation of stock) makes clear that this section takes priority over the provisions of that Chapter.

Clause 126: Information if election made
482. This clause allows an officer of Revenue and Customs to obtain information about the animals kept for the purposes of the trade. It is based on paragraph 10 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 128 of ITTOIA.

Clause 127: Further assessment etc if herd basis rules apply
483. This clause enables effect to be given to a herd basis election made after an assessment has become final, either by amendment or by repayment of tax. It is based on paragraph 11 of Schedule 5 to ICTA. The corresponding rule for income tax is in section 129 of ITTOIA.

Chapter 9: Trade profits: other specific trades
Overview
484. This Chapter contains special rules for the taxation of particular trades.

Clause 128: Taxation of amounts taken to reserves
485. This clause contains a special rule for the treatment of securities held by a company carrying on a banking or insurance business, or a business of dealing in securities, and on which profits and losses are calculated by reference to the "fair value" of the securities rather than on a realisation basis. It is based on section 472A of ICTA. The corresponding rule for income tax is in section 149 of ITTOIA.

486. Financial assets can be dealt with in a number of ways for accounting purposes.

487. Where a company dealing in securities uses United Kingdom generally accepted accountancy practice ("UK GAAP"), profits and losses calculated by reference to the fair value of securities treated as trading assets are taken to profit and loss account. "Fair value" is an accounting term, the meaning of which is broadly equivalent to market value. UK GAAP is defined in section 50(4) of FA 2004.

488. Where a company dealing in securities prepares accounts in accordance with international accounting standards, the securities would usually fall to be accounted for as at fair value, in accordance with paragraph 9 of International Accounting Standard 39 ("IAS 39"), and any profits and losses calculated by reference to the fair value of securities taken to the profit and loss account. But the company may instead account for certain securities as "available for sale" if they do not meet the conditions for being treated as at fair value through profit or loss. In such a case profits and losses calculated by reference to the fair value of securities are taken initially to a statement of changes in equity.

489. Since 2005, UK GAAP in this area follows IAS 39. Under UK GAAP the profits and losses on "available for sale" assets are taken to the statement of total recognised gains and losses.

490. Clause 46 of this Bill provides that the calculation of profits or losses from a trade must be based on accounts drawn up in accordance with generally accepted accountancy practice, subject to any adjustment authorised by law. Implicit in this rule is that the profits must appear in the profit and loss account. There is no tax law (apart from this clause) which allows profits on equity securities taken to any form of reserve to be treated for corporation tax purposes as if they were taken to profit and loss account.

491. *Subsection (3)(b)* provides that subsection (2) does not apply to "an amount recognised for accounting purposes by way of correction of a fundamental error". This refers to the requirement in International Accounting Standard 8 (Accounting Policies, Changes in Accounting Estimates and Errors) that the correction of a fundamental error should be treated as a prior period adjustment. "For accounting purposes" is defined in section 832(1) of ICTA as "for the purposes of accounts drawn up in accordance with generally accepted accounting practice".

492. Section 472A(4)(a) of ICTA defines "securities" to include rights, interests or options treated as shares for the purposes of sections 126 to 136 of TCGA by virtue of sections 135(5) or 136(5) of TCGA. Sections 135(5) and 136(5) of TCGA define "shares" in the case of a company with no share capital as "any interests in the company possessed by members of the company." So *subsection (4)(c)* of this clause defines "securities" to include such interests.

Clause 129: Conversion etc of securities held as circulating capital

493. This clause provides for relief on the conversion or exchange of securities held as part of the circulating capital of a company dealing in securities. It is based on section 473 of ICTA. The corresponding rule for income tax is in section 150 of ITTOIA.

494. Section 473(1) of ICTA applies to securities to which a company carrying on a banking or insurance business, or a business of dealing in securities, is beneficially entitled, the profits from the sale of which would "form part of the trading profits of

that business”. This clause does not stipulate that the company must be beneficially entitled to the securities in question. See *Change 33* in Annex 1.

495. *Subsection (3)* excludes securities brought into account at “fair value” in calculating the profits for the period in which the relevant transaction takes place. These are instead dealt with in clause 128.

496. Section 137(1) of TCGA provides that sections 135 and 136 of TCGA do not apply to an exchange of shares unless the exchange is:

> effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax.

497. *Subsection (7)* of this clause adapts the rule in section 137(1) of TCGA to include the avoidance of income tax. This covers, for example, a scheme or arrangement the purpose of which is the avoidance of income tax by a director of, or participator in, the company rather than the avoidance of corporation tax by the company itself.

Clause 130: Traders receiving distributions etc

498. This clause provides that distributions of a UK resident company, and payments “representative of” such distributions, are brought into account in calculating the profits of a trade if those distributions and payments are receipts or expenses of the trade on first principles. It is based on section 95 of ICTA. The corresponding rule for income tax is in section 366(1) of ITTOIA.

499. A payment “representative of” a distribution may arise, for example, if shares are on loan at the dividend date. The dividend is received by the person to whom the shares are lent. A payment made by that person to compensate the lender for the dividend which would have been received if the shares had not been lent “represents” that dividend.

500. Section 95 of ICTA operates by bringing the distribution or representative payment into account in calculating the profits of a company which is a dealer in relation to that distribution or payment. That company holds the shares in respect of which the distribution is received (or the payment made) as assets on current account rather than as investments.

501. *Subsections (1)* and *(2)* focus on the nature of the receipt rather than on the recipient. Similarly, s*ubsections (3)* and *(4)* focus on the nature of the payment. See *Change 34* in Annex 1.

502. Clause 1285 of this Bill is the general rule that no liability to corporation tax arises on dividends or other distributions of a UK resident company. Subsection (2) of this clause disapplies clause 1285 in the case of a UK distribution or a payment representing such a distribution.

503. Clause 1305 of this Bill is the general rule that no deduction is allowed in respect of a dividend or other distribution. Schedule 23A to ICTA contains special rules for the treatment of amounts representative of dividends on UK shares. In accordance with paragraph 2(2)(b) of Schedule 23A, a payment representative of a UK dividend is treated, in relation to the company by which it is paid, as if it were a dividend on its own shares.

504. Subsections (3) and (4) override clause 1305. So a payment representative of a UK distribution is to be taken into account in calculating the corporation tax profits of the company making the payment.

505. Subsection (3) applies to a payment which would be allowed but for clause 1305. A payment in respect of which a deduction is disallowed under paragraph 7A of Schedule 23A of ICTA is not within subsection (3). So it is not necessary to rewrite section 95(1C) ICTA in this clause.

Clause 131: Incidental costs of issuing qualifying shares

506. This clause allows a deduction to building societies for the incidental costs of issuing shares. It is based on section 477B of ICTA.

507. Most shares issued by building societies fall with the loan relationship rules in Parts 6 and 7 of this Bill. This is because they are excluded from the definition of "share" in clause 476(1) of this Bill. The result is that most of the incidental costs associated with the issue of the shares are relieved under clause 307 of this Bill.

508. But it is possible for some building society shares not to qualify as loan relationships. And, even if they do, some incidental costs may not fall within clause 307. So this clause deals with the costs that are not relieved under the loan relationship rules.

Clause 132: Dividends etc granted by industrial and provident societies

509. This clause ensures that a "divi" paid by an industrial and provident society is allowed as a trading deduction. It is based on section 486 of ICTA.

510. The main rules about industrial and provident societies are in Chapter 5 of Part 6 of this Bill (loan relationships).

511. A definition of "registered industrial and provident society" is inserted into section 834(1) of ICTA (see Schedule 1).

512. *Subsection (1)* sets out the sort of society to which the clause applies. An example is an agricultural co-operative that sells (or buys) on behalf its farming members.

513. *Subsection (2)* is the trading income rule. In practice it is likely that the payments with which the clause is concerned would be allowable under the normal trading income rule. But this clause puts the matter beyond doubt.

514. The source legislation refers to the calculation of any profits "for the purpose of any provision of the Tax Acts relating to profits chargeable under Case I of Schedule D". It is probable that the quoted words, read with sections 21A and 21C of ICTA, apply the rule for the purpose of a calculation of Schedule A profits. But, in the context of a property business, a "divi" is not paid "on account of the recipient's transactions with the society". So in practice the rule does not apply to a property business and the clause refers simply to calculating the profits of the trade.

515. *Subsection (5)* is a signpost to the rule (inserted into ICTA by Schedule 1) that the "divi" is not a distribution.

Clause 133: Annual payments paid by a credit union
516. This clause denies a trading deduction for an annual payment made by a credit union. It is based on section 487 of ICTA.

517. Most credit unions do not carry on a trade for tax purposes. This is the consequence of clause 40. But it is possible that some of the activities of a credit union fall outside the scope of the rule in that clause. In that case, a calculation of the profits of the trade is required.

518. It is also possible that a credit union carries on a property business. So clause 210(2) applies the trading income rule to property businesses.

Clause 134: Purchase or sale of woodlands
519. This clause applies to a person carrying on a trade of dealing in land who buys and sells land on which trees are growing. It is based on section 99 of ICTA. The corresponding rule for income tax is in section 156 of ITTOIA.

520. Any profit on the sale of the trees and underwood is tax-free because of the exemption for the occupation of commercial woodlands. See clause 37 of this Bill. *Subsection (2)* prevents the dealer in land obtaining a trade deduction for that part of the cost of the land that is attributable to the cost of the trees.

521. The legislation rewritten by subsection (2) only applies to woodlands purchased under a contract entered into on or after 1 May 1963. This limitation is preserved in Schedule 2 (transitions and savings). The corresponding provision for income tax is paragraph 42 of Schedule 2 to ITTOIA.

Clause 135: Relief in respect of mineral royalties
522. This clause gives relief if trade receipts include mineral royalties. It is based on section 122 of ICTA. The corresponding rule for income tax is in section 157 of ITTOIA.

523. Most mineral royalties are taxed under Chapter 7 of Part 4 of this Bill. That Chapter rewrites the charge under Schedule D Case VI if rents are received from a concern listed in section 55 of ICTA. That list includes mines and quarries. In nearly all cases the rents are taxed under Chapter 7 of Part 4 of this Bill as they are not received in respect of a trade. But it is possible that the receipt of the rent will be incidental to a trade. In that case clause 287 of this Bill provides that the rent is taxed under Part 3 of this Bill. This is only likely to happen if the rent is received by a property developer in respect of land held as trading stock.

524. The mineral royalties are halved. The relief is rewritten under the italicised heading "dealers in land" because they are the traders who are most likely to benefit from the relief. But the relief is not confined to dealers in land.

Clause 136: Lease premiums etc: reduction of receipts

525. This clause prevents a person, carrying on a trade of dealing in land, from being taxed on all or part of a lease premium, or of certain other amounts received in respect of a lease, both as a receipt of the trade under this Part and as a receipt of a property business under Part 4 of this Bill. It is based on section 99(2) and (3) of ICTA. The corresponding rule for income tax is in section 158 of ITTOIA.

Clause 137: Mineral exploration and access

526. This clause deals with intangible drilling costs of production wells in the oil and gas industry. It is based on section 91C of ICTA. The corresponding rule for income tax is in section 161 of ITTOIA.

527. Intangible costs are those which do not result in the acquisition or creation of machinery or plant. An example would be the cost of hiring a drilling rig. Production wells are wells that are drilled after the presence of oil in an area has been established and which are used to extract the oil.

528. Before the enactment of section 91C of ICTA, a deduction was allowed for the intangible drilling costs of the second and subsequent production wells in any area. This reflected a Special Commissioners decision in 1920 that this expenditure is of a revenue nature. This clause disallows a deduction for such costs. It does this by denying a deduction for expenditure which, if it had been carried out while exploring for oil, would not have been allowed as a deduction.

529. These costs are capital expenditure and qualify for mineral extraction capital allowances (see Part 5 of CAA).

Clause 138: Payments by companies liable to pool betting duty

530. This clause gives a special deduction to companies which pay pool betting duty. It is based on those parts of section 126 of FA 1990 and section 121 of FA 1991 which relate to the calculation of the profits of traders. The corresponding rule for income tax is in section 162 of ITTOIA.

531. In 1990, following the Hillsborough disaster, pool betting duty was reduced on condition that the money saved be paid to the Football Trust 1990 to implement Lord Justice Taylor's recommendations on safety and comfort at football grounds. In 1991 the duty was reduced again, this time on condition that the money be paid to the Foundation for Sport and the Arts, a charitable trust which supports athletic sports and games and promotes the arts. The reductions were initially for a limited period, but have so far been maintained.

532. *Subsection (1)* sets out the circumstances in which the clause applies. It introduces the expression "qualifying payment".

533. *Subsection (2)* defines a "qualifying payment" to which the clause applies. It does not specify that payments in consequence of the 1990 reduction in pool betting duty must be paid for football safety and comfort, and that payments in consequence of the 1991 reduction must be paid to the Foundation for Sport and the Arts. Instead the clause applies to a payment for either purpose in consequence of any reduction in pool betting duty. See *Change 35* in Annex 1.

534. The clause retains a general description of the payments, without identifying the bodies which were the targets of the original legislation. It is clear that payments made as a consequence of a reduction in pool betting duty to either body would qualify for relief under the clause.

535. The source legislation is restricted to the 1990 and 1991 reductions in pool betting duty. This clause applies to payments made in consequence of any reduction in the duty. See *Change 36* in Annex 1.

536. *Subsection (3)* is the rule that allows the payments as a trading deduction. Without this rule the payments might be disallowed because they are not made wholly and exclusively for the purposes of the company's trade.

Clause 139: Deduction for deemed employment payment

537. This clause sets out the trading income rules that were originally part of the "IR35" scheme for the taxation of workers supplied by an intermediary. It is based on paragraph 17 of Schedule 12 to FA 2000. The corresponding rule for income tax is in section 163 of ITTOIA.

538. The worker is treated as receiving a "deemed employment payment" and is taxed accordingly (see Chapter 8 of Part 2 of ITEPA). This clause ensures that an equivalent amount is allowed as a trading deduction in calculating the profits of the intermediary.

539. *Subsection (3)* is a timing rule. Generally, the deemed employment payment is treated as made at the end of the tax year (see section 50(3) of ITEPA). In some circumstances the payment is treated as made earlier (see section 57 of ITEPA). In

either case, the trading deduction is given for the period of account in which the payment is treated as made.

540. *Subsection (4)* is the rule that prevents any double deduction. It caters for the possibility that the payment may qualify as a trading deduction on first principles and also qualify as a trading deduction in a period of account different from that specified in subsection (3).

Clause 140: Special rules for partnerships

541. This clause sets out two additional rules that apply if a deduction under clause 139 is to be given in calculating the trading profits of a firm. It is based on paragraph 18 of Schedule 12 to FA 2000. The corresponding rule for income tax is in section 164 of ITTOIA.

542. Clause 1257 of this Bill explains that "firm" is used in this Bill to refer to persons carrying on a trade in partnership. It includes a limited liability partnership (see clause 1273).

543. *Subsection (2)* is the rule that a deduction under clause 139 of this Bill cannot be used to create a loss in a firm. It operates by reference to the firm's period of account. See *Change 37* in Annex 1.

544. *Subsection (3)* is the rule that limits the trading deduction to the amount that would have been deductible if the worker had been an employee of the intermediary, plus a margin to cover the expenses of the firm.

545. In accordance with paragraph 244 of Schedule 6 to ITEPA, "deemed Schedule E payment" in paragraph 18 of Schedule 12 to FA 2000 is replaced by "deemed employment payment". Similarly, in the same paragraph, "Schedule E" is replaced by "the employment income Parts of the Income Tax (Earnings and Pensions) Act 2003".

546. But the specific statutory references, such as those to "paragraph 7" (of Schedule 12 to FA 2000), are covered by the general rule in paragraph 5 of Schedule 7 to ITEPA. That general rule is that any reference to a repealed provision is to be read as a reference to the rewritten provision.

547. Paragraph 7 of Schedule 12 to FA 2000 has been repealed and rewritten as section 54(1) of ITEPA. So the reference to that paragraph in paragraph 18 of Schedule 12 is to be read as a reference to section 54(1) of ITEPA. This clause updates the references to paragraph 7.

Clause 141: Deduction for deemed employment payments

548. This clause gives a trading deduction if a managed service company ("MSC") makes a "deemed employment payment" to a worker under section 61D of ITEPA. It is based on paragraph 10 of Schedule 3 to FA 2007. The corresponding rule for income tax is in section 164A of ITTOIA.

549. The worker is treated as receiving a "deemed employment payment" and is taxed accordingly (see Chapter 9 of Part 2 of ITEPA). This clause ensures that an equivalent amount (and no more) is allowed as a trading deduction in calculating the profits of the MSC.

550. *Subsection (5)* prevents any double deduction. It caters for the possibility that the payment may qualify as a trading deduction on first principles and also qualify as a trading deduction in a period of account different from that specified in subsection (3).

Clause 142: Deduction for site preparation expenditure

551. This clause sets out the rules for expenditure on preparing a site so that it can be used for waste disposal. It is the first of four clauses that deal with waste disposal. They are based on sections 91B and 91BA of ICTA. The corresponding rules for income tax are in sections 165 to 168 of ITTOIA.

552. This clause covers expenditure which is not deductible because it is capital and which is not eligible for capital allowances; in other words, expenditure that would otherwise go unrelieved for corporation tax purposes.

553. *Subsection (1)* introduces the concept of waste materials being deposited on a "waste disposal site", an expression defined in clause 144.

554. *Subsection (2)* is the link to clause 143, which calculates the amount of expenditure that is allowed as deduction.

555. A deduction under section 91B of ICTA is allowed only if the company makes a claim (in such form as the Commissioners for HMRC may direct) and submits such plans and other documents (if any) as the Commissioners may require. This clause drops the requirement for a claim. See *Change 38* in Annex 1.

556. Schedule 2 to this Bill rewrites the transitional provision in section 91BA(1) of ICTA. Expenditure cannot be "inherited" if the site changed hands before March 2000.

557. *Subsection (4)* treats the company's trade as the same as that of its predecessor. This is necessary because the activities taken over may amount to less than the whole of the predecessor's trade (see subsection (3)(a)).

Clause 143: Allocation of site preparation expenditure

558. This clause spreads site preparation expenditure over the useful life of the site. It is based on section 91B of ICTA. The corresponding rule for income tax is in section 166 of ITTOIA.

559. Some waste disposal sites, notably in the nuclear waste industry, have preparation expenditure dating from before 6 April 1989. So this clause preserves the rules for the pre-1989 expenditure.

Clause 144: Site preparation expenditure: supplementary

560. This clause contains the definitions of the expressions used in the waste disposal clauses and sets out the rules for pre-trading expenditure. It is based on sections 91A, 91B and 91BA of ICTA. The corresponding rule for income tax is in section 167 of ITTOIA.

561. Although the definitions are expressed to apply "for the purposes of clauses 142 and 143", the definition of "waste disposal licence" is also used to define a "site restoration payment" in clause 145(5).

562. In *subsection (1)(b)* the corresponding Northern Ireland provision is Part 2 of the Waste and Contaminated Land (Northern Ireland) Order 1997 (SI 1997/2778 (N.I.19)).

563. *Subsection (1)(c)* identifies more specifically the provisions described in section 167(1)(c) of ITTOIA. It reflects the amendments to section 91A(6) of ICTA made by:

- the Pollution Prevention and Control (England and Wales) Regulations (SI 2000/1973);
- the Pollution Prevention and Control (Scotland) Regulations (SI 2000/323); and
- paragraph 3 of Schedule 11 to the Pollution Prevention and Control Regulations (Northern Ireland) 2003 (SR 2003/46).

Clause 145: Site restoration payments

564. This clause deals with payments for the restoration of a site after it has been used for waste disposal. It is based on section 91A of ICTA. The corresponding rule for income tax is in section 168 of ITTOIA.

565. In *subsection (6)(a), (c)* and *(d)* the corresponding Northern Ireland provision is Article 40 of the Planning (Northern Ireland) Order 1991 (SI 1991/1220 (N.I. 11)).

Clause 146: Cemeteries and crematoria: introduction

566. This clause, and the following three clauses, contain special rules for companies carrying on a trade of operating a cemetery or crematorium. They are based on section 91 of ICTA. The corresponding rules for income tax are in sections 169 to 172 of ITTOIA.

567. Without special provisions, no allowance would be due for the cost of land sold for interments, memorial gardens attached to crematoria or the surrounding land and buildings because expenditure on such land and buildings is in the nature of capital. The provisions in clauses 146 to 149 recognise that most land and buildings in a cemetery or memorial garden are of little value when the cemetery or memorial garden is full.

568. This clause introduces the provisions in clauses 147 to 149 and defines some of the terms used in those clauses.

569. Section 91(7)(a) of ICTA adapts the rules for cemeteries in section 91 of ICTA to crematoria and treats “land which is devoted wholly to memorial garden plots” as a cemetery, or as land in a cemetery. *Subsection (1)* of this clause instead includes the carrying on of a crematorium, and the maintenance of “memorial gardens plots” in the trades to which clauses 146 to 149 apply.

570. Section 91(5) of ICTA provides that a change of ownership is ignored in calculating the relief due to the person then carrying on the trade. So *subsection (4)* of this clause includes expenditure incurred by “a predecessor” of the company carrying on the trade in the definition of ancillary capital expenditure.

Clause 147: Deduction for capital expenditure

571. This clause provides for a deduction for certain capital expenditure incurred by the trader or a predecessor. It is based on section 91 of ICTA. The corresponding rule for income tax is in section 170 of ITTOIA.

572. Section 91 of ICTA refers to “land” in a cemetery or crematorium. *Subsection (1)* refers instead to “an interest in” such land. This accommodates better the possibility that operators of cemeteries and crematoria might sometimes hold land in leasehold rather than in freehold form.

Clause 148: Allocation of ancillary capital expenditure

573. This clause contains special rules for allocating ancillary capital expenditure to a period of account. It is based on section 91 of ICTA. The corresponding rule for income tax is in section 171 of ITTOIA.

574. See clause 146(4) for the definition of “ancillary capital expenditure”.

Clause 149: Exclusion of expenditure met by subsidies

575. This clause excludes certain expenditure for the purposes of clause 147. It is based on section 91 of ICTA which applies the provisions of section 532 of CAA for the purposes of section 91 of ICTA. The corresponding rule for income tax is in section 172 of ITTOIA.

576. *Subsection (3)* refers to a grant made under Northern Ireland legislation and declared by the Treasury to correspond to a grant under Part 2 of the Industrial

Development Act 1982. The term "Northern Ireland legislation" is defined by Schedule 1 to, and section 24(5) of, the Interpretation Act 1978.

577. The Capital Allowances (Corresponding Northern Ireland Grants) Order 2001 (SI 2001/810) lists various grants made in Northern Ireland and declared by the Treasury to correspond to a grant under Part 2 of the Industrial Development Act 1982 in so far as they are made towards capital expenditure. The Industrial Development Act 1982 has been repealed. But a deduction under clause 147 of this Bill continues to be allowed for expenditure met by a grant corresponding to a grant under Part 2 of the 1982 Act incurred by the trader, or by a predecessor.

Clause 150: Revenue nature of expenditure

578. This clause provides for the trader's expenditure, on producing or acquiring the original master version of a sound recording, to be treated as expenditure of a revenue nature. It is based on section 48 of FA 2006.

579. Where this clause applies to a sound recording any of the trader's receipts from it are treated as having a revenue nature.

Clause 151: Allocation of expenditure

580. This clause provides for the allocation of a trader's expenditure on producing or acquiring the original master version of a sound recording except where that master version is trading stock. It is based on section 49 of FA 2006.

581. *Subsection (3)* sets out the basis for the allocation and *subsection (4)* provides for an enhanced allocation in certain cases.

Clause 152: Interpretation of sections 150 and 151

582. This clause provides definitions of terms used in the previous two clauses. It is based on sections 31 and 50 of FA 2006.

Clause 153: Reserves of marketing authorities and certain other statutory bodies

583. This clause, and the following two clauses, contain special rules for the treatment of the statutory reserve funds which must in certain circumstances be maintained by certain statutory authorities. It is based on section 509 of ICTA.

584. This clause allows a qualifying statutory body a deduction in calculating its trade profits for any amount of its trade surplus that it is required to pay into a reserve fund. Any amount withdrawn from the fund is taxed as a trade receipt unless it is a repayment of the levy or paid to the producers or a Government Department.

585. *Subsections (1)* and *(2)* identify the statutory bodies to which this clause applies.

586. *Subsection (5)* provides definitions for the purposes of this clause.

587. The roll of statutes which confer functions that are relevant to these clauses and the population of statutory authorities to which these clauses might apply has declined in recent years. The Cereals Marketing Act 1965 and the Agriculture Act 1967 still confer functions that are relevant for the purposes of these clauses. See, in particular, the powers to make schemes under section 16 of the 1965 Act and section 13 of the 1967 Act.

Clause 154: Conditions to be met by reserve fund
588. This clause contains conditions which must be met by the reserve fund if the relief under clause 153 is to be available. It is based on section 509 of ICTA.

Clause 155: Interpretation of sections 153 and 154
589. This clause provides definitions of constitutional authorities for the purposes of the two previous clauses. It is based on section 509 of ICTA, paragraph 11 of Schedule 12 to the Northern Ireland Act 1998 and section 85 of the Government of Wales Act 2006.

590. *Subsections (1)* and *(2)* rewrite the source legislation to reflect the effect of devolution settlements. See *Change 15* in Annex 1.

591. The Government of Wales Act 2006 created a new devolution settlement for Wales. It replaced the National Assembly for Wales constituted under the Government of Wales Act 1998 ("the old Assembly") with a new National Assembly for Wales. Schedule 11 to the 2006 Act provides for functions conferred on the old Assembly (with certain exceptions that are not relevant here) to be transferred to the Welsh Ministers. It is in theory possible that schemes such as are mentioned in section 509(1) of ICTA could have been approved by the old Assembly before its functions were transferred to the Welsh Ministers. A paragraph in Schedule 2, the Schedule of transitionals and savings (reserves of marketing authorities etc), affecting clause 153(5), covers this possibility.

592. Subsection (1) refers to "a Minister within the meaning of the Northern Ireland Act 1988". This rewrites the reference in section 509(3) of ICTA to a "head of department" read with paragraph 11(1) of Schedule 12 to the Northern Ireland Act 1998.

Chapter 10: Trade profits: changes in trading stock
Overview
593. This Chapter rewrites the rules in Part 2 of Schedule 15 to FA 2008. The rules relate to the corporation tax consequences of taking stock from, or introducing stock to, a trade.

Clause 156: Meaning of "trading stock"
594. This clause provides a definition for the purposes of this Chapter. It is based on paragraph 5 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172A of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

595. *Subsection (2)* sets out the main difference between this definition and the one used in Chapter 11 of this Part.

Clause 157: Trading stock appropriated by trader

596. This clause sets out the rule for trading stock taken by a trader. It is based on paragraph 6 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172B of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

Clause 158: Trading stock supplied by trader

597. This clause sets out the rule for something that is supplied by a trader for use as trading stock. It is based on paragraph 7 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172C of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

Clause 159: Disposals not made in the course of trade

598. This clause sets out the rule for trading stock disposed of by a trader. It is based on paragraph 8 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172D of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

599. The rule in this clause applies to non-trading disposals to a person other than the trader. If the stock is taken by the trader clause 157 applies instead.

Clause 160: Acquisitions not made in the course of trade

600. This clause sets out the rule for trading stock acquired by a trader. It is based on paragraph 9 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172E of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

601. The rule in this clause applies to non-trading acquisitions from a person other than the trader. If the stock is acquired from the trader clause 158 applies instead.

Clause 161: Transfer pricing rules to take precedence

602. This clause gives priority to the transfer-pricing rules in Schedule 28AA to ICTA. It is based on paragraph 10 of Schedule 15 to FA 2008. The corresponding income tax rule is in section 172F of ITTOIA (inserted by Part 1 of Schedule 15 to FA 2008).

603. The rule in this clause ensures that none of the exemptions in Schedule 28AA to ICTA can be overridden by an adjustment imposed by this Chapter of the Bill.

Chapter 11: Trade profits: valuation of stock on cessation of trade

Overview

604. This Chapter sets out the rules for valuing stock when a company ceases to carry on a trade. The rules for valuing work in progress are not rewritten because, for tax purposes, a company cannot carry on a profession (see *Change 2* in Annex 1). If a company has incomplete services when it ceases to carry on a trade they are included

in its trading stock (see clause 163(2) of this Bill) and valued in accordance with the rules in this Chapter.

Clause 162: Valuation of trading stock on cessation

605. This clause sets out two general propositions. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 173 of ITTOIA. The first proposition is that a valuation has to be made. The second is that the valuation has to be made in accordance with the rules in this Chapter.

606. *Subsection (3)* is the rule for trades carried on in partnership. The general rule in ICTA is that a change in the companies carrying on a trade is treated as the cessation of the trade. But, in the case of a trade carried on in partnership, section 114(1) of ICTA provides that there is a cessation for the purpose of calculating the profits of the firm's trade only if there is a complete change in the companies carrying on the trade.

Clause 163: Meaning of "trading stock"

607. This clause defines trading stock. It is based on sections 100 and 101 of ICTA. The corresponding rule for income tax is in section 174 of ITTOIA.

608. The definition of trading stock applies:

- in clause 151 (sound recordings);
- in this Chapter;
- in clause 185 (adjustment on change of basis); and
- in clause 195 (post-cessation receipts).

609. Section 101(3) of ICTA is invoked by section 100(2) of that Act and is concerned with valuation of incomplete services "at the discontinuance". So the definition in this clause refers to incomplete services "at the time of the cessation".

Clause 164: Basis of valuation of trading stock

610. This clause introduces the five clauses that follow. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 175 of ITTOIA.

611. The five clauses (including clause 168 which defines "connected persons") deal with the valuation of stock that is transferred to another trader. In each case, the requirement in section 100 of ICTA that the transferee carries on a trade is relaxed to include transfers to a person carrying on a profession or vocation. The income tax rules are amended to bring the income tax and corporation tax codes into line. See *Change 39* in Annex 1.

612. *Subsection (4)* of this clause deals with the case where the stock is not transferred to a person carrying on a trade, profession or vocation.

Clause 165: Sale basis of valuation: sale to unconnected person

613. This clause sets out the rule for the common case where the trading stock is transferred to an unconnected trader. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 176 of ITTOIA.

614. The clause leads directly to the use of the sale price of the stock as the basis of valuation. If the transfer is other than by sale, clause 170 explains how the expressions used in this clause are to be interpreted.

Clause 166: Sale basis of valuation: sale to connected person

615. This clause sets out the rule for the case where the stock is transferred to a connected person. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 177 of ITTOIA.

616. The clause preserves the concept of an arm's length price. This will usually be the same as the open market value (see clause 164(4)) but sometimes there will be a difference.

617. For example, in a capital transfer tax case, IRC v Spencer-Nairn [1991] STC 60, the Court of Session considered the meaning of an arm's length price and distinguished it from open market value. This was on the basis that the seller in that case had imperfect information. A sale at arm's length by that seller would not assume that the seller had better information; a sale in the open market would assume perfect information on both sides of the bargain.

618. Furthermore, in the case of an actual sale to a connected trader, there is no need to *assume* there is a sale. It is enough to treat the sale as made at arm's length. This leaves open the possibility that the stock is worth something different from open market value to a person who intends to use the stock in the trade.

Clause 167: Sale basis of valuation: election by connected persons

619. This clause allows the seller and purchaser of stock that would otherwise be valued at arm's length under clause 166 to elect to use instead the price paid for the stock. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 178 of ITTOIA.

620. The election cannot be made unless the arm's length value of the stock is greater than its "acquisition value" in the hands of the seller.

621. The "acquisition value" of the stock for the company which ceases to trade is effectively book value, but the definition in *subsection (5)* is more complicated than this. In the case where the net realisable value of stock has fallen below cost in the period leading up to cessation, a new period is deemed to start just before the deemed

sale. That allows the new, lower, net realisable value to be used. It may be possible to manipulate net realisable value by selling the stock at an undervalue after the accounting date. So paragraph (a) of the definition assumes that the sale is at an arm's length value.

622. The election substitutes the price paid for the arm's length value of the stock. But the price paid must be higher than the acquisition value. Otherwise, the election substitutes the acquisition value for the arm's length value.

623. This clause does not specify that the election is to be made to "the inspector". 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 168: Connected persons

624. This clause provides a definition of connected persons for the stock valuation clauses. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 179 of ITTOIA.

625. This clause is one of the exceptions to the general rule in clause 1258 that a firm is not to be regarded for tax purposes as a separate entity. If a firm is connected with the seller or purchaser of its stock, clause 166 (rather than clause 165) applies but the firm may make an election under clause 167.

Clause 169: Cost to buyer of stock valued on sale basis of valuation

626. This clause sets out the rule for the buyer of the stock. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 180 of ITTOIA.

627. In a "sale basis" case, the value given to the trading stock of the company whose trade has ceased is also used to calculate the profits of the buyer of the stock.

628. The reference to ITTOIA caters for the case where the stock is acquired from a person liable to income tax. The valuation under that Act for income tax purposes is used as the cost to the buyer who is liable to corporation tax.

Clause 170: Meaning of "sale" and related expressions

629. The stock valuation clauses refer to a sale of stock. This clause explains how the clauses are to be interpreted if the stock is transferred other than by way of sale. It is based on section 100 of ICTA. The corresponding rule for income tax is in section 181 of ITTOIA.

Clause 171: Determination of questions

630. This clause treats any "question" arising under clauses 164 to 167 as an appeal (to be determined by the tribunal). It is based on section 102 of ICTA. The corresponding rule for income tax is in section 186 of ITTOIA.

Chapter 12: Deductions from profits: unremittable amounts

Overview

631. This Chapter gives statutory effect to ESC C34. The corresponding rules for income tax are in Chapter 13 of Part 2 of ITTOIA. See part (A) of *Change 40* in Annex 1. This change reproduces Change 50 in ITTOIA and so brings the income tax and corporation tax codes back into line.

632. The extra-statutory concession provides relief for trade debts that cannot be remitted to the United Kingdom. It is similar in scope to section 584 of ICTA (relief for unremittable overseas income), which is rewritten as Part 18 of this Bill (unremittable income). The corresponding provision for income tax is Chapter 4 of Part 8 of ITTOIA.

633. Section 584 of ICTA provides relief for unremittable income arising outside the United Kingdom, including unremittable trade profits. But relief under section 584 of ICTA does not extend to trade debts owed to, or paid to, the company outside the United Kingdom if the profits of the trade arise in the United Kingdom. This Chapter provides relief for such debts and payments.

634. ESC C34 requires the relief to be claimed. Under this Chapter the relief is allowed as a deduction without the need for a formal claim. See part (B) of *Change 40* in Annex 1.

635. The deduction is not mandatory if the qualifying conditions are met. A company can choose whether or not to include the deduction in its tax return. If a deduction is taken the recovery provisions in clause 175 follow automatically.

Clause 172: Application of Chapter

636. This clause defines the basic concepts. It is based on ESC C34. The corresponding rule for income tax is in section 188 of ITTOIA.

637. The relief applies both to amounts owed to the company and to amounts that have been paid to the company. Relief is allowed if some, or all, of those amounts cannot be remitted to the United Kingdom because of foreign exchange restrictions. The different definitions of “unremittable” in *subsections (2)* and *(3)* reflect the differences between an amount that has been paid and an amount owed.

638. The relief is available to any company, including a company carrying on a financial trade.

639. *Subsection (4)* provides a definition of “foreign exchange restrictions”. Local foreign exchange restrictions are not defined in the extra-statutory concession but are clearly a key concept in the operation of the concession. This subsection introduces a definition based on section 584(1)(a) of ICTA. That subsection is rewritten as clause 1274 (unremittable income: introduction) in Part 18. The corresponding provision for

income tax is section 841(3) of ITTOIA. By basing the definition on section 584 of ICTA this Bill brings the two reliefs into line.

640. This clause and the rewrite of section 584 of ICTA in Part 18 of this Bill clarify the scope of section 584 of ICTA and the extra-statutory concession in two ways.

641. First, sections 584(1)(a) of ICTA refers to "the impossibility of obtaining foreign currency in that territory". It could be argued that this condition is not met if it is possible to obtain foreign currency in the overseas territory regardless of whether that currency may be transferred to the United Kingdom. Clause 1274 of Part 18 of this Bill makes clear that it must not be possible to obtain foreign currency that could be transferred to the United Kingdom.

642. Second, clause 1274 of Part 18 of this Bill makes clear that the reference to foreign currency in section 584(1)(a) of ICTA does not include currency of the overseas country or territory. In relation to sterling the currency of the overseas country or territory clearly is foreign but in this context "foreign" means foreign to the local territory.

643. *Subsection (5)* deals with the interaction with the loan relationship rules. Most of the amounts in this Chapter will be within the scope of Chapter 2 of Part 4 of FA 1996 because they are loan relationships (rewritten in Parts 5 and 6 of this Bill). In particular section 100 of FA 1996 treats trade debts as loan relationships (see Chapter 2 of Part 6).

644. Section 80(5) of FA 1996 is a wide-ranging rule which provides that only Chapter 2 of Part 4 of FA 1996 applies to any loan relationship unless there is an express provision to the contrary. Section 80(5) of FA 1996 has been rewritten as clause 464(1). This rule would prevent relief being given under clause 173 or recovered under clause 175. Subsection (5) overrides clause 464(1).

Clause 173: Relief for unremittable amounts

645. This clause sets out how the relief is given. It is based on ESC C34. The corresponding rule for income tax is in section 189 of ITTOIA.

646. The clause has more detail than the extra-statutory concession about the mechanics of the relief. This is necessary to give the certainty required for corporation tax self assessment. Relief can be given only against the profits of the trade that include the unremittable amount. It cannot be used to create or increase a loss. But any excess relief is not lost. It is carried forward and set against future profits of the trade.

Clause 174: Restrictions on relief

647. This clause describes the various circumstances in which relief is not allowed. It is based on ESC C34. The corresponding rule for income tax is in section 190 of ITTOIA.

648. *Subsection (1)* denies a deduction if the funds are applied outside the United Kingdom.

649. *Subsection (2)* denies a deduction if the company has received an insurance recovery in respect of the debt. This differs from the approach in the extra-statutory concession. Paragraph 4 of the concession denies relief if any part of the debt is insured. This Bill denies, or recovers, relief only if an insurance recovery is received. See part (C) of *Change 40* in Annex 1.

650. *Subsection (3)* denies a deduction if the company can make a claim under clause 1275 (claim for relief for unremittable income) in Part 18 that the income is unremittable. The corresponding provision for income tax is section 842 of ITTOIA.

651. This restriction will apply only if the profits of the trade that include the unremittable amounts arise outside the United Kingdom, for example, because the profits arise in an overseas branch.

Clause 175: Withdrawal of relief

652. This clause sets out the circumstances in which relief is withdrawn and the machinery by which it is withdrawn. It is based on ESC C34. The corresponding rule for income tax is in section 191 of ITTOIA.

653. *Subsection (2)* lists the events that trigger a withdrawal of the relief. Paragraphs (a) and (e) deal with the straightforward cases in which the amount, or part of it, ceases to be unremittable or is exchanged for an amount that can be remitted. Paragraphs (c), (d), and (f) deal with the events listed in clause 174 that would have prevented relief being given if they had occurred before the deduction was allowed.

654. Paragraph (f) deals with the case of insurance recoveries. It differs from the approach in the extra-statutory concession, which denies any relief if the debt is insured. This Chapter denies or recovers relief only if an insurance recovery is received (see the commentary on clause 174). See part (C) of *Change 40* in Annex 1.

655. This follows the approach in section 584 of ICTA when a payment is received from the Exports Credit Guarantee Department. The withdrawal of relief under section 584 of ICTA is rewritten as clause 1276 (unremittable income: withdrawal of relief) in Part 18. The corresponding provision for income tax is section 843 of ITTOIA.

656. *Subsection (3)* sets out the way the relief is recovered. The amount identified in subsection (2) is treated as a trade receipt for the accounting period in which the

event occurs. It is possible that more than one event will apply to the same amount. Subsection (3)(b) ensures the relief is withdrawn only once.

657. *Subsection (4)* applies if the amount of the insurance recovery is less than the amount that is unremittable. In that case the amount of the recovery is limited to the amount of the insurance recovery.

Chapter 13: Disposal and acquisition of know-how
Overview

658. This Chapter sets out the rules for calculating trade profits if a trading company receives a payment for know-how. Payments to non-traders are dealt with by the rules in Chapter 2 of Part 9 of this Bill.

659. 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). So the Part 8 rules generally apply instead of the rules in this Chapter. But Chapter 16 of Part 8 ensures that the new rules apply only to assets created or acquired on or after 1 April 2002.

660. The Chapter refers to the "disposal" of know-how. As Walton J pointed out in John and E Sturges Ltd v Hessel (1975), 51 TC 183 ChD[6] (on page 206):

> the mere imparting of "know-how" cannot be equated with the disposal of a capital asset. Just like the schoolmaster's knowledge, it remains the property of the person imparting it as well after as before another is told.

661. This Bill retains "disposal" because "disclosure" gives rise to difficulties in identifying the person to whom the disclosure is made (who may not be the person who buys the know-how).

Clause 176: Meaning of "know-how" etc

662. This clause sets out the meaning of know-how and explains other concepts used in the Chapter. It is based on sections 531 and 533 of ICTA and section 572 of CAA. The corresponding rule for income tax is in section 192 of ITTOIA.

663. The definition of "mineral deposits" in *subsection (2)* is restored to what it was before the enactment of CAA. See *Change 41* in Annex 1.

664. *Subsections (5)* and *(6)* extend the meaning of "sale" to include an exchange. This rule is based on section 572 of CAA, which applies to section 531 of ICTA in accordance with section 532 of ICTA.

[6] [1975] STC 127

Clause 177: Disposal of know-how if trade continues to be carried on

665. This clause sets out a general rule for the treatment of payments received for the disposal of know-how. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 193 of ITTOIA.

666. *Subsections (3)* to *(6)* deal with the case where know-how is disposed of with other assets. The rules are based on sections 562 and 563 of CAA, which apply to section 531 of ICTA in accordance with section 532 of ICTA.

Clause 178: Disposal of know-how as part of disposal of all or part of a trade

667. This clause sets out the main exception to the general rule in clause 177. It is based on section 531 of ICTA. The corresponding rule for income tax is in section 194 of ITTOIA.

668. *Subsection (2)* provides that a payment for know-how as part of the disposal of a trade is generally treated as a capital receipt for goodwill. This rule applies only if the person making the disposal is liable to corporation tax. If that person is liable to income tax the rule in section 194 of ITTOIA applies, with the same result.

669. *Subsection (5)* allows the parties to the transaction to elect for the payment not to be treated as one for goodwill. The effect of an election for the purchaser is that the payment may qualify for capital allowances under Part 7 of CAA. Or, exceptionally, the purchaser may be able to treat the payment as a trading expense. As such an election may affect both parties to the transaction the election has to be made by both.

670. The question whether the election is made under this clause or under section 194(5) of ITTOIA is decided by reference to the position of the person disposing of the know-how. If that person is liable to corporation tax this clause applies; if the person is liable to income tax, ITTOIA applies.

671. This clause does not specify that the election is to be made to "the inspector". 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.

672. *Subsection (6)* gives the time limit for the election. Most elections in this Bill have to be made "not later than two years after the end of the accounting period …". But in this case one of the persons making the election may be chargeable to income tax. So the time limit for an election is based on the date of the disposal.

673. *Subsection (7)* deals with a disposal by an income tax payer to a corporation tax payer. An election under section 194(5) of ITTOIA is treated as an election under this clause. The corresponding rule for a disposal by a corporation payer to an income tax payer is in section 194(7) of ITTOIA.

Clause 179: Seller controlled by buyer etc

674. This clause ensures that if the seller and buyer are under common control:

- the general rule in clause 177 does not apply; and

- the parties to the transaction may not elect for the payment for know-how not to be treated as a capital payment for goodwill.

675. The clause is based on section 531 of ICTA. The corresponding rule for income tax is in section 195 of ITTOIA.

676. For the purposes of this clause, "control" is defined in section 840 of ICTA (as applied by clause 1316 of this Bill). The ICTA definition of "control" is identical in effect to that in section 574 of CAA. But, as the relevance of "control" in this Bill goes wider than this Chapter, the ICTA definition is used here.

677. This clause is one of the exceptions to the general rule in clause 1258 of this Bill that a firm is not to be regarded for tax purposes as a separate entity. If a firm is connected with the seller or purchaser of its know-how the payment for know-how is treated as one for goodwill.

Chapter 14: Adjustment on change of basis

Overview

678. This Chapter sets out the rules for dealing with two sorts of changes in the way profits of a trade are calculated.

679. The first sort of change is in the way the accounts are drawn up. The rule is that profits must be calculated on the basis of accounts drawn up in accordance with generally accepted accounting practice (see section 50 of FA 2004 and clause 46 of this Bill).

680. If there is a change in the basis on which accounts are drawn up, some receipts and expenses may fall out of account for tax purposes. This sort of change was dealt with originally in the rules that became section 104(4) to (7) of ICTA. Those rules were replaced by the rules in section 44 of, and Schedule 6 to, FA 1998. The 1998 rules were replaced by section 64 of, and Schedule 22 to, FA 2002.

681. The second sort of change is in the way tax adjustments are made. These are the adjustments "required or authorised by law in calculating profits for tax purposes" (clause 46). This sort of change was dealt with for the first time by the 2002 legislation.

682. Clause 1267 of this Bill applies the rules to trades carried on in partnership.

683. The corresponding rules for income tax are in Chapter 17 of Part 2 of ITTOIA. The title of that Chapter is "adjustment income" because there is a charge on such

income in section 228(2) of ITTOIA. For corporation tax a positive adjustment is treated as a trade receipt. So the title of this Chapter is more general.

Clause 180: Application of Chapter

684. This clause sets out the circumstances in which an adjustment may arise. It is based on section 64 of FA 2002. The corresponding rule for income tax is in section 227 of ITTOIA.

685. Section 64 of FA 2002 refers to a change of the basis on which profits are calculated. This might mean *any* change of basis. But paragraph 3(2) of Schedule 22 to FA 2002 makes clear that it does not include a change which occurs on a change of ownership of a trade.

686. The trading income rules in this Part are generally "company-based". So this clause applies when *a company* changes the basis. That company must be the same before and after the change of basis. So this clause reproduces the effect of paragraph 3(2) of Schedule 22 to FA 2002.

687. An adjustment has to be made if:

- the "old basis" accorded with the law *or* practice at the time; and

- the "new basis" accords with the current law *and* practice.

688. The difference in wording is to cater for a case in which a decision of the Courts makes it clear that a previously accepted view of the law was wrong. In that case, the old basis accorded with the practice but not the law. The 1998 rules did not cater for this. But the 2002 rules (and the rules in this Chapter) do.

689. The clause refers to "a trade". So the rules apply to trades carried on wholly outside the United Kingdom as they apply to trades carried on at least partly in the United Kingdom.

Clause 181: Giving effect to positive and negative adjustments

690. This clause sets out the treatment of the adjustment. It is based on paragraphs 4 and 5 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 228 of ITTOIA.

691. If the adjustment is positive it is treated as a trade receipt; if the adjustment is negative it is treated as a trade expense.

692. In both cases the treatment is the same whether the trade is taxable under Case I or Case V of Schedule D in the source legislation. The adjustment is treated as arising on the first day of the first period of account for which the new basis is adopted. This contrasts with the income tax treatment which is that the adjustment arises on the last day of the period (see sections 232 and 233 of ITTOIA).

Clause 182: Calculation of the adjustment

693. This clause contains the main rules for calculating the adjustment. It is based on paragraph 2 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 231 of ITTOIA. The clause presents the rules as a method statement.

694. In item 3 of each of Step 1 and Step 2 there is a reference to work in progress as an alternative to trading stock. This follows the source legislation and is needed because the extended meaning of "trading stock" in clause 163 of this Bill does not apply outside Chapter 11.

Clause 183: No adjustment for certain expenses previously brought into account

695. This clause deals with the case where the old basis of calculation allowed a tax deduction but the new basis requires the deduction to be spread over several periods. It is based on paragraph 6 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 234 of ITTOIA.

696. In the absence of this clause there would be a positive adjustment within item 2 of Step 1 of the calculation of the adjustment in clause 182. That would produce the right result overall but the rule would take effect too early. Instead, no adjustment is calculated but no deduction is allowed in future for expenses that have already been taken into account.

Clause 184: Cases where adjustment not required until assets realised or written off

697. This clause is a timing rule for an adjustment which results from any of the amounts in subsection (2). It is based on paragraph 7 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 235 of ITTOIA.

698. The amounts in subsection (2) are:

- closing trading stock;
- opening trading stock; and
- depreciation.

699. The general timing rule is that any adjustment is made at the start of the first period of account on the new basis (see clause 181(2) and (3)). But any adjustment for stock or depreciation is made when the asset is realised or written off.

Clause 185: Change from realisation basis to mark to market

700. This clause is concerned with a change from the realisation basis to "mark to market" accounting. It is based on paragraph 8 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 236 of ITTOIA.

701. "Mark to market" is a basis of accounting used by traders in financial assets. Instead of carrying the assets in the books at cost, financial traders draw up accounts to show the assets at fair value at the accounting date. But for tax purposes the realisation basis may have been used.

702. In the first period in which mark to market is adopted for tax purposes, the opening stock may be valued at a higher (market) value than the closing stock of the previous period. Or a financial asset may have been carried in the accounts at cost but appear as a deduction in a later period at fair value. In either case, there is an adjustment within clause 182.

703. As in clause 184, the adjustment is postponed until the asset is realised.

Clause 186: Election for spreading if section 185 applies
704. This clause provides for an election to be made if there is a receipt (following a change to mark to market) under clause 185. It is based on paragraph 9 of Schedule 22 to FA 2002. The corresponding rule for income tax is in section 237 of ITTOIA.

705. The election is to spread the adjustment receipt over six periods of account beginning with the first one in which the new basis is adopted. As the receipt is postponed under clause 185 until the asset is realised, this first period is not necessarily the one in which the charge would be made without the election.

706. "Period of account" is defined in section 832(1) of ICTA.

Clause 187: Transfer of insurance business
707. This clause further postpones the charge on an adjustment in the case of assets to which clause 185 or 186 applies. It is based on paragraph 10 of Schedule 22 to FA 2002. It is the only clause in this Chapter that has no corresponding section in Chapter 17 of Part 2 of ITTOIA.

708. The clause applies only to insurance companies. If the asset of an insurance company is transferred to another insurance company in accordance with a relevant transfer scheme, it is not treated as "realised" for the purpose of clauses 185 and 186 until it is realised by the transferee company.

Chapter 15: Post-cessation receipts
Overview
709. This Chapter charges receipts which are derived from a trade but are not received until after the trade has ceased and have not been brought into the calculation of profits.

710. The Chapter rewrites sections 103 and 104 of ICTA without distinguishing between trade profits calculated on an earnings basis and trade profits calculated on a "conventional basis" (see section 110(4) of ICTA). One consequence of this approach is that there is no need to rewrite section 104(3) or section 110(3) to (5) of ICTA.

Clause 188: Charge to tax on post-cessation receipts

711. This clause applies the corporation tax charge on income to post-cessation receipts. It is based on sections 103 and 104 of ICTA. This application of the charge is separate from that on the profits of a trade (see clause 35 of this Bill). The corresponding rule for income tax is in section 242 of ITTOIA.

Clause 189: Extent of charge to tax

712. This clause sets out the charge to tax. It is based on sections 103 and 104 of ICTA, which create a charge under Schedule D Case VI on post-cessation receipts. This Bill deals with the income where it logically belongs. In this case the income is trading income. The corresponding rule for income tax is in section 243 of ITTOIA.

713. The charge in the source legislation under Schedule D Case VI has consequences for loss relief. This Bill preserves the position for loss relief by amending section 396 of ICTA and listing this Chapter in section 834A of ICTA (see Schedule 1 to this Bill).

714. *Subsection (3)* deals with a company which has become non-UK resident after the trade has ceased. A trade carried on at least partly in the United Kingdom may include income that arises abroad. When the company was resident in the United Kingdom all the profits of the trade would have been within the charge under Part 2 of this Bill (see clause 5). This subsection removes the charge on a non-UK resident company if the receipt arises abroad.

Clause 190: Basic meaning of "post-cessation receipt"

715. This clause sets out the basic meaning of "post-cessation receipt". It is based on sections 103, 104 and 110 of ICTA. The corresponding rule for income tax is in section 246 of ITTOIA.

716. *Subsection (2)* deals with the unusual case of a company receiving a "sum" which arises from the carrying on of a trade by a person liable to income tax.

717. Paragraph (a) deals with a non-UK resident company liable to income tax. If a company becomes liable to corporation tax it is treated as ceasing to carry on the income tax trade. A post-cessation receipt from that trade may be charged to corporation tax.

718. Paragraph (b) applies where the trade was carried on in partnership. If a partner leaves a firm and a company receives a sum arising from the carrying on of the trade by that partner, the sum may be a post-cessation receipt.

Clause 191: Other rules about what counts as post-cessation receipts

719. This clause is new. It contains signposts to:

- the seven clauses in this Bill that treat other sums as post-cessation receipts; and

- the two clauses in this Bill that exclude certain sums from the charge on post-cessation receipts.

720. The corresponding rule for income tax is in section 247 of ITTOIA.

Clause 192: Debts paid after cessation

721. This clause sets out what happens when a trader is allowed a deduction for a bad or doubtful debt owed to the trade but then recovers the debt after the trade has ceased. It is based on section 103 of ICTA. The corresponding rule for income tax is in section 248 of ITTOIA.

722. If a deduction for the debt has been given during the course of the trade section 103(5) of ICTA makes it clear that the recovery has not been "brought into account" in calculating the trade profits. The result is that the recovery is within the charge in section 103 of ICTA.

723. *Subsections (1)* and *(2)* treat the recovery of the debt as a post-cessation receipt. The references to section 35 of ITTOIA and income tax cater for the possibility that a deduction for a bad debt is allowed to a person liable to income tax but the debt is paid to a person liable to corporation tax.

Clause 193: Debts released after cessation

724. This clause sets out the rules that apply when a debt owed by the trader is released after the trade has ceased. It is based on section 103 of ICTA. The corresponding rule for income tax is in section 249 of ITTOIA.

725. *Subsection (1)* sets out the four conditions to be met if the clause is to apply. It is the equivalent of clause 94 of this Bill which applies in the case of a continuing trade. The reference to income tax caters for the possibility that a deduction for an expense is allowed to a person liable to income tax but a person liable to corporation tax takes over the related trade debt and is released from it.

Clause 194: Transfer of rights if transferee does not carry on trade

726. This clause deals with the position of the transferor if the right to a post-cessation receipt is transferred for value to a non-trading transferee. It is based on section 106 of ICTA. The corresponding rule for income tax is in section 251 of ITTOIA.

727. The transferor is charged to tax on the amount received for the transfer if the transfer is at arm's length. Otherwise the transferor is charged to tax on the arm's length value of the transfer. There is no later charge to tax on the transferee when the post-cessation receipt is received.

728. Clause 95 of this Bill sets out the position if the transfer is to a trading transferee.

Clause 195: Transfer of trading stock
729. This clause excludes from the charge on post-cessation receipts sums arising from the transfer of stock. It is based on sections 103, 104 and 110 of ICTA. The corresponding rule for income tax is in section 252 of ITTOIA.

730. *Subsection (1)* makes explicit the general rule that there is no tax charge on a post-cessation receipt arising from trading stock.

731. The policy is that stock should be valued at cessation in accordance with the rules in Chapter 11 of this Part. Once that has been done there is no need to charge tax on any sums arising from the disposal or realisation of stock.

Clause 196: Allowable deductions
732. This clause is the first of two that set out the rules for allowing deductions from sums charged as post-cessation receipts. It is based on section 105 of ICTA. The corresponding rule for income tax is in section 254 of ITTOIA.

733. *Subsection (3)* ensures that a deduction is not allowed for any expenses for which relief has already been allowed (for income tax) under section 96 of ITA or under any other provision.

Clause 197: Further rules about allowable deductions
734. This clause is the second of two that set out the rules for allowing deductions from sums charged as post-cessation receipts. It is based on section 105 of ICTA. The corresponding rule for income tax is in section 255 of ITTOIA.

735. *Subsection (2)* ensures that any loss unused at the date of cessation is set off against post-cessation receipts in the same order as it would have been set off against profits under section 393 of ICTA, that is, against an earlier accounting period before a later accounting period.

736. The references to capital allowances in section 105(1)(b) and (3) of ICTA are no longer needed because any capital allowance is allowed as a trading expense.

Clause 198: Election to carry back
737. This clause allows a company to elect to have a post-cessation receipt taxed as though it had been received in the accounting period in which the company ceased to carry on the trade. It is based on section 108 of ICTA, although that section was repealed by ITTOIA. The corresponding rule for income tax is in section 257 of ITTOIA.

738. See *Change 42* in Annex 1.

739. *Subsection (1)* requires that the post-cessation receipt is received (broadly) within six years after the company ceases to carry on the trade. This corresponds to

the limit in section 108 of ICTA (which was expressed in terms of years of assessment).

740. *Subsection (3)* gives a two year time limit for the election. This was the original time limit in section 108 of ICTA before it was amended for (income tax) Self Assessment.

Clause 199: Deductions already made are not displaced

741. This clause is a rule about losses allowed against a post-cessation receipts carried back to the period of cessation under clause 198. It is new.

742. The rule in this clause is broadly the same as the income tax rule in paragraph 5(5) of Schedule 1B to TMA. If relief has already been given under clause 196, for a period later than the period of cessation, this clause makes clear that the relief is not to be re-calculated as a result of the election under clause 198.

743. The clause refers only to a "loss" for which a deduction has already been made. Any "expense or debit" already allowed under clause 196 would in any event not be available for the accounting period in which the cessation occurred.

744. *Subsection (3)* makes clear that the rule about "displacing" a deduction for a loss does not apply to a deduction that has been made from the post-cessation receipt that is to be carried back.

745. See *Change 42* in Annex 1.

Clause 200: Election given effect in accounting period in which receipt is received

746. This clause sets out the procedure for dealing with an election under clause 198. It is new.

747. The procedure for giving the relief is broadly the same as that for income tax. This is an election to which paragraph 58 of Schedule 18 to FA 1998 applies. This clause makes clear that the relief is in terms of tax and corresponds to the income tax rule in paragraph 5 of Schedule 1B to TMA.

748. See *Change 42* in Annex 1.

Chapter 16: Priority rules

Clause 201: Provisions which must be given priority over this Part

749. This clause sets out the priority rules that apply when a receipt or other credit item might otherwise fall within more than one head of charge. It is based on section 18 of ICTA. The corresponding rules for income tax are in section 4 of ITTOIA.

750. *Subsection (2)* deals with potential overlap with ITEPA. It is based on section 18 of ICTA. In the source legislation Schedule D is the residual Schedule. So the charge in ITEPA on employment income, and other income formerly within Schedule E, has priority over the charge on profits of a trade (Schedule D in the source legislation).

Part 4: Property income

Overview

751. This Part applies to "property income". That is, income from land. The corresponding rules for income tax are in Part 3 of ITTOIA.

752. This Part covers income that is taxed under different Schedules and Cases in the source legislation. So it covers, for example, income from land both in the United Kingdom and abroad, as well as post-cessation receipts from property businesses.

753. This reflects the approach of grouping types of income which are logically part of the same "family". In this Part the unifying factor is that all the elements are amounts that are, ultimately, attributable to exploiting an interest in land.

754. As a consequence, this Part groups elements which in the source legislation are separate. But those elements do not lose their identity for all purposes. Loss relief, for example, requires them to be kept apart. For this reason the charge to corporation tax on "property income" has specific components (see clause 202).

755. This Part is not an exhaustive statement of the rules for the calculation of property income. Other regimes may affect that calculation. In particular, Parts 8, 11 and 14 of this Bill contain rules that may affect property business profits.

756. References to "profits or gains" in the source legislation which relate only to income are rewritten in this Part omitting the reference to "gains". This continues the tidying up of such references begun in section 46(3) of, and Schedule 7 to, FA 1998.

Chapter 1: Introduction

Clause 202: Overview of Part

757. This clause is introductory. It is new.

Chapter 2: Property businesses

Clause 203: Overview of Chapter

758. This clause introduces the Chapter and provides a "road map" to the key provisions. It is new.

759. Chapter 2 sets out the key concepts underlying the main component of income within this Part of this Bill by defining "property business" and "generating income from land".

Clause 204: Meaning of “property business”

760. This clause defines “property business”. It is new.

761. *Subsection (1)* reflects the fact that section 70A of ICTA applies the same basic rules for income from UK land to income from overseas land. So most of the provisions in this Part apply to both UK and overseas property businesses alike. Where they do not, the particular clause makes that clear by, for example, referring to a UK property business only.

762. The term “property business” is not entirely straightforward. The term used in the source legislation, “Schedule A business”, was introduced as part of the 1995 reform of Schedule A for income tax and was applied to corporation tax in 1998. That concept was helpful in providing a vessel to contain all the income from land previously charged under Schedule A and to which the rules for calculating trade profits could be applied. But the concept of a Schedule A business, and a UK property business, is rather more complex than that of a trade. That is reflected in this and the other clauses that, together, define the range of income that is assessed as income of a property business.

Clause 205: UK property business

763. This clause defines “UK property business” and introduces the concept of “generating income from land”. It is based on section 15(1) of ICTA. The corresponding rule for income tax is in section 264 of ITTOIA.

764. It gives a basic “one business per company” rule: that (subject to special cases such as those mentioned in clause 203(3) and (4)) all the income from a company’s UK land interests is treated as falling within a single UK property business.

765. Although the Chapter builds on the concept of the “business”, the approach differs from the approach in the source legislation. This Bill adopts the same approach as ITTOIA and uses the term “UK property business” rather than “Schedule A business”.

Clause 206: Overseas property business

766. This clause defines “overseas property business”. It is based on section 70A of ICTA. The corresponding rule for income tax is in section 265 of ITTOIA.

767. The definition is identical to that of “UK property business” except that the land from which the income arises is outside the United Kingdom.

768. For the purpose of deciding whether there is an overseas property business, overseas land law is interpreted in accordance with clause 290.

Clause 207: Meaning of "generating income from land"

769. This clause defines "generating income from land". It is based on sections 15(1) and 24 of ICTA. The corresponding rule for income tax is in section 266 of ITTOIA.

770. The clause defines what may be described as the essence of the property business. That is, exploiting rights of land ownership for profit. But it is not intended to identify everything that must be taken into account in calculating the profits of such a business. The concept of the property business is wider than that. "Property business" includes, for example, amounts specifically charged under other provisions such as certain insurance recoveries (see clause 103 applied by clause 210(2)).

771. *Subsection (2)* extends the meaning of "rents" and is based on section 24(6)(b) of ICTA. Including this extension in the main clause (in the source legislation it is relegated to a "construction" section) keeps all the relevant definitions together.

772. *Subsection (3)* explains "other receipts" in subsection (1). This list is not exhaustive but amounts that are not listed here would have to be of a similar nature to those that are listed to come within the definition.

773. *Subsection (4*) extends the charge to particular types of receipt. The source legislation cross-refers to a definition of "caravan" in the Caravan Sites and Control of Development Act 1960. There is a Bill-wide definition of "caravan" in clause 1314 (and see *Change 96* in Annex 1). "Houseboat" is defined in clause 1319 (other definitions).

Clause 208: Activities not for generating income from land

774. This clause excludes certain "land-related" income from property income and cross-refers to the trading income provisions under which that income is charged. It is based on section 15(1) of ICTA. The corresponding rule for income tax is in section 267 of ITTOIA.

Chapter 3: Profits of property businesses: basic rules

Clause 209: Charge to tax on profits of a property business

775. This clause applies the corporation tax charge to the profits of a property business. It is based on sections 9, 15 and 18 of ICTA.

Clause 210: Profits of a property business: application of trading income rules

776. This is the main rule for calculating the profits of a property business. It is based on section 21A of ICTA. The corresponding rule for income tax is in section 272 of ITTOIA.

777. The same basic rules apply to the calculation of both UK and overseas property businesses.

778. From 1998, the profits of a Schedule A business charged to corporation tax are calculated by treating the business as similar to a trade and applying the calculation rules of Schedule D Case I.

779. In the source legislation this is achieved by section 21A of ICTA. But, at the margins, the application of certain of the Case I rules to Schedule A is not altogether clear.

780. First, the relationship of section 21A(2) of ICTA to section 21A(1) of ICTA is uncertain. Section 21A(2) of ICTA refers to provisions that apply "in accordance" with section 21A(1). It is open to debate whether section 21A(2) of ICTA merely contains examples of the Schedule D Case I provisions that apply in accordance with the general rule in section 21A(1) of ICTA or whether it contains an exhaustive list of those provisions. The former appears the better view and the one best reflecting the underlying policy.

781. Second, some Schedule D Case I provisions that are applied to Schedule A are inherently incapable of applying to income from land. The "herd basis" provisions in section 97 of, and Schedule 5 to, ICTA (rewritten in Chapter 8 of Part 3 of this Bill) are an example. They are among the provisions of Chapter 5 of Part 4 of ICTA that are applied to Schedule A specifically (subject to stated exceptions) by section 21A(2) of ICTA. But they are not among the exceptions referred to in section 21A(4) of ICTA. On the other hand, some Schedule D Case I provisions outside Chapter 5 of Part 4 of ICTA that seem potentially more relevant, such as the car hire provisions in sections 578A and 578B of ICTA, are not applied specifically.

782. Clause 210 clarifies these matters by listing all the trading income provisions in Part 3 of this Bill that are relevant to property business profits.

783. Some of the clauses in Part 3 of this Bill that are applied to a property business contain rewrite changes. Those changes are carried through to property income. Details of those changes are recorded in the Annex 1 notes on the particular clauses in Part 3.

784. *Subsection (2)* lists all the provisions in Part 3 that are relevant to property business income. It reflects the principle that section 21A(1) of ICTA applies all Schedule D Case I calculation provisions to Schedule A unless they are expressly disapplied elsewhere. Provisions that are expressly disapplied in the source legislation are excluded from the list.

785. Also excluded are provisions which are attracted to Schedule A in the source legislation either expressly by section 21A(2) of ICTA or under the general principle expressed in section 21A(1) of ICTA, but which are incapable of applying once carried over to the context of the property business. Exclusion is achieved simply by omitting them from the list of provisions that do apply.

786. The majority of the provisions in Part 3 that can apply to a property business are applied by subsection (2). But in some cases later clauses set out the provisions specifically (clauses 261 and 262 (adjustment on change of basis) and the clauses in Chapter 9 of this Part (post-cessation receipts)).

787. The following clauses that are applied by subsection (2) merit specific mention. These are:

- clauses 56 to 58: expenses of car hire; and

- clauses 172 to 175: deduction for unremittable amounts.

788. Including these accurately reflects the effect of section 21A(1) of ICTA.

789. Although the list in subsection (2) excludes trading income provisions that are inherently incapable of applying to a property business it does not exclude those that are merely unlikely to apply. This recognises the possibility of certain provisions applying in unusual circumstances. Examples are clauses 87 and 88 (scientific research). Although their relevance to a property business is unlikely, it is not inconceivable and they are needed to cater for the possibility of a landlord funding an activity that would qualify as "scientific research". An example might be research on the decontamination of brown land with a view to building an investment property on it.

Clause 211: Loan relationships and derivative contracts

790. This clause defines the relationship of the rules in Parts 5 and 7 to those in this Part. It is based on section 15 of ICTA.

791. *Subsection (1)* drops the words of the source "carried on by a company" in referring to a property business because in the context of corporation tax only legislation, they are redundant.

792. *Subsection (2)* is based on the premise that, in the source legislation, the second sentence of paragraph 2(3) of Schedule A is really about the relationship between that provision and section 80(5) of FA 1996 and paragraph 1(2) of Schedule 26 to FA 2002. The source makes a wide statement about the relationship between "this Schedule [A]" and Part 4 of FA 1996 and Schedule 26 to FA 2002. The Bill disposes of the concept of Schedule A so the rewritten references are necessarily more focussed.

Clause 212: Items treated as receipts and expenses

793. This clause gives signposts to other relevant rules of calculation. It is new.

794. In particular the CAA rules override the rules against the inclusion of capital items in clauses 53 and 93 of this Bill (applied to this Part by clause 210(2)).

Clause 213: Certain amounts brought into account under Part 3

795. This clause excludes from the profits of a property business certain income from land that, exceptionally, may be taxed as profits of a trade. It is based on section 15 of ICTA. See *Changes 4*, *5* and *6* in Annex 1 and the commentary on clauses 43, 44 and 45. The corresponding rule for income tax is in section 273 of ITTOIA .

Clause 214: Relationship between rules prohibiting and allowing deductions

796. This clause determines the interaction between those provisions that prohibit a deduction and those provisions that allow a deduction. It is new. The corresponding rule for income tax is in section 274 of ITTOIA.

797. This clause does a similar job in Part 4 to that which clause 51 does in Part 3. The general principle is that a rule allowing a deduction takes priority over a rule prohibiting a deduction. But that is subject to the exceptions the clause mentions. See *Change 7* in Annex 1.

798. *Subsection (4)* makes it clear that the effect of this priority rule extends to the large number of trading income rules that apply to property income indirectly through clause 210.

Chapter 4: Profits of property businesses: lease premiums etc

Overview

799. This Chapter contains rules under which a company may be treated as receiving property business receipts in relation to certain lease premiums, or certain other amounts, which would otherwise generally be amounts of a capital nature. It also contains rules whereby relief can, in certain cases, be given to companies in relation to an earlier property business receipt that another person was treated as receiving. The Chapter is based on sections 34 to 38 and 42 of ICTA. The corresponding provisions for income tax are in Chapter 4 of Part 3 of ITTOIA.

800. See clauses 62 to 67 for cases in which trading expenses are treated as incurred and deductible by reference to an earlier deemed lease receipt. See clause 136 for a case in which trading receipts are reduced by property business receipts that are treated as arising under clauses 217 to 225.

Clause 215: Overview of Chapter

801. This clause provides an overview of the Chapter. It is new. The corresponding provision for income tax is in section 276 of ITTOIA.

Clause 216: Meaning of "short-term lease"

802. This clause defines "short-term lease" as "a lease whose effective duration is 50 years or less". It is new. The corresponding provision for income tax is in section 276 of ITTOIA.

803. The "effective duration" of a lease is its duration for the purpose of this Chapter. This may not be the same as the contractual duration of the lease. See commentary on clauses 243 and 244.

Clause 217: Lease premiums

804. This clause treats a property business receipt as arising if a premium is payable in relation to the grant of a short-term lease. It is based on sections 34(1), (6) and (7A) and 37(2) of ICTA. The corresponding provision for income tax is in section 277 of ITTOIA.

805. *Subsection (2)* treats a company to which the premium is due as receiving an amount as a result of entering into a transaction mentioned in clause 205 (UK property business) or clause 206 (overseas property business), depending on the location of the land to which the lease relates. The effect is that the amount will be treated as a receipt of the company's UK or overseas property business.

806. The approach adopted in subsection (2) is also followed in clauses 219 to 225.

807. *Subsection (3)* requires the company to which the premium is due to bring the amount into account in calculating the profits of the property business for the accounting period in which the lease is granted. Source legislation is not explicit about the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

Clause 218: Amount treated as lease premium where work required

808. This clause treats a lease premium as payable if a lease places an obligation on the tenant to carry out certain works. It is based on section 34(2) and (3) of ICTA. The corresponding provision for income tax is in section 278 of ITTOIA.

809. Such treatment could lead to a property business receipt, or a greater receipt, being treated as arising to the landlord under clause 217.

Clause 219: Sums payable instead of rent

810. This clause treats a property business receipt as arising in certain cases where a payment is made instead of rent for some or all of the duration of a lease. It is based on sections 34(1), (4), (6) and (7A) and 37(2) of ICTA. The corresponding provision for income tax is in section 279 of ITTOIA.

811. *Subsection (1)* makes clear that, irrespective of the length of the lease, the payment of a sum instead of rent for a period of 50 years or less is within the scope of this clause. Source legislation is not explicit on this point. See *Change 44* in Annex 1.

812. *Subsection (3)* requires the company to which the sum is due to bring an amount into account in calculating the profits of its property business for the accounting period in which the sum is payable. Source legislation is not explicit about

the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

813. In calculating the amount to be treated as received in respect of a sum in lieu of rent within section 34(4) of ICTA, the duration of the lease for the purposes of the formula in section 34(1) of ICTA must be adjusted in accordance with section 34(4)(a) of ICTA. For this purpose, there is excluded from the duration of the lease any period other than that in respect of which the sum in lieu of rent is paid. *Subsections (4) and (6)* have the same effect as those provisions of section 34(1) and (4)(a) of ICTA.

Clause 220: Sums payable for surrender of lease

814. This clause treats a property business receipt as arising in certain cases where a sum is payable for the surrender of a short-term lease. It is based on sections 34(1), (4), (6) and (7A) and 37(2) of ICTA. The corresponding provision for income tax is in section 280 of ITTOIA.

815. *Subsection (3)* requires the company to which the sum is due to bring an amount into account in calculating the profits of its property business for the accounting period in which the sum is payable. Source legislation is not explicit about the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

Clause 221: Sums payable for variation or waiver of terms of lease

816. This clause treats a property business receipt as arising in certain cases where a payment is made for the variation or waiver of any of the terms of a lease. It is based on section 34(1), (5), (6), (7) and (7A) of ICTA. The corresponding provision for income tax is in section 281 of ITTOIA.

817. *Subsection (1)* makes clear that, irrespective of the length of the lease, the payment of a sum as consideration for the variation or waiver of the terms of a lease for a period of 50 years or less is within the scope of this clause. Source legislation is not explicit on this point. See *Change 44* in Annex 1.

818. Subsection (1) also provides that this clause applies only if the sum is due to the landlord or to a connected company. Source legislation does not contain this restriction. See *Change 45* in Annex 1.

819. *Subsection (3)* requires the company to which the sum is due to bring an amount into account in calculating the profits of its property business for the accounting period in which the contract providing for the variation or waiver is entered into. Source legislation is not explicit about the accounting period concerned in the case of a company which is not the landlord. See *Change 43* in Annex 1.

820. Clause 227(1) extends relief under clause 228 (the additional calculation rule) to receipts in respect of sums payable for the variation or waiver of the terms of a lease. This is reflected in *subsection (5)* of this clause. See *Change 46* in Annex 1.

821. In calculating the amount to be treated as received in respect of a sum for the variation or waiver within section 34(5) of ICTA, the duration of the lease for the purposes of the formula in section 34(1) of ICTA must be adjusted in accordance with section 34(5)(a) of ICTA. For this purpose, there is excluded from the duration of the lease any period other than that in respect of which the variation or waiver has effect. *Subsections (4) and (6)* have the same effect as those provisions of section 34(1) and (5)(a) of ICTA.

Clause 222: Assignments for profit of lease granted at undervalue

822. This clause treats a property business receipt as arising in certain cases where a company makes a profit on the assignment of a lease that had been granted at an undervalue. It is based on sections 35(1), (2) and (2A) and 37(2) of ICTA. The corresponding provision for income tax is in section 282 of ITTOIA.

823. The formula in *subsection (4)* for calculating the deemed receipt if there is an assignment at a profit is based on section 35(2) of ICTA (which refers back to the formula in section 34(1) of ICTA).

Clause 223: Provisions supplementary to section 222

824. This clause supplements clause 222. It is based on section 35(1) and (2) of ICTA. The corresponding provision for income tax is in section 283 of ITTOIA.

Clause 224: Sales with right to reconveyance

825. This clause treats a property business receipt as arising in certain cases where a property is sold on terms which provide for the property to be reconveyed to the seller, or to a connected person, at less than the sale price. It is based on section 36(1) and (4A) of ICTA. The corresponding provision for income tax is in section 284 of ITTOIA.

826. *Subsection (1)(b)* provides that this clause applies only if the period between sale and reconveyance is 50 years or less. Source legislation effectively applies if the period is 51 years or less. See *Change 47* in Annex 1.

Clause 225: Sale and leaseback transactions

827. This clause treats a property business receipt as arising in certain cases where a company sells property on terms which provide for the grant of a lease to the vendor or to a connected person. It is based on section 36(1), (3), (4) and (4A) of ICTA. The corresponding provision for income tax is in section 285 of ITTOIA.

828. *Subsection (1)(b)* provides that this clause applies only if the period between sale and leaseback is 50 years or less. Source legislation effectively applies if the period is 51 years or less. See *Change 47* in Annex 1.

Clause 226: Provisions supplementary to sections 224 and 225

829. This clause supplements sections 224 and 225. It is based on section 36(2), (3) and (4B) of ICTA. The corresponding provision for income tax is in section 286 of ITTOIA.

Clause 227: Circumstances in which additional calculation rule applies

830. This clause sets out cases where a deemed business property receipt is to be reduced, under clause 228, by reference to an earlier taxed receipt. It is based on section 37(1), (2), (3) and (9) of ICTA. The corresponding provision for income tax is in section 287 of ITTOIA.

831. *Subsection (1)* provides that those cases include a deemed business property receipt arising in relation to payments for a variation or waiver of terms of a lease. See *Change 46* in Annex 1.

832. Amounts within clause 218 (amount treated as lease premium where work required) are not specified separately in subsection (1), or in clause 228(2), because clause 218(2) treats such amounts as premiums within clause 217.

833. *Subsection (3)* sets out the connection that must exist between the lease in relation to which the taxed receipt arises and the lease in relation to which the later deemed business property receipt arises.

834. *Subsection (4)'s* definitions of "taxed lease" and "taxed receipt" are based on the definitions of "head lease" and "amount chargeable on the superior interest" in section 37(1) of ICTA. The definition of a taxed lease, and taxed receipt, includes leases of land, and associated receipts, outside the UK. This restores a relief that was incorrectly removed by ITTOIA. See *Change 48* in Annex 1.

835. *Subsection (5)* stipulates that for clause 228 to apply there must be at least one taxed receipt with an "unused amount". That is because clause 235 (limit on reductions and deductions) prevents relief being given under clause 228 by reference to a taxed receipt if that taxed receipt does not have an unused amount. Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

Clause 228: The additional calculation rule

836. This clause provides for the amount of a deemed business property receipt to be reduced, in cases within clause 227, by reference to an earlier taxed receipt. It is based on section 37(2), (3), (7) and (9) of ICTA. The corresponding provision for income tax is in section 288 of ITTOIA.

837. The amount to be reduced is referred to in this clause, and in clause 229, as "the receipt under calculation".

838. Clause 227 extends relief to deemed business property receipts arising in relation to the variation or waiver of the terms of a lease. *Subsection (2)* reflects this by referring to clause 221. See *Change 46* in Annex 1.

839. This clause introduces the label "basic relieving amount" for the amount by which the receipt under calculation is to be reduced.

840. *Subsection (3)* requires the basic relieving amount to be restricted under clause 229(5) so that it does not exceed the amount of the receipt under calculation. Source legislation is not as explicit about what happens if relief is given in relation to more than one earlier taxed receipt. If there is more than one taxed receipt by reference to which the receipt under calculation may be reduced, it is for the company entitled to the relief to decide the order in which relief is to be taken by reference to those taxed receipts.

841. For subsection (3) to apply there must be at least one taxed receipt with an "unused amount". That is because clause 235 (limit on reductions and deductions) prevents relief under this clause being given by reference to a taxed receipt if that taxed receipt does not have an unused amount. Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

842. *Subsection (4)*'s use of the "unreduced amount" of the taxed receipt (defined in clause 230(2)) in the formula makes clear that the basic relieving amount by reference to a taxed receipt is to be calculated according to the amount of that receipt *before* any reductions or deductions.

843. The definition in *subsection (6)* of "receipt period" in relation to a receipt under clauses 217 and 219 to 222 is based on the definition of "the period in respect of which an amount arose" in section 37(7)(b) of ICTA.

Clause 229: The additional calculation rule: special cases

844. This clause:

- modifies the rule in clause 228 if the receipt under calculation arises in respect of part only of the premises subject to the taxed lease; and
- sets limits on the reduction under that clause in two cases.

It is based on section 37(2), (3) and (9) of ICTA. The corresponding provision for income tax is in section 289 of ITTOIA.

845. Clause 227 extends relief under clause 228 to business property receipts treated as arising in relation to the variation or waiver of the terms of a lease. This is reflected in the reference in *subsection (2)* to clause 221. See *Change 46* in Annex 1.

846. But subsection (2) does not apply to receipts under clause 222 (assignments for profit of lease granted at undervalue) because it is not possible for a lease to be assigned other than in respect of the whole of the premises subject to the lease.

847. *Subsection (3)* requires the fraction in subsection (2) to be calculated on a "just and reasonable basis", where section 37(3) of ICTA requires a "just apportionment". See *Change 12* in Annex 1.

848. *Subsection (4)* restricts the reduction calculated under clause 228(4) or subsection (2) of this clause to the "unused amount" of the taxed receipt by reference to which it is calculated. That is because giving greater relief would create a conflict with clause 235 (limit on reductions and deductions). Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

Clause 230: Meaning of "unused amount" and "unreduced amount"

849. This clause is based on section 37(1), (8) and (9) of ICTA. The corresponding provision for income tax is in section 290 of ITTOIA.

850. The "unused amount" of a taxed receipt is defined in *subsections (1)* and *(5)*. That label is used by clauses 228 and 229 to ensure that relief given by reference to a taxed receipt under those clauses does not conflict with clause 235 (limit on reductions and deductions). Source legislation is not as explicit about the way in which relief in relation to a taxed receipt must not exceed the amount of the taxed receipt. See *Change 49* in Annex 1.

Clause 231: Deductions for expenses under section 232

851. This clause provides business property deductions to a company for expenses that it is treated as incurring in respect of an earlier taxed receipt. This clause is based on section 37(4) and (9) of ICTA. The corresponding provision for income tax is in section 291 of ITTOIA.

852. *Subsection (2)* provides that a deduction for an expense which the tenant is treated as incurring under clause 232 is allowed for each "qualifying day" on which all or part of the premises subject to the taxed lease is either occupied for the purposes of the tenant's property business or is sublet. A "qualifying day" is defined in clause 232(3) as a day which falls within the receipt period of the taxed receipt.

853. *Subsection (3)* provides that a deduction for an expense which a tenant is treated as incurring under clause 232 is subject to the application of any provision of Chapter 4 of Part 3 (rules restricting deductions). This is based on the source legislation providing that the amounts, corresponding to those in subsection (2), are treated as rent, whose deductibility is therefore subject to rules corresponding to those in Chapter 4 of Part 3.

854. *Subsection (4)* provides that the deduction allowed in respect of an expense under clause 232 may be restricted to prevent the cap in clause 235, on the total relief which can be given by reference to a taxed receipt, being exceeded. See *Change 49* in Annex 1.

Clause 232: Tenants under taxed leases treated as incurring expenses

855. This clause sets out the method of calculating the expense for which a deduction may be allowed under clause 231. It is based on section 37(4) of ICTA. The corresponding provision for income tax is in section 292 of ITTOIA.

856. The formula in *subsection (4)* calculates the expense for each qualifying day by spreading the amount of the taxed receipt evenly over the receipt period of that receipt. Defining “A” in that formula as “the unreduced amount of the taxed receipt” makes clear that the amount of the expense which the tenant is treated as incurring for each qualifying day is calculated by reference to the amount of the taxed receipt *before* any reductions or deductions.

Clause 233: Restrictions on section 232 expenses: the additional calculation rule

857. This clause supplements clause 232’s application to a taxed receipt where a lease premium receipt is also reduced by reference to that taxed receipt. It is based on sections 37(5) and (7) and 37A of ICTA. The corresponding provision for income tax is in section 293 of ITTOIA.

858. *Subsections (2)* and *(3)* provide for a tenant to be treated as incurring an expense for a qualifying day under clause 232 only to the extent that the “daily amount of the taxed receipt” exceeds the “daily reduction of the lease premium receipt”. This prevents relief being lost in certain cases where more than one taxed receipt has been used to reduce the lease premium receipt to nil. See *Change 13* in Annex 1.

859. The daily amount of the taxed receipt and the daily reduction of the lease premium receipt are calculated according to the formulas in *subsection (6)*:

- the formula for calculating the daily amount of the taxed receipt is the same formula used in clause 232(4) to calculate the amount of the expense which the tenant is treated as incurring for each qualifying day; and
- the formula for calculating the daily reduction of the lease premium receipt spreads the reduction calculated under clause 228 or the corresponding section in ITTOIA evenly over the receipt period of the lease premium receipt.

860. *Subsection (5)* deals with the case where for a qualifying day a taxed receipt reduces more than one lease premium receipt. In such a case, the tenant is treated as incurring an expense for that day under clause 232 only to the extent that the daily amount of the taxed receipt exceeds the *total* of the daily reductions of each of the lease premium receipts. See *Change 13* in Annex 1.

Clause 234: Restrictions on section 232 expenses: lease of part of premises

861. This clause adapts clauses 232 and 233 for cases where the lease premium receipt arises in relation to only a part of the premises in respect of which the taxed receipt arose. It is based on sections 37(6) and 37A of ICTA. The corresponding provision for income tax is in section 294 of ITTOIA.

862. Clause 227 extends relief under clause 228 to business property receipts treated as arising in relation to the variation or waiver of the terms of a lease. This is reflected in the reference in *subsection (2)* to clause 221. See *Change 46* in Annex 1.

863. *Subsection (4)* applies clauses 232 and 233 separately to that part of the premises in relation to which the lease premium receipt arises and to the remainder of the premises. And *subsection (5)* deals with the case where there is more than one sublease which does not extend to the whole of the landlord's premises. See *Change 13* in Annex 1.

864. *Subsection (6)* adapts clauses 232 and 233 by multiplying the unreduced amount of the taxed receipt ("A") by the fraction of the premises to which the lease premium relates in the formulas for calculating:

- the expense for a qualifying day in clause 232(4); and
- the daily amount of the taxed receipt in clause 233(6).

865. *Subsection (7)* requires the fraction in subsection (6) to be calculated on a "just and reasonable basis", where section 37(6) of ICTA is not explicit about the necessary basis of apportionment. See *Change 12* in Annex 1.

Clause 235: Limit on reductions and deductions

866. This clause places a limit on the relief that can be given under this Chapter in relation to a taxed receipt. It is based on section 37(9) of ICTA. The corresponding provision for income tax is in section 295 of ITTOIA.

867. The clause restricts total relief in respect of a taxed receipt by way of:

- reductions under the additional calculation rule in clause 228; and
- deductions under clause 232.

868. The total relief is restricted to the amount of the taxed receipt after the following (so far as given by reference to the taxed receipt):

- any reductions or deductions under sections 288 or 292 of ITTOIA (which correspond to clauses 228 and 232 respectively); and

- any deductions under clause 63 (trading expense), or under section 61 of ITTOIA (which corresponds to clause 63).

See *Change 49* in Annex 1.

Clause 236: Payment of tax by instalments
869. This clause provides for corporation tax, attributable to lease premium receipts, to be paid by instalments in certain cases. It is based on section 34(8) of ICTA. The corresponding provision for income tax is in section 299 of ITTOIA.

870. *Subsection (2)* attributes the power to determine the amount and timing of instalments to an officer of Revenue and Customs where the source legislation refers to "the Board" (defined by source legislation to mean "the Commissioners of Inland Revenue"). See *Change 1* in Annex 1.

Clause 237: Statement of accuracy for purposes of section 222
871. This clause provides for an officer of Revenue and Customs to certify a statement, made in cases where assignment of a lease does or may give rise to a taxed receipt, if satisfied that that the statement is accurate. It is based on section 35(3) of ICTA. The corresponding provision for income tax is in section 300 of ITTOIA.

Clause 238: Claim for repayment of tax payable by virtue of section 224
872. This clause provides for corporation tax, paid in respect of a receipt under clause 224 (sales with right to reconveyance), to be repaid in certain cases. It is based on section 36(2) of ICTA. The corresponding provision for income tax is in section 301 of ITTOIA.

873. *Subsection (3)* refers to a period of four years where the source legislation provides for six years. Schedule 2 preserves the six year period in the source legislation until an order is made by the Treasury reducing the period to four years.

Clause 239: Claim for repayment of tax payable by virtue of section 225
874. This clause provides for corporation tax, paid in respect of a receipt under clause 225 (sale and leaseback transactions), to be repaid in certain cases. It is based on section 36(2) and (3) of ICTA. The corresponding provision for income tax is in section 302 of ITTOIA.

875. *Subsection (3)* refers to a period of four years where the source legislation provides for six years. Schedule 2 preserves the six year period in the source legislation until an order is made by the Treasury reducing the period to four years.

Clause 240: Appeals against proposed determinations
876. This clause provides for determinations of amounts under this Chapter that may affect the tax liability of more than one person and for appeals against proposed determinations. It is based on section 42(1), (2) and (3) of ICTA.

Clause 241: Section 240: supplementary

877. This clause supplements clause 240. It is based on section 42(6) and (7) of ICTA.

Clause 242: Determination by tribunal

878. This clause provides for objections to provisional determinations under clause 240 to be determined by an independent tribunal. It is based on section 42(4) and (5) of ICTA.

879. Schedule 2 provides for objections to be determined by the Special Commissioners or General Commissioners until their functions are transferred to the First-tier Tribunal and Upper Tribunal.

Clause 243: Rules for determining effective duration of lease

880. This clause contains rules for determining the effective duration of a lease. It is based on section 38(1) and (6) of ICTA. The corresponding provisions for income tax are in section 303 of ITTOIA.

881. *Subsection (1)* sets out various circumstances in which a lease may be treated as ceasing other than on the date specified in the lease. Rules 1, 2 and 3 are based on paragraphs (a), (b) and (c) respectively of section 38(1) of ICTA.

882. Rule 1 provides that the lease is treated as ending on the date beyond which it is unlikely that the lease will continue. See *Change 50* in Annex 1.

883. *Subsection (3)* is new. It ensures that all amounts that may give rise to a charge to tax by reason of clauses 218 to 221 are treated as premiums in applying Rule 1 in subsection (1). See *Change 50* in Annex 1.

884. Schedule 1 to this Bill amends section 303 of ITTOIA (rules for determining effective duration of lease) so that the changes also apply for income tax. See *Change 50* in Annex 1.

Clause 244: Applying the rules in section 243

885. This clause supplements the rules in clause 243. It is based on section 38(2), (3) and (4) of ICTA. The corresponding provisions for income tax are in section 304 of ITTOIA.

886. Section 38(4) of ICTA refers to benefits conferred and payments made for the purposes of securing a corporation tax advantage in the application of Part 2 of ICTA (provisions relating to the Schedule A charge) or an income tax advantage in the application of Chapter 4 of Part 3 of ITTOIA (profits of property businesses: lease premiums etc).

887. Part 2 of ICTA consists of sections 21A to 42 of ICTA. Other than the lease premiums rules in sections 34 to 39, the sections of Part 2 of ICTA which are in force

are sections 21A to 21C (calculation of the profits of a Schedule A business), section 24 (construction of Part 2), section 30 (sea walls), sections 31ZA to 31ZC (energy-saving items), section 40 (receipts and outgoings on sale of land) and section 42 (appeals against determinations under sections 34 to 36 of ICTA or Chapter 4 of Part 3 of ITTOIA).

888. Sections 43A to 43G of ICTA were also in Part 2 of ICTA and could have applied to leases granted before 6 June 2006. But where those sections applied they gave rise to taxable receipts, rather than deductions from taxable income.

889. It is considered that the only tax advantage that could be secured in the context of section 38(4) of ICTA would be under sections 34 to 37 of ICTA. So *subsection (4)* refers to a corporation tax advantage under this Chapter or an income tax advantage in the application of Chapter 4 of Part 3 of ITTOIA.

Clause 245: Information about effective duration of lease

890. This clause provides for an officer of Revenue and Customs to require, by notice, information relevant to determining the effective duration of a lease. It is based on section 38(5) of ICTA. The corresponding provision for income tax is in section 305 of ITTOIA.

Clause 246: Provisions about premiums

891. This clause contains rules about sums that may be treated as premiums and the lease to which a premium may be attributed. It is based on section 24(2) to (4) of ICTA. The corresponding provision for income tax is in section 306 of ITTOIA.

Clause 247: Interpretation

892. This clause provides rules about the interpretation of “premium” and the application of the Chapter to Scotland. It is based on sections 24(1), (4) and (5), 37(10) and 37A(9) of ICTA. The corresponding provision for income tax is in section 307 of ITTOIA.

Chapter 5: Profits of property businesses: other rules about receipts and deductions

Overview

893. This Chapter contains provisions that supplement the basic calculation rules in Chapter 3 of this Part of the Bill. The corresponding rules for income tax are in Chapter 5 of Part 3 of ITTOIA.

894. The provisions in this Chapter are about particular receipts or more unusual circumstances.

Clause 248: Furnished lettings

895. This clause brings the “letting” of furniture, when it is part and parcel of the letting of accommodation, within the property income charge. It is based on

section 15 of ICTA. The corresponding rule for income tax is in section 308 of ITTOIA.

896. Without this provision, rent paid for use of the furniture in furnished lettings would not be included in the property income charge because the "rent" for the furniture does not derive from land.

897. The purpose of *subsection (1)(b)* is to make it clear that related revenue expenses such as the expenses of repair and insurance of the furniture are deductible in calculating the profits of the property business.

898. *Subsection (2)* excludes income and expenses where the hiring of the furniture is not simply incidental to exploiting an interest in land.

899. *Subsection (4)(a)* refers to a "caravan and a houseboat". There is a Bill-wide definition of "caravan" in clause 1314: see the commentary on clause 1314 and *Change 96* in Annex 1. "Houseboat" is defined in clause 1319 (other definitions), the corporation tax equivalent of section 878 of ITTOIA.

Clause 249: Acquisition of business: receipts from transferor's UK property business

900. This clause sets out what happens if a successor to a property business receives a sum that arose from the business when it was carried on by the predecessor. It is based on sections 21B and 106 of ICTA. The corresponding rule for income tax is in section 310 of ITTOIA.

901. *Subsection (2)* treats the "sum" received as a receipt of the property business. As this rule affects the calculation of the profits of a property business it appears in this Chapter rather than with the post-cessation receipt rules, where it is in the source legislation.

902. The source legislation applies "for all purposes". This clause applies for corporation tax purposes. Section 310 of ITTOIA applies for income tax purposes. Section 37(1) of TCGA (as construed in accordance with section 8(4) of TCGA) ensures that any sums received as a result of the transfer are not charged to corporation tax on a company's chargeable gains.

Clause 250: Reverse premiums

903. This clause sets out the rules for taxing reverse premiums as receipts of a property business. It is based on Schedule 6 to FA 1999. The corresponding rule for income tax is in section 311 of ITTOIA.

904. *Subsection (1)* refers to a "reverse premium". In accordance with *subsection (6)* that expression has the same meaning as in clause 96. So this clause applies to reverse premiums excluding any of the "excluded cases" within clause 97.

The subsection also excludes any reverse premium that is charged to tax as a trade receipt by clause 98.

905. *Subsections (2)* and *(3)* bring the reverse premium within the scope of the property income rules as United Kingdom or overseas property business even if the recipient is not already carrying on a property business.

906. Schedule 2 to this Bill rewrites the transitional provision in section 54(2) of FA 1999. This clause does not apply to pre 9 March 1999 reverse premiums.

Clause 251: Deduction for expenditure on energy-saving items

907. This clause provides a deduction for certain expenditure on energy-saving items where that expenditure would not otherwise be allowable because it is capital. It is based on section 31ZA of ICTA.

Clause 252: Restrictions on relief

908. This clause imposes certain restrictions on the relief that would otherwise be due under clause 251. It is based on section 31ZB of ICTA.

Clause 253: Regulations

909. This clause provides for the Treasury's powers to make regulations for the purposes stated. It is based on section 31ZC of ICTA.

Clause 254: Deduction for expenditure on sea walls

910. This is the first of four clauses that provide relief to a landlord for making a sea wall or other embankment to protect let premises against flooding by the sea or a tidal river. The corresponding rules for income tax are in sections 315 to 318 of ITTOIA.

911. This clause states the circumstances in which the relief is given. It is based on section 30(1), (4) and (5) of ICTA. The corresponding rule for income tax is in section 315 of ITTOIA.

912. *Subsection (2)* makes it clear that to obtain a deduction for sea walls expenditure, the person carrying on the property business and the person incurring the sea walls expenditure must be the same person. This may appear to be stating the obvious but section 30(1) of ICTA says merely that the person incurring the expenditure is treated as making a payment "for the purpose of computing the profits of *any* Schedule A business carried on in relation to those premises" (emphasis added). This does not mean literally any such business carried on by someone other than the person incurring the expenditure: there would be no point in deeming the payment to be made by that person if it were otherwise. And the provisions on transfer of interests in section 30(2) to (3) of ICTA reflect the notion that the deemed payment, and hence the right to relief, moves from the former owner to the transferee. There is no suggestion of involvement by any other party.

913. *Subsection (3)* defines the "deduction period" referred to in subsection (2). Qualifying expenditure is deducted over 21 years in calculating the profits of the property business. The "deduction period" is comparable to the "writing-down period" over which expenditure qualifying for capital allowances is written off. This reflects the similarity between the relief given by the sea walls provisions and certain capital allowances provisions. The relief is for expenditure which would otherwise be capital in nature. And the expenditure is not relieved all at once but over a period, even if there are changes in the person who obtains the relief.

914. *Subsection (5)* is based on section 30(4) of ICTA which deals with the unusual fact that for corporation tax purposes sea walls relief is given by reference to a year of assessment ("tax year" in ITTOIA and this Bill). A year of assessment is not a term that is normally relevant to corporation tax where the relevant measures of time are financial years and accounting periods. "Tax year" is defined in a clause 1319 (other definitions), the equivalent for corporation tax purposes of section 878 of ITTOIA.

Clause 255: Transfer of interest in premises

915. This clause deals with the case where the person who incurred the sea walls expenditure sells the premises during the 21 year period over which the deduction is due. It is based on section 30(2) and (3) of ICTA. The corresponding rule for income tax is in section 316 of ITTOIA.

916. *Subsection (1)* applies to transfers of the relevant interest "whether by operation of law or otherwise". These words derive directly from the source legislation. They ensure that the provision applies to, for example, successions to estates as well as the sort of merger of interests envisaged in clause 256.

917. *Subsection (2)(b)* requires any apportionment to be "just and reasonable" whereas section 30(2)(a) of ICTA refers simply to an apportionment that is "just". This change reflects the approach that was adopted in CAA and which has been followed in similar contexts elsewhere for consistency. There is no practical difference between the two forms of words. See *Change 12* in Annex 1.

918. *Subsection (5)* makes explicit what is merely implicit in the source legislation, namely, the extent of the transferor's entitlement to a deduction in subsequent years. In particular, subsection (5)(a) makes it clear that if the transfer is of only part of the premises, the transferor continues to be entitled to a deduction in relation to the part not transferred.

Clause 256: Ending of lease of premises

919. This clause deals with the case where the sea walls expenditure is incurred by a lessee and the lease comes to an end before the end of the deduction period. It is based on section 30(3) of ICTA. The corresponding rule for income tax is in section 317 of ITTOIA.

920. The cases to which *subsection (3)* applies include renewals of the lease to the same person. Then the deduction passes to the immediate reversioner.

921. In the source legislation "lease" is defined for the purposes of the sea walls provisions in section 24(6)(a) of ICTA. But that definition is redundant and, since it no longer applies to any other provision, is not rewritten in this Bill. It is redundant in the sea walls context for the following reasons.

922. Section 24(6)(a) of ICTA defines references to a lease as extending only to a lease conferring a right, as against the person whose interest is subject to the lease, to the possession of the premises. It originated as paragraph 16 of Schedule 4 to FA 1963. Notes on Clauses to FA 1963 explain that the reference to possession was to ensure that a "lease" in Schedule A and sections 25 to 31 of ICTA must be one of land and not of incorporeal hereditament. So a lease of sporting rights, or a right of way, would not be covered. However, Street v Mountford [1985], AC 809 established that a "lease" of land which does not confer on the tenant exclusive possession is not, in fact, a lease but a licence.

923. Section 30(2) of ICTA does not explain the meaning of the transfer of the whole of a person's interest in any premises or part of any premises. The transfer of the whole of a person's interest is significant because it can lead to the transfer of entitlement to a deduction for sea walls expenditure. But entitlement to a deduction for sea walls expenditure does not arise anyway unless a person is the owner or tenant of premises. A lease which makes a person a tenant of premises is not a lease of an incorporeal hereditament. So, although section 30 of ICTA does not expressly exclude leases of incorporeal hereditaments, to the extent that they might cover leases of incorporeal hereditaments references to "leases" in that provision are simply redundant.

Clause 257: Transfer involving person within the charge to income tax

924. This clause ensures that entitlement to a deduction for expenditure on sea walls continues properly when the interest in the premises is transferred between a corporation tax payer and an income tax payer. It is based on section 30(2A) of ICTA. The corresponding rule for income tax is in section 318 of ITTOIA.

925. Entitlement to a deduction for expenditure on sea walls can be transferred with ownership of the premises. That transfer can be between a corporation tax payer and an income tax payer. Clause 255 deals with transfers between corporation tax payers. But it cannot deal with a transfer from a corporation tax payer to an income tax payer or the reverse because the provisions in this Bill apply only to corporation tax payers.

926. Clause 257 allows the seawalls provisions in this Bill to work properly in respect of the party to the transfer who is subject to corporation tax.

927. *Subsection (4)* signposts to the provisions in ITTOIA that deal with the party to the transfer who is subject to income tax.

Clause 258: Relief in respect of mineral royalties

928. This clause provides that only half the net profits received in respect of mineral royalties are charged to corporation tax on income. It is based on section 122 of ICTA. The other half of the profits are charged to corporation tax on chargeable gains by section 201 of TCGA. The corresponding rule for income tax is in section 319 of ITTOIA.

929. The clause applies only to mineral royalties that are not taxed under Chapter 7 of this Part. That Chapter taxes rents and royalties from concerns such as mines and quarries. In practice nearly all mineral royalties will be taxed under Chapter 7 of Part 4 of this Bill. For this reason this clause cross-refers to the definitions in that Chapter.

Clause 259: Nature of item apportioned on sale of estate or interest in land

930. This clause preserves the capital or revenue nature of an amount due, or payable in arrears, that is apportioned to a seller on the sale of land. It is based on section 40(3)(b) of ICTA. The corresponding rule for income tax is in section 320 of ITTOIA.

931. Most of section 40 of ICTA is not rewritten because it has become redundant following the application of Schedule D Case I principles to Schedule A.

932. The original predecessor of section 40 of ICTA (section 20 of FA 1964) was introduced to deal with a specific problem. That was reflecting, in the calculation of income from land, any apportionments of rent (as a receipt or an expense) that took place between seller and purchaser when land was sold. That required two kinds of rule. The first were calculation rules. They were necessary because at the time section 20 of FA 1964 was introduced the charge on income from land was based on *entitlement* to incoming rent and *payment* of outgoing rent. Where there were apportionments on sale there might be neither entitlement nor payment by the "right" person. The second were timing rules to ensure that the consequential adjustments fell in the right tax year.

933. As a result of the 1995 Schedule A reforms and their application, in 1998, to corporation tax, these rules are no longer necessary. Two main factors lead to this conclusion.

934. The first relates to the object of charge under Schedule A: the profit of a Schedule A business. For there to be a Schedule A business a person has to be exploiting United Kingdom land for rent (section 15(1)1(1) of ICTA). In order to be a receipt (or outgoing) of the Schedule A business it is enough that an amount relates to a period when the person was exploiting the land.

935. The second factor relates to the time when income within the charge is brought into account. Accounting principles have been imported from Schedule D Case I into Schedule A. These principles bring an item into account in the period to which it

relates. So the rules in section 40(1) to (3) of ICTA about the time of receipt and payment are unnecessary.

936. Section 40(4) of ICTA is similarly now unnecessary. It provides that any reference in section 40(1) and (2) of ICTA to a party to a contract includes a person to whom the rights and obligations of that party under the contract have passed by assignment or otherwise. Since the test of whether or not an item is to be brought into account under Schedule A is whether it arises from a person's exploitation of land then whether the rights and obligations under the contract pass by assignment or otherwise, the person to whom they pass will be the person exploiting the land.

937. Section 40(4A) of ICTA is not rewritten. It is linked to the parts of section 40 of ICTA that are unnecessary and also gives in certain circumstances the wrong result.

938. Section 40(3)(b) of ICTA has a clear anti-avoidance purpose that is preserved in clause 259. But it also contains a timing rule. The timing rule in section 40(3)(b) of ICTA is not rewritten because accounting principles again attribute the apportioned amount to the correct period.

939. This clause rewrites the anti-avoidance part of section 40(3)(b) of ICTA which preserves the capital or revenue nature of any amount due or paid in arrears and apportioned by the buyer to the seller on the sale of land.

940. The time of apportionment referred to in the clause is normally the time of completion of the sale.

Clause 260: Mutual business

941. This clause makes it clear that the concept of "mutuality" does not apply in the property income context. It is based on section 21C of ICTA. The corresponding rule for income tax is in section 321 of ITTOIA.

942. Mutuality is a concept that has been developed by the courts over a long period. It derives from the principle that one cannot make a profit by dealing with oneself. It may arise in the trading context where a class of contributors to a common fund are entitled, as a class, to share in the surpluses of that fund.

943. The approach in this clause differs from that of the source and is simpler. The approach in section 21C of ICTA is to apply the normal profit calculation rules to any "mutual business" and add the result to the profits of the rest of the Schedule A business. This clause on the other hand prevents, from the outset, the concept of mutuality operating on amounts within this Part of this Bill.

Clause 261: Adjustment on change of basis

944. This clause sets out the circumstances in which an adjustment may arise. It is based on section 64 of FA 2002. The equivalent rule for trades is in clause 180. The corresponding rule for income tax is in section 329 of ITTOIA.

945. In the source legislation the change of basis rules apply to a Schedule A business because they are "other rules applicable to Case I of Schedule D" (see section 21B of ICTA). On the other hand, for an overseas property business section 70A(5) of ICTA imports only "the rules applicable to the computation of the profits" (see section 21A of ICTA). So the change of basis rules do not apply to an overseas property business.

Clause 262: Giving effect to positive and negative adjustments

946. This clause sets out how to calculate an adjustment and how it is treated for tax purposes. It is based on paragraphs 2 and 4 to 7 of Schedule 22 to FA 2002. The corresponding rules for income tax are in sections 330, 333 and 334 of ITTOIA.

947. *Subsection (6)* is a cross-reference to the trading income rule about expenses for which a deduction has already been made.

Clause 263: Expenditure on integral features

948. This clause draws attention to the rule in section 33A(3) of CAA. There is a signpost to that rule in section 74(1)(da) of ICTA. That subsection is repealed. The signpost is not formally rewritten but it is replaced in this clause (and in the trading income clause 60).

Chapter 6: Commercial letting of furnished holiday accommodation

Overview

949. The clauses in this Chapter define the lettings that can qualify for special tax advantages: "the commercial letting of furnished holiday accommodation". They are based on section 504 of ICTA. The corresponding rules for income tax are in sections 322 to 327 of ITTOIA.

950. The clauses do not, themselves, provide for the tax advantages. That is the function of the particular "relieving" provisions (such as the loss relief provisions) that are cross-referred to.

951. The primary purpose of this Chapter is to provide a central definition of this particular type of letting, income from which benefits from tax advantages provided for in other Acts.

952. This income is part of the single property business denoted in clause 205 and chargeable therefore under this Part.

Clause 264: Overview of Chapter

953. This clause is introductory and explanatory. It is new. It makes clear that the provisions that provide for the tax advantages are to be found elsewhere. The corresponding rule for income tax is in section 322 of ITTOIA.

Clause 265: Meaning of “commercial letting of furnished holiday accommodation”

954. This clause defines the lettings that can benefit from the special tax treatment. It is based on section 504 of ICTA. The corresponding rule for income tax is in section 323 of ITTOIA.

955. It is not sufficient that the letting is simply of furnished holiday accommodation: it must also be “qualifying holiday accommodation”. *Subsection (3)(b)* provides a signpost to the clauses that define “qualifying holiday accommodation”.

Clause 266: Meaning of “relevant period” in sections 267 and 268

956. This clause defines the period during which certain conditions need to be satisfied in order to benefit from the special tax treatment. It is based on section 504(5) of ICTA. The corresponding rule for income tax is in section 324 of ITTOIA.

957. *Subsection (4)* gives the general rule and identifies the relevant period for the case where there is established and continuing letting. It follows the source legislation (in section 504(5)(c) of ICTA) by putting the general rule covering what is likely to be the most common case, last. This is because the company still needs to read the first two rules to know whether it falls within the general rule.

Clause 267: Meaning of “qualifying holiday accommodation”

958. This clause sets out the additional tests the letting must satisfy to qualify for the special treatment. It is based on section 504(3) and (5) of ICTA. The corresponding rule for income tax is in section 325 of ITTOIA.

959. *Subsection (1*), which is based on section 504(3), introduces the term “qualifying holiday accommodation” and defines it by reference to the three conditions that are set out in the subsequent subsections.

960. Subsection 504(3) of ICTA is particularly complex. The three tests it imposes in paragraphs (a) to (c) are referred to in the subsequent subsections of this clause as, respectively, the “availability”, “letting” and “pattern of occupation” conditions. If all three are met, the accommodation is “qualifying holiday accommodation”.

961. *Subsections (4)* to *(6)* are based on section 504(3)(c) of ICTA. Section 504(3)(c) of ICTA is particularly ambiguous and this clause seeks to reduce that ambiguity. The approach differs from that in the source legislation and involves a change that alters the period during which, in order to qualify for the special treatment, the accommodation must not be occupied for more than 31 days at a time. See *Change 51* in Annex 1.

Clause 268: Under-used holiday accommodation: averaging elections

962. This clause allows accommodation that would be "qualifying holiday accommodation", were it not simply for insufficient actual letting, nevertheless to qualify if, *on average*, the letting condition in clause 267(3) is met. It is based on section 504(6) to (8) of ICTA. The corresponding rule for income tax is in section 326 of ITTOIA.

963. *Subsection (1)* introduces a new term, "under-used accommodation", to denote this accommodation.

964. *Subsection (4)* introduces a change. This changes the period over which lettings are averaged for the purpose of treating infrequently let property as qualifying holiday accommodation from the accounting period to the relevant period (as defined in clause 266). See *Change 52* in Annex 1.

Clause 269: Capital allowances and loss relief

965. This clause provides for separate calculations in order to give effect to the tax advantages of qualifying holiday lettings. It is new. The corresponding rule for income tax is in section 327 of ITTOIA.

966. There is no explicit requirement for separate furnished holiday lettings calculations in section 503 of ICTA. But it is clearly not possible to give effect to the special corporation tax treatments available to furnished holiday lettings without separating out the relevant income and expenditure. Requiring, where appropriate, separate calculations makes explicit what is only implicit in section 503 of ICTA.

967. This clause provides a mechanism to ensure that the special rules that can give tax advantages in respect of these lettings work properly and clearly in the context of a UK property business of which the furnished holiday lettings is part: the profit from such lettings must be identified separately but only when there is a practical need to do so.

Chapter 7: Rent receivable in connection with a UK section 39(4) concern
Overview

968. This Chapter charges as property income rent receivable in connection with a section 39(4) concern. It also provides for certain deductions and reliefs to be given from that income.

969. This Chapter makes the relationship between the rules derived from sections 119 (rent payable in connection with mines, quarries and similar concerns) and 122 (relief in respect of mineral royalties) of ICTA clear. So section 201(2) of TCGA (mineral leases: royalties) is omitted, see Part 2 of Schedule 1 to this Bill.

Clause 270: Charge to tax on rent receivable in connection with a UK section 39(4) concern

970. This clause applies the charge to corporation tax to rent receivable in connection with a "UK section 39(4) concern". It is based on section 119 of ICTA. The corresponding rule for income tax is in section 335 of ITTOIA.

971. The loss regime in section 396 of ICTA applies to income charged under this Chapter and not the regime in section 392A of ICTA.

972. The charge under Schedule D Case III imposed by section 119(2) of ICTA is not rewritten. It is otiose. See *Change 53* in Annex 1. This Change reproduces Change 158 in ITTOIA in relation to section 119(2) of ICTA and so brings the income and corporation tax codes back into line.

Clause 271: Meaning of "rent receivable in connection with a UK section 39(4) concern"

973. This clause clarifies:

- what is meant by "UK section 39(4) concern";
- what is meant by "rent"; and
- when rent is treated as "receivable in connection with" such a concern.

974. It is based on section 119 of ICTA. The corresponding rules for income tax are in section 336 of ITTOIA.

975. *Subsection (1)* identifies when rent is receivable in connection with a "UK section 39(4) concern". It uses the language of clause 207(1) (meaning of "generating income from land") to rewrite the phrase "in respect of any land or easement" in section 119(1) of ICTA. Clause 207 is based on paragraph 1(1) of Schedule A (section 15(1) of ICTA). The concept in clause 207 of "generating income from land" serves to determine the scope of Schedule A. The approach in this clause assumes that the income taxed by section 119 of ICTA would otherwise have been taxed under Schedule A.

976. The justification for this assumption is that section 119 of ICTA can have no application to income that is already taxed under Schedule D Case VI. Neither is there any question that the rent would go untaxed if it were not for section 119 of ICTA. Rents are clearly annual profits or gains as described in Schedule D Case VI of ICTA. The effect of section 119 of ICTA is to take income that would be taxed under Schedule A and tax it under Schedule D. So in identifying the scope of the charge it is possible to use the ordinary property business definitions and avoid the need to rewrite the complicated definitions of "easement" and "rent" in section 119(3) of ICTA.

977. The section makes explicit a territorial restriction to the United Kingdom that is implicit in section 119(1) of ICTA. If a "UK section 39(4) concern" is located outside the United Kingdom it would be a foreign possession for the purposes of the charge under Schedule D Case V. Any income arising from such a possession would have been taxed under Schedule D Case V. Section 119 of ICTA could have had no application to income that was already taxed under Schedule D.

978. *Subsection (3)* provides the definition of rent. It is based on section 119(3) of ICTA. As explained in the commentary on subsection (1), this clause is based on the assumption that the rents taxed by section 119 of ICTA would otherwise have been taxed under Schedule A. This means it is not necessary to reproduce the definition of "rent" in section 119(3) of ICTA.

Clause 272: Deduction for management expenses of owner of mineral rights

979. This clause allows a deduction for the expenses of managing mineral rights. It is based on section 121 of ICTA. The corresponding rule for income tax is in section 339 of ITTOIA.

980. *Subsection (1)* sets out the conditions for the clause to apply. It does not reproduce the condition that the expenses must be incurred "necessarily". See *Change 54* in Annex 1. The "necessarily" test is impractical in this context. This change reproduces Change 78 in ITTOIA and so brings the income and corporation tax codes back into line.

981. *Subsection (2)* provides that a deduction is allowed for the qualifying expenses paid in the accounting period. This rewrites the requirement that the expenses are "disbursed" in the period.

982. The relief applies only to rents received from a "UK section 39(4) concern". If the income is taxed as income from a UK property business there is no need for special rules identifying what deductions are allowable. The normal rules apply.

Clause 273: Relief in respect of mineral royalties

983. This clause provides that only half of the net profit earned in respect of mineral royalties is charged to corporation tax. It is based on section 122 of ICTA. The other half of the net profit is charged to corporation tax on chargeable gains by section 201 of TCGA. The corresponding rule for income tax is in section 340 of ITTOIA.

984. *Subsection (1)* limits the relief to royalties taxed under this Chapter of this Bill. If the royalty is not taxed under this Chapter the same relief is given by clause 135 or clause 258.

Clause 274: Meaning of "mineral lease or agreement" and "mineral royalties"

985. This clause defines various terms used in clause 273. It is based on section 122 of ICTA. The corresponding rules for income tax are in section 341 of ITTOIA.

986. Clause 291 includes a definition of "lease" that applies for the purposes of this Part. It is based on section 24 of ICTA, which applies for the purposes of Schedule A in the source legislation. Because the definition applies only for Schedule A in strictness it does not extend to the income taxed under clause 273. But the definition of "mineral lease or agreement" in section 122(6) of ICTA applies to any agreement conferring a right to win and work minerals in the United Kingdom. Such an agreement would also satisfy the definition in section 24 of ICTA so there is no change in the law.

987. The legislation rewritten by *subsection (2)* does not include any rent receivable before 6 April 1970. This limitation is preserved in Schedule 2 (transitionals and savings).

Clause 275: Extended meaning of "mineral royalties" etc in Northern Ireland

988. This clause modifies the definition of "mineral royalties" to deal with the different rules that apply to the ownership of mineral rights in Northern Ireland. It is based on section 122 of ICTA. The corresponding rule for income tax is in section 342 of ITTOIA.

989. The right to win, and win and work, most minerals in Northern Ireland is vested in the Department of Enterprise, Trade and Investment (DETI). The DETI will grant licences to work the minerals and make compensatory payments to the former owners of the mineral rights under various Acts of the Northern Ireland Parliament. This clause treats those payments as mineral royalties for the purposes of clause 273.

Clause 276: Power to determine what counts as "mineral royalties"

990. This clause allows the Commissioners to make regulations concerning the application of the relief in clause 273. It is based on section 122 of ICTA. The corresponding rule for income tax is in section 343 of ITTOIA. Any regulations made under this power would apply also to clauses 135 and 258 through clauses 135(3) and 258(3).

Chapter 8: Rent receivable for UK electric-line wayleaves

Overview

991. This Chapter rewrites the Schedule D Case VI charge on rent received for a wayleave granted in the United Kingdom. It is based on section 120 of ICTA.

992. If a landowner receives rent for a UK electric-line wayleave section 120 of ICTA provides that:

- the rent is charged under Schedule A if the landowner receives other rent in respect of the same land; otherwise

- the rent is charged under Schedule D.

993. In practice this meant that if the landowner carries on a trade on the land the rent can be treated as a trade receipt. Otherwise the rent was taxed under Schedule D Case VI.

994. Section 396 of ICTA gives the rules for dealing with Schedule D Case VI losses. In order to preserve that loss regime it is necessary to isolate the income that ICTA charges under Schedule D Case VI.

Clause 277: Charge to tax on rent receivable for a UK electric-line wayleave

995. This clause applies the charge to corporation tax to rent receivable for a UK electric-line wayleave. It is based on section 120 of ICTA. The corresponding rule for income tax is in section 344 of ITTOIA.

Clause 278: Meaning of "rent receivable for a UK electric-line wayleave"

996. This clause provides the definition of "rent receivable for a UK electric-line wayleave". It is based on section 120 of ICTA. The corresponding rule for income tax is in section 345 of ITTOIA.

997. Section 120(1) of ICTA identifies the right in respect of which the rent is payable as an "easement". Section 120(5) of ICTA cross-refers to the definition of "easement" in section 119(3) of ICTA. Section 119 of ICTA is rewritten in Chapter 7 of this Part. As explained in the commentary on clause 45 both this Chapter and clause 45 use the term "wayleave" to describe the right in respect of which the rent is received. In practice this is how most of the payments covered by this clause are usually described. But the generality of the words in section 119(3) of ICTA has not been lost. The clause also uses the Scottish term for "easement", "servitude".

998. *Subsection (2)* clarifies the meaning of "electric, telegraph or telephone wire or cable". It does not repeat the reference to "transformer" in the source legislation. In its context it is clear that "apparatus" would include "transformer".

Clause 279: Extent of charge to tax

999. This clause sets out the two exceptions under which the rent received in respect of a UK electric-line wayleave is not taxed under this Chapter. It is based on section 120 of ICTA. The corresponding rule for income tax is in section 346 of ITTOIA.

1000. *Subsections (1)* and *(2)* deal with the case in which the company receives other rent in respect of the land except rent from another wayleave. The rent from the wayleave is taxed as property income.

1001. *Subsections (3)* and *(4)* deal with the case in which the company carries on a trade on the land. See *Change 6* in Annex 1 and the commentary on clause 45. The rent may be taxed as a trade receipt.

Chapter 9: Post-cessation receipts

Overview

1002. This Chapter applies the rules about post-cessation receipts to UK property businesses, broadly as they apply to trades. The main rules for trades are in Chapter 15 of Part 3 of this Bill. The application of the rules to property businesses is based on section 21B of ICTA, which specifically mentions sections 103 to 106 of ICTA.

1003. Although the post-cessation receipt rules apply to a Schedule A business, they do so by virtue of section 21B of ICTA. That section deals with "other rules applicable to Case I of Schedule D". On the other hand, section 21A of ICTA deals with rules about the computation of profits of a trade. So section 70A of ICTA imports only the computation rules in section 21A and the post-cessation receipt rules do not apply to an overseas property business.

1004. A property business cannot have trading stock. So clause 195 (transfer of trading stock) does not have a corresponding rule in this Chapter.

1005. The following trading income rules apply to property businesses but are not in separate clauses in this Chapter:

- clauses 192 and 193: rules about debts (these rules are applied by clause 283(2)); and

- clauses 196 and 197: allowable deductions (these rules are applied by clause 285).

Clause 280: Charge to tax on post-cessation receipts

1006. This clause applies the corporation tax charge on income to post-cessation receipts. It is based on sections 103 and 104 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 349 of ITTOIA.

Clause 281: Extent of charge to tax

1007. This clause restricts the charge on the post-cessation receipts. It is based on sections 103 and 104 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 350 of ITTOIA.

Clause 282: Basic meaning of "post-cessation receipt"

1008. This clause defines post-cessation receipts of a UK property business. It is based on sections 103, 104 and 110 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 353 of ITTOIA.

1009. *Subsection (2)* explains that a person permanently ceases to carry on a UK property business if:

- a company ceases to be within the charge to income tax in respect of the UK property business; or

- a company or any other person ceases to be a member of a firm which carries on a UK property business.

Clause 283: Other rules about what counts as a "post-cessation receipt"

1010. This clause brings together signposts to rules that operate so as to treat certain sums as post-cessation receipts and to exclude others from the charge. It is new. The corresponding rule for income tax is in section 354 of ITTOIA.

1011. *Subsection (1)* is a signpost to the clause that deals with the transfer of a right to receive a post-cessation receipt to a person who does not carry on a UK property business.

1012. *Subsection (2)* lists the trading income rules that apply to create post-cessation receipts for the purpose of this Chapter.

1013. *Subsection (3)* draws attention to the rule in Chapter 5 of this Part that treats a sum received as not being a post-cessation receipt if the right to it was transferred with a property business. It also mentions the rule in Part 18 of this Bill that treats profits of an overseas property business as post-cessation receipts (of a UK property business) if they become remittable after the company has ceased to carry on the business.

Clause 284: Transfer of rights if transferee does not carry on UK property business

1014. This clause sets out the positions of the transferor and transferee if the right to a post-cessation receipt is transferred for value. It is based on section 106 of ICTA, as applied by section 21B of ICTA. The corresponding rule for income tax is in section 355 of ITTOIA.

Clause 285: Allowable deductions

1015. This clause applies the trading income rules about allowable deductions. It is based on section 105 of ICTA, as applied by section 21B of ICTA.

Clause 286: Election to carry back

1016. This clause allows a company to elect to have a post-cessation receipt taxed as though it had been received in the accounting period in which the company ceased to carry on the UK property business. It is based on section 108 of ICTA, as applied by section 21B of ICTA, although section 108 was repealed by ITTIOA. The corresponding rule for income tax is in section 257 of ITTOIA, as applied by section 351(2)(b) of ITTOIA.

1017. See *Change 42* in Annex 1 and the commentary on clause 198.

Chapter 10: Supplementary

Clause 287: Provisions which must be given priority over this Part

1018. This clause provides the rules to determine which Part takes priority in the event of any overlap of the charge on the profits of a trade and the charge on the profits of an overseas property business or the charge under Chapter 7 or 8 of this Part. It is based on sections 18 and 70A of ICTA.

1019. The definitions of Schedule D Cases I and VI are in section 18 of ICTA. Those definitions deal with any overlap between a trade and the profits of a UK concern or the profits of a UK electric line wayleave. Case VI charges income that is not charged under any other case. So this clause gives trading income (Case I in the source legislation) priority.

1020. The clause also gives statutory effect to the Crown Option between an overseas property business and a United Kingdom trade. See *Change 55* in Annex 1. The corresponding rules for income tax are in section 261 of ITTOIA.

Clause 288: Priority between Chapters within this Part

1021. This clause gives an order of priority between Chapters 3, 7 and 8 of this Part. It is based on sections 119 and 120 of ICTA. The corresponding rules for income tax are in section 262 of ITTOIA.

1022. *Subsection (3)* deals with income that falls within both Chapter 7 and Chapter 8 of this Part. See *Change 6* in Annex 1 and the commentary on clause 45.

Clause 289: Effect of company starting or ceasing to be within charge to corporation tax

1023. This clause treats a company as starting or ceasing to carry on a property business in particular circumstances. It is based on section 337 of ICTA. The corresponding rule for income tax is in section 362 of ITTOIA.

1024. This clause applies when a company moves into or out of the corporation tax regime. Non-UK resident companies are within the charge to corporation tax only if they are trading, are trading in the United Kingdom, and through a permanent establishment in the United Kingdom. Then they are chargeable to corporation tax on all the profits attributable to that permanent establishment. If those profits include the profits of a property business, first meeting or ceasing to meet those conditions will result in a change of taxing regime from income tax to corporation tax or vice versa.

Clause 290: Overseas property businesses and overseas land: adaptation of rules

1025. This clause sets out how the rules for United Kingdom property businesses are to be adapted to apply to overseas property businesses. It is based on section 70A of ICTA. The corresponding rule for income tax is in section 363 of ITTOIA.

1026. The clause explains how to apply the UK property business rules if foreign property law does not correspond exactly with United Kingdom property law.

Clause 291: Meaning of "lease" and "premises"
1027. This clause is interpretative. It is based on section 24(1) of ICTA. The corresponding rule for income tax is in section 364 of ITTOIA.

Part 5: Loan Relationships
Overview
1028. This overview deals with Parts 5 and 6.

1029. This and the following Part contain provisions on loan relationships. The extent of the legislation merits two Parts.

1030. A company has a loan relationship when it stands in the position of a creditor or debtor in respect of a money debt which is a transaction for the lending of money. The rules dealing with loan relationships are found in this Part. This Part is based mainly on Chapter 2 of Part 4 of FA 1996, which brings into account for corporation tax purposes all gains and losses arising to a company from its loan relationships.

1031. Other arrangements which are treated as loan relationships such as debt which does not involve the lending of money, finance arrangements that do not involve the payment or receipt of interest, particular share issues, repurchase agreements etc are found in Part 6. The source legislation for this Part is sometimes found outside FA 1996.

1032. Although the rules for computing the credits and debits on loan relationships used for the purposes of a trade are within this Part, the credits are treated as receipts and the debits as expenses in computing the trading profits within Part 3 of the Bill. Profits on loan relationships that are not used for the purposes of a trade are charged under this Part. The charge on such profits is separate from the charge on trading profits.

1033. Losses on non-trading loan relationships (where debits exceed credits) are relieved against company profits.

1034. Profits on derivative contracts which are not used for the purposes of a trade are charged as if they were gains on loan relationships, but the rules for computing such profits are to be found in the Part 7 (derivative contracts) of this Bill. Losses on such derivatives are also dealt with as if they were losses on a loan relationship.

1035. Provisions on capital gains within the loan relationships provisions have not been rewritten in this Part or Part 6 but are inserted into TCGA by Schedule 1.

Chapter 1: Introduction
Overview
1036. This Chapter acts as an introduction to this Part. It sets out the structure of the Part and the way in which credits and debits on a loan relationship are brought into account in the case of both trading and non-trading loan relationships.

Clause 292: Overview of Part

1037. This clause provides an overview of the Part. It is new.

1038. *Subsection (1)* refers only to "profits" on a loan relationship and not "profits and gains" as does the source legislation. This has been followed throughout the Part on the ground that only one term is necessary. "Profits" has been adopted as being the usual taxation term and as making the link to case law on profits for corporation tax purposes clearer for the two Parts.

1039. The term "loan relationship" has been retained for its familiarity although the term is not as appropriate now as it was when the source legislation was enacted in 1996. The provisions now apply to a number of relationships which are not "loans".

Clause 293: Construction of references to profits or losses from loan relationships

1040. This clause provides that profits and losses from loan relationships include profits and losses from related transactions. It is based on section 84(1) of FA 1996. The inclusion of related transactions avoids the repetition of the source legislation ("gains and losses on loan relationships and related transactions, etc").

Clause 294: Matters treated as loan relationships

1041. This clause requires references to this Part of the Bill to include references to Part 6 and arises from the decision to spread the loan relationships provisions over two Parts of the Bill. It is new.

Clause 295: General rule: profits arising from loan relationships chargeable as income

1042. This clause provides the basic rule that all profits on loan relationships are charged as income. It is based on section 80(1) of FA 1996.

Clause 296: Profits and deficits to be calculated using credits and debits given by this Part

1043. This clause is based on section 82(1) of FA 1996.

Clause 297: Trading credits and debits to be brought into account under Part 3

1044. This clause explains how debits and credits are to be treated where a loan relationship is used for the purposes of a trade. It is based on sections 80(2) and 82(2) and (7) of FA 1996.

Clause 298: Meaning of trade and purposes of trade

1045. This clause explains what is meant by a company being a party to a creditor relationship for the purposes of a trade. It is based on section 103(2) and (3) of FA 1996.

Clause 299: Charge to tax on non-trading profits

1046. This clause brings the company into charge to corporation tax on its non-trading profits. It is based on sections 9(1) to (3), 18(1) to (3) and 582(2) of ICTA and section 80(1) and (3) of FA 1996. See *Change 59* in Annex 1 under clause 413 in respect of the Schedule D Case VI charge in section 582(2) of ICTA.

Clause 300: Method of bringing non-trading deficits into account

1047. This clause explains how non-trading deficits on loan relationships are brought into account. It is based on section 80(4) of FA 1996.

Clause 301: Calculation of non-trading profits and deficits from loan relationships: non-trading credits and debits

1048. This clause explains the use of the terms "non-trading credits" and "non-trading debits" in respect of loan relationships which are not used for the purposes of a trade and provides the rules for set-offs between the two. It is based on section 82(1) and (3) to (6) of FA 1996.

Chapter 2 Basic definitions

Overview

1049. This Chapter provides definitions for this Part and Part 6.

Clause 302: "Loan relationship", "creditor relationship", "debtor relationship"

1050. This clause defines three important terms used in the two Parts. It is based on sections 81(1) and 103(1) of FA 1996.

Clause 303: "Money debt"

1051. This clause defines "money debt" for the purposes of the definition of a loan relationship in clause 302 and elsewhere. It is based on section 81(2) to (4) of FA 1996.

1052. Section 81(6) which states that "money" includes money expressed in a currency other than sterling is unnecessary and has not been rewritten. "Money", in its usual meaning, already includes currencies other than sterling.

Clause 304: "Related transaction"

1053. This clause explains what is meant by a "related transaction". It is based on section 84(5) and (6) of FA 1996.

Clause 305: Payments, interest, rights and liabilities under a loan relationship

1054. This clause explains what is meant by these terms. It is based on section 81(5) of FA 1996.

Chapter 3: The credits and debits to be brought into account: general

Overview

1055. This Chapter provides the rules for bringing profits and deficits on loan relationships into account for corporation tax purposes. The provisions in this Chapter all represent rules that apply generally rather than to specific types of securities or specific types of companies. They have therefore been placed early on in the Part.

Clause 306: Overview of Chapter

1056. This clause provides an overview of the Chapter, explains the purpose of the clauses within the Part and signposts other relevant Chapters. It is new.

Clause 307: General principles about the bringing into account of credits and debits

1057. This clause provides the rule that credits and debits are those recognised in determining the company's profit and loss for a period and must fairly represent profits and losses from loan relationships and also gives further rules on allowable expenses. It is based on section 84(1) and (3) and 85A(1) of FA 1996.

1058. *Subsections (3)(c)* and *(4)* allow certain expenses on loans to be treated as debits for the purposes of this Part.

1059. The inclusion of profits of a capital nature in section 84(1)(a) of FA 1996 is rewritten in clause 293(3).

Clause 308: Amounts recognised in determining a company's profit or loss

1060. This clause explains what is meant by amounts recognised in determining a company's profit or loss account for a period. It is based on section 85B(1) and (2) of FA 1996.

1061. This clause updates the references in section 85B(1)(a) and (b) of FA 1996 to a company's statement of income and gains, etc in line with current accountancy practice.

1062. Accounting terms appearing more than once are included in clause 476 (other definitions). "Profit and loss account" (*subsection (1)(a)*) and "prior period adjustment" (*subsection (2)*) appear here only and take their ordinary accountancy meaning.

1063. *Subsection (1)(b)* rewrites "statement of recognised gains and losses" as "statement of total recognised gains and losses" as being the usual accountancy term.

1064. "Generally accepted accounting principles" appears in the Schedule 4 to this Bill.

1065. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals section 85B(6) of FA 1996 with effect from a date to be appointed.

Clause 309: Companies without GAAP-compliant accounts

1066. This clause gives the rule to be applied where accounts have not been prepared in accordance with generally accepted accounting practice. It is based on section 85A(2) to (4) of FA 1996 and paragraph 14(8) of Schedule 13 to FA 2007.

1067. "Correct accounts" in section 85A(2) has been rewritten as "GAAP-compliant accounts" in *subsection (1)* as being a more neutral term.

Clause 310: Power to make regulations about recognised amounts

1068. This clause gives powers to make regulations affecting clause 308. It is based on section 85B(3) to (6) of FA 1996 and paragraph 52 of Schedule 4 to FA 2005.

1069. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals section 85(6) of FA 1996 with effect from a day to be appointed. *Subsection (5)*, which rewrites section 85B(6) of FA 1996, will therefore cease to have effect from an appointed day (see Part 8 (loan relationships) of Schedule 2 to the Bill).

Clause 311: Amounts not fully recognised for accounting purposes: introduction

1070. This clause sets out the circumstances in which clause 312 applies. It is based on section 85C(1) and (2) of FA 1996. This and the following clause apply where, as a result of GAAP (generally accepted accounting practice), the full amount arising on transactions is not brought into account. This can arise in two circumstances: first where assets and liabilities are "matched" and GAAP permits the whole or part of the income arising on those assets to be "derecognised" and second where there is a capital contribution and the company is not treated as a party to a debtor relationship or as having a recognised accounting liability.

Clause 312: Determination of credits and debits where amounts not fully recognised

1071. This clause gives the rule to be applied where the circumstances in the preceding clause are in point and requires credits and debits arising on transactions which are not recognised in determining the company's profit or loss to be recognised. It is based on section 85C(3) to (8) of FA 1996.

Clause 313: Basis of accounting: "amortised cost basis", "fair value accounting" and "fair value"

1072. This clause deals with the accounting bases that may apply to loan relationships. It is based on section 85A(1) and section 103(1) of FA 1996.

1073. In general a company may make use of either an amortised cost basis or fair value in accounting for loan relationships (both these terms are defined in the clause) but certain provisions specify that an amortised cost basis or fair value basis must be used. These are listed in *subsection (2)*.

Clause 314: Power to make regulations about changes from amortised cost basis
1074. This clause provides the powers for the Treasury to make regulations providing for the continued use of an amortised costs basis. It is based on section 90A(1) and (2) of FA 1996.

Clause 315: Introduction to sections 316 to 319
1075. This clause acts as an introduction to the following four clauses which provide the rules to apply where there is a change in accounting policy from one period of account to the next. It is based on paragraph 19A(1) and (2) of Schedule 9 to FA 1996.

1076. Although this provision was enacted specifically to deal with companies changing from UK GAAP to international accounting standards or *vice versa* it will apply equally to other changes where both policies accord with the law and practice.

Clause 316: Change of accounting policy involving change of value
1077. This clause requires debits or credits to be brought into account representing the difference between the value of the asset or liability at the end of the last period of account under the old accounting policy and the beginning of the first period under the new accounting policy. It is based on paragraph 19A(3) and (5) of Schedule 9 to FA 1996.

Clause 317: Carrying value
1078. This clause gives the meaning of terms used in the previous clause. It is based on paragraph 19A(4), (4A) and (4B) of Schedule 9 to FA 1996.

Clause 318: Change of accounting policy following cessation of loan relationship
1079. This clause provides for debits and credits representing differences in the value of assets and liabilities following a change of accounting policy to be brought into account where clause 331 (company ceasing to be party to a loan relationship) also applies. It is based on paragraph 19A(4C) to (5) of Schedule 9 to FA 1996.

1080. Sub-paragraph (4C) of paragraph 19A provides for the difference between the two values to be brought into account *at the beginning* of the later period. This is not rewritten as it is unnecessary. This brings the clause into line with paragraph 50A(3C) of Schedule 26 to FA 2002, the equivalent provision for derivative contracts.

Clause 319: General power to make regulations about changes in accounting policy
1081. This clause gives the Treasury powers to make regulations providing for debits and credits to be brought into account or not to be brought into account under this Part where a change of accounting policy affects the amounts brought into account for accounting purposes. The clause is based on paragraph 19B of Schedule 9 to FA 1996 and paragraph 52 of Schedule 4 to FA 2005.

Clause 320: Credits and debits treated as relating to capital expenditure
1082. This is the first of several clauses which require debits and credits to be brought into, or not brought into, account for the purposes of this Part where normal accounting treatment is not followed. It is based on paragraph 14 of Schedule 9 to FA 1996. This clause provides that a credit or debit which has been capitalised but which is in respect of a loan relationship is, in certain circumstances, to be brought into account.

1083. The words "for the purposes of corporation tax" in paragraph 14(2) have been rewritten in *subsection (2)* more narrowly as "for the purposes of this Part", the wider purpose being unnecessary in this context.

1084. In *subsection (6)* "the interest component of the asset" is the interest element capitalised with the relevant asset.

Clause 321: Credits and debits recognised in equity
1085. This clause provides that credits and debits on loan relationships taken directly to reserves should be brought into account as if they were taken to the profit and loss account. It is based on paragraph 14A of Schedule 9 to FA 1996.

Clause 322: Release of debts: cases where credits not required to be brought into account
1086. This clause provides that credits are not brought into account by a debtor company on the release of the debt when an amortised cost basis is used and certain conditions are met. It is based on paragraph 5(3), (4), (7) and (8) of Schedule 9 to FA 1996.

1087. Conditions 2 and 3 of paragraph 5 of Schedule 9 to FA 1996 apply only where the debtor and creditor companies are connected and are rewritten in clauses 358 and 359 in Chapter 6 of this Part (connected companies relationships: impairment losses and releases of debts).

1088. *Subsection (6)* lists the insolvency conditions from paragraph 6A(1) of Schedule 9 to FA 1996 rather than cross-referring as does paragraph 5(7).

Clause 323: Meaning of expressions relating to insolvency etc
1089. This clause gives the meaning of various terms relevant to the preceding clause. It is based on paragraphs 5(7) and 6A(3) to (5) of Schedule 9 to FA 1996.

1090. References to Northern Ireland legislation in this clause have been updated to take into account amendments made by the Insolvency (Northern Ireland) Order 2005 (SI 2005/1455 (NI10)).

Clause 324: Restriction on debits resulting from revaluation
1091. This clause precludes debits from being brought into account on revaluation of assets representing creditor relationships for the purposes of this Part (other than

impairment losses or debt releases on the revaluation of asset) unless under fair value accounting. It is based on paragraph 6D(1) and (3) to (5) of Schedule 9 to FA 1996.

Clause 325: Restriction on credits resulting from reversal of disallowed debits

1092. This clause provides that the reversal of debits disallowed under the previous clause are not brought into account under this Part. It is based on paragraph 6D(2) and (5) of Schedule 9 to FA 1996.

Clause 326: Writing off government investments

1093. This clause provides that no credit need be brought into account where the government releases a liability on a government debt. It is based on paragraph 7 of Schedule 9 to FA 1996.

Clause 327: Disallowance of imported losses etc

1094. This clause ensures that no part of a loss on a loan relationship is brought into account if it arose at a time when the loan relationship was not subject to United Kingdom taxation. It is based on paragraph 10 of FA 1996.

Clause 328: Exchange gains and losses

1095. This clause includes exchange gains and losses within credits and debits on loan relationships. It is based on section 84A(1) to (3A) and (8) to (10) of FA 1996.

1096. This clause updates the references in section 84A(3)(b) of FA 1996 in line with current accountancy practice.

1097. *Subsection (3)(b)* rewrites “statement of recognised gains and losses” as “statement of total recognised gains and losses” as being the usual accountancy term.

1098. Section 84A(8) of FA 1996 as it applies to chargeable gains (section 84A(9)(b)) is rewritten as an insertion into TCGA. See Schedule 1 to this Bill.

1099. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals section 84A of FA 1996 with effect from a day to be appointed. This clause, which rewrites that section, therefore ceases to have effect from an appointed day (see Schedule 2 to this Bill).

Clause 329: Pre-loan relationship and abortive expenses

1100. This clause allows abortive expenditure in connection with a loan relationship. It is based on section 84(4) of FA 1996.

Clause 330: Debits in respect of pre-trading expenditure

1101. This clause provides for an election to be made for non-trading debits incurred before the commencement of a trade to be treated as trading debits after that trade has commenced. It is based on section 401(1AB) and (1AC) of ICTA.

Clause 331: Company ceasing to be party to loan relationship

1102. This clause provides for debits and credits to be taken into account in respect of a loan relationship to which a company is no longer a party if those debits and credits have not already been fully taken into account. It is based on section 103(6) to (8) of FA 1996.

Clause 332: Repo, stock lending and other transactions

1103. This clause provides that where a company ceases to be party to a loan relationship in any period (whether as a result of a repo or otherwise) but continues in accordance with GAAP to recognise amounts in its accounts in respect of that relationship the company must bring those amounts into account. It is based on paragraph 15 of Schedule 9 to FA 1996.

Clause 333: Company ceasing to be UK resident

1104. This clause provides that a company ceasing to be resident in the United Kingdom is treated as disposing of assets and liabilities which represent loan relationships at fair value unless they are held or owed by a permanent establishment in the United Kingdom. It is based on paragraph 10A(1) to (3) of Schedule 9 to FA 1996.

Clause 334: Non-UK resident company ceasing to hold loan relationship for UK permanent establishment

1105. This clause provides for a deemed disposal for fair value where an asset or liability representing a loan relationship of a non-UK resident company ceases to be held or owed by a permanent establishment in the United Kingdom other than as a result of a disposal etc. It is based on paragraph 10A(1), (1A) and (4) of Schedule 9 to FA 1996.

Chapter 4: Continuity of treatment on transfers within groups or on reorganisations

Overview

1106. This Chapter sets out what happens when a loan relationship is transferred between members of a group and on a reorganisation.

Clause 335: Introduction to Chapter

1107. This clause acts as an introduction by setting out the three cases under which the continuity of treatment provisions in the Chapter apply and explaining how the Chapter is organised. It is based on paragraphs 12(1) and (8) and 12G(1) and (4) of Schedule 9 to FA 1996.

Clause 336: Transfers of loans on group transactions

1108. This clause specifies the transfers within the first case in clause 335(1) where the continuity rules of the Chapter apply – transfers between group members. It is based on paragraph 12(1) and (3) of Schedule 9 to FA 1996.

Clause 337: Transfers of loans on insurance business transfers

80 This clause specifies the transfer within the second case in clause 335(1) where the continuity rules of the Chapter apply. It is based on paragraph 12(1), (4) and (5) of Schedule 9 to FA 1996.

81 In *subsection (6)(b)* "corresponding category" means the category of asset in section 440(4) of ICTA as modified by regulation 11(3) of The Overseas Life Insurance Companies Regulations 2006 (SI 2006/3271).

Clause 338: Meaning of company replacing another as party to loan relationship

1109. This clause explains what is meant by one party replacing the other as a party to a loan relationship for the purposes of clause 335. It is based on paragraph 12(6) to (7A) of Schedule 9 to FA 1996.

1110. *Subsections (3)* and *(4)* deal with the position where a company replaces another company as a creditor and *subsections (5)* and *(6)* where it replaces the other company as a debtor. The debtor rules will apply where a company has borrowed money but substitutes another group company as the debtor by novating the debt.

Clause 339: Issues of new securities on certain cross-border reorganisations

1111. This clause sets out the third case in clause 335(1) where the continuity rules of the Chapter apply. This case is where section 135(3) of TCGA (exchange of securities for those in another company) applies (or would do but for section 116(5) of that Act) and certain conditions are met. It is based on paragraphs 12G(1), (3) and (6) and 12J(2) of Schedule 9 to FA 1996.

Clause 340: Group transfers and transfers of insurance business: transfer at notional carrying value

1112. Under this clause any gain or loss is disregarded where, as a result of a transaction or series of transactions referred to in clause 335(1)(a) and (b) 335, one company replaces another as a party to a loan relationship. It is based on paragraph 12(1), (2ZA), (2), (2C) and (9) of Schedule 9 to FA 1996. The clause provides that the transaction or series of transactions take place at book value ("carrying value").

1113. The rules in this clause regarding the bringing into account of debits and credits apply only where the company being replaced as party to the loan relationship accounts for the relationship under the amortised cost basis. Clause 341 provides rules for where the company being replaced as a party to the loan relationship uses fair value accounting.

Clause 341: Transferor using fair value accounting

1114. This clause applies where the company making the transfer under clause 340 uses fair value accounting as respects the loan relationship or the debits and credits to be brought into account rather than the amortised cost basis. It is based on 12(2A) to (2C) of Schedule 9 to FA 1996.

1115. The company which is being replaced as a party to the loan relationship brings in the asset or liability at fair value. The company becoming a party to the loan relationship is treated as acquiring the asset or liability for the same value it has in the accounts of the company being replaced.

Clause 342: Issues of new securities on reorganisations: disposal at notional carrying value
1116. This clause provides that where clause 339 applies (the third case in clause 335(1)), debits and credits are to be brought into account as if there were a disposal of the loan relationship at its carrying value in the accounts. It is based on clause 12G(1) and (3) to (5) of Schedule 9 to FA 1996.

Clause 343: Receiving company using fair value accounting
1117. This clause provides the rule to apply in place of the rule in clause 342 where fair value accounting is used by the company to which the issue of shares or debentures is made. It is based on paragraph 12G(5) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

Clause 344: Introduction
1118. This clause introduces the two following clauses and provides that they apply where a company leaves a group within six years and an asset or liability was transferred to that company in circumstances where clause 340 applies. It is based on paragraph 12A(1), (5), (5A) and (8) of Schedule 9 to FA 1996.

Clause 345: Transferee leaving group otherwise than because of exempt distribution
1119. This clause provides the first of the degrouping rules: where a company ceases to be a member of a group otherwise than as a result of an exempt distribution under section 213(2) of ICTA. It is based on paragraph 12A(1) to (5) and (9) of Schedule 9 to FA 1996. Because section 213 of ICTA is designed to facilitate demergers, there is no degrouping charge where that section applies to exempt a distribution of the company's shares. This clause deems there to have been a disposal and reacquisition at market value just before the company leaves the group and any resulting credit must be brought into account.

1120. *Subsection (4)* is designed to ensure parity of treatment between a loan relationship and a derivative contract that is being used to hedge it. The effect is to allow a debit on the loan relationship on deemed disposal if a credit is brought into account on the derivative contract.

Clause 346: Transferee leaving group because of exempt distribution
1121. This clause applies to bring in a charge, in certain circumstances, where one group member replaces another group member as a party to a loan relationship and ceases to be a group member as a result of an exempt distribution under section 213(2) of ICTA. It is based on paragraph 12A(3) to (9) of Schedule 9 to FA 1996.

1122. Where a company exploits a demerger for avoidance purposes by transferring within a five year period funds or assets to its members, a chargeable payment arises under section 214(2) of ICTA. Where such chargeable payments are made this clause treats the company as disposing of, and immediately reacquiring, the loan relationship at fair value when the chargeable payment is made.

Clause 347: Disapplication of Chapter where transferor party to avoidance

1123. This clause applies where an asset or liability is likely to be transferred by the transferee company and the continuity provisions applying for clauses 336 and 337 would otherwise apply. It is based on paragraph 12(2D) to (2F) of Schedule 9 to FA 1996. Where the transfer is under arrangements to which the transferor company is a party and the intention is to avoid tax, the continuity provisions of this Chapter which would otherwise apply do not.

Chapter 5: Connected companies relationships: introduction and general

Overview

1124. Connected companies loan relationships are subject to special rules under this Part. The Chapter explains what is meant by such a relationship, the accounting rules to apply to that relationship and what happens when a company begins or ceases to be a connected company.

Clause 348: Introduction: meaning of "connected companies relationship"

1125. This clause provides the meaning of "connected companies relationship". It is based on section 87(1), (3) and (5) of FA 1996.

1126. "Person" in section 87(1), (3) and (5) of FA 1996 has been rewritten as "company". See *Change 56* in Annex 1.

1127. Section 87(5) deals with intermediaries between two connected companies through which a loan is "dog-legged". Such intermediaries may be individuals. This has been rewritten in this clause by treating debtor and creditor relationships separately. Paragraph (b) of *subsections (2) and (4)* is necessary because loans between individuals do not fall into the definition of a loan relationship in section 81(1) of FA 1996.

1128. *Subsection (6)* brings out more clearly than in the source legislation (section 87(3) of FA 1996) that where there is a connection at any time in an accounting period there is a connected companies relationship for the whole of the period.

Clause 349: Application of amortised cost basis to connected companies relationships

1129. This clause provides that where a loan relationship is a "connected companies relationship" (the parties to a loan relationship are connected) both parties must use the same basis of accounting – the amortised cost basis rather than the fair value basis. It is based on section 87(1) and (2) of FA 1996. The same basis of accounting ensures both that the value of the loan cannot be artificially depressed and that debits in the one company are matched by credits in the other.

1130. In *subsection (2)* "for the period" has been added for clarification. The words do not appear in section 87(2) which this subsection rewrites.

1131. *Subsection (3)* makes the requirement for amortised cost basis subject to clause 454 (reset bonds) which requires fair value accounting to apply. See *Change 57* in Annex 1.

Clause 350: Companies beginning to be connected

1132. This clause provides the rule to be applied when companies begin to be connected under clause 348 and this involves a change in accounting basis from fair value accounting to the amortised cost basis. It is based on section 87(2A) and (2B) of FA 1996.

Clause 351: Companies ceasing to be connected

1133. This clause provides the rule to be applied when companies cease to be connected under clause 348 and this involves a change in accounting basis from the amortised cost basis to fair value accounting. It is based on section 87(2A) and (2C) of FA 1996.

Clause 352: Disregard of related transactions

1134. This clause provides that credits and debits in respect of related transactions are only brought into account where they do not create greater deductions or smaller credits than would have been the case if the transactions had not taken place. The clause is based on paragraph 6(1), (2) and (6) to (8) of Schedule 9 to FA 1996.

Chapter 6: Connected companies relationships: impairment losses and releases of debts

Overview

1135. This Chapter provides rules for impairment losses and release of debt where there is a connection between the debtor and creditor companies.

1136. Paragraph 5ZA of Schedule 9 to FA 1996 requires paragraphs 6, 6A and 6C of that Schedule to apply in relation to a debit in respect of the release of a liability as they apply in relation to an impairment loss. In rewriting these paragraphs references to a debt on the release of a liability (referred to here as a "release debit") have been inserted into the relevant clauses.

Clause 353: Introduction to Chapter

1137. This clause explains the subject and layout of the Chapter and provides some definitions. It is based on section 87(3) of, and paragraphs 4A(8), 5ZA and 6C(1) of Schedule 9 to, FA 1996.

Clause 354: Exclusion of debits for impaired or released connected companies debts

1138. This clause provides the basic rule that neither impairment losses nor debits arising as a result of the release of liability under a creditor relationship ("release debits") are brought into account if the debtor and creditor company are connected. It is based on paragraph 6(1) to (3) and (8) of Schedule 9 to FA 1996.

Clause 355: Cessation of connection

1139. This clause provides that debits for impairment losses or release debits which are not brought into account under the preceding clause are not to be brought into account in subsequent accounting periods after connection ceases. It is based on paragraph 6C(1) and (3) of Schedule 9 to FA 1996.

1140. Paragraph 6C(3) of Schedule 9 refers to a "debit …. in respect of an amount" although there is now no preceding reference in the paragraph to an amount. This reference was not repealed following an amendment by FA 2002. Sub-paragraph (1) previously read:

> (1) Where, in the case of a creditor relationship of a company,-
>
> (a) a departure that would otherwise have been allowed under paragraph 5(1) above in respect of <u>an amount</u> is or was, by virtue of paragraph 6 above, not allowed in the case of an accounting period; and
>
> (b) there is a subsequent accounting period for which there is, within the meaning of section 87 of this Act, no connection between the company and any person standing in the position of a debtor as respects the debt,
>
> sub-paragraphs (2) and (3) below shall apply.

1141. The paragraph has been rewritten to reflect the fact that "the amount" refers to the impairment loss (or release debit by virtue of paragraph 5ZA of Schedule 9).

Clause 356: Exception to section 354: swapping debt for equity

1142. This clause provides the first of two exceptions to the basic rule in clause 354. It is based on paragraph 6(4) and (5) of Schedule 9 to FA 1996. The exception in this clause applies when the liability is released in consideration for shares in the debtor company which give rise to the connection.

Clause 357: Exception to section 354: insolvent creditors

1143. This clause provides the second exception to the basic rule in clause 354. It is based on paragraph 6A(1) and (2) of Schedule 9 to FA 1996. The exception in this clause applies where the creditor is in insolvent liquidation, etc and the impairment loss or release debit accrues during the winding up, etc.

Clause 358: Exclusion of credits on release of connected companies debts: general

1144. This clause precludes a debtor company from bringing a credit into account under this Part on the release of a debt where the debtor and creditor companies are connected. It is based on paragraph 5(3) and (5) of Schedule 9 to FA 1996. This clause excludes the credits on the release since the debits have been disallowed (see clause 354).

1145. *Subsection (1)(b)* brings out the fact that the clause applies in respect of the accounting period in which the release occurs.

Clause 359: Exclusion of credits on release of connected companies debts during creditor's insolvency

1146. This clause precludes a debtor company from bringing a credit into account on the release of a debt where the creditor company meets the insolvency, etc conditions in clause 357 if the insolvency, etc breaks the connected company relationship. It is based on paragraph 5(3) and (6) of Schedule 9 to FA 1996.

1147. *Subsection (1)(d)* and *(e)* reflect the rule in section 12(7) and (7ZA) of ICTA that an accounting period ends with insolvency or administration.

Clause 360: Exclusion of credits on reversal of impairments of connected companies debts

1148. This clause provides that the credit on a reversed impairment loss is not brought into account under this Part where that loss is not brought into account under clause 354. It is based on paragraph 6(3A) and (8) of Schedule 9 to FA 1996.

Clause 361: Acquisition of creditor rights by connected company at undervalue

1149. This clause applies where a company acquires a debt from a third party as a result of which it becomes connected to the debtor. The clause is based on paragraph 4A of Schedule 9 to FA 1996. If the pre-acquisition value of the debt exceeds the consideration, the difference is treated as a release by the acquiring company and hence a charge on the debtor company.

1150. Under paragraph 4A(2)(d) the provisions of that paragraph do not apply where the new creditor acquires the debt from a connected person. "Person" has been rewritten in *subsection (1)(d)* to apply to a company only. See *Change 56* in Annex 1.

Clause 362: Parties becoming connected where creditor's rights subject to impairment adjustment

1151. Under this clause where a debtor company and a creditor company become connected, any reduction in the value of the debt as a result of an impairment loss which was not yet reflected in the book value of the debt at the time of acquisition is treated as a release by the creditor. It is based on paragraph 4A(1), (4), (5), (7) and (10) of Schedule 9 to FA 1996.

Clause 363: Companies connected for sections 361 and 362

1152. This clause explains what is meant by connected companies for the purposes of the two preceding clauses. It is based on paragraph 4A(8) and (9) of Schedule 9 to FA 1996.

1153. This definition differs from the definition for connectedness in clause 466 by its application to periods of account rather than accounting periods.

Chapter 7: Group relief claims involving impaired or released consortium debts
Overview

1154. This Chapter provides rules to prevent both a claim to group relief surrendered by a consortium company and debits for impairment losses on loans made to the consortium company. The purpose of these rather complex provisions is to prevent a claim to "double relief", ie in respect of both an impairment loss for the consortium member and a group relief claim surrendered by the consortium company. This situation would not arise in the case of companies within a group as a result of the rule in clause 354 which disallows impairment losses if the debtor and creditor companies are connected.

1155. Paragraph 5ZA of Schedule 9 to FA 1996 applies paragraph 5A, on which this Chapter is based, in relation to a debit in respect of the release of a liability as it applies in relation to an impairment loss. In rewriting these paragraphs in this Chapter references to a debit on the release of a liability (referred to here as a "release debit") have been inserted into the relevant clauses.

Clause 364: Introduction to Chapter

1156. This clause sets out the general circumstances when the provisions of the Chapter will apply, what the Chapter does and, in *subsection (2),* provides an important definition. It is based on paragraphs 5ZA and 5A(1) to (4) and (16) of Schedule 9 to FA 1996.

Clause 365: Reduction of impairment loss debits where group relief claimed

1157. This clause provides the basic rule: where group relief is surrendered to a consortium member (or a member's group company) by the consortium company and there is an excess of impairment losses over credits arising on loans to the consortium company, those impairment losses are reduced by the group relief claimed. It is based on paragraphs 5ZA and 5A(5) to (7) and (19) of Schedule 9 to FA 1996.

Clause 366: Effect where credit for release brought into account on amortised cost basis

1158. This clause provides that where a consortium company brings in a credit on an amortised cost basis on the release of a liability by a consortium member and that member debits an equal amount, the debit is not taken into account under this Chapter. It is based in paragraph 5A(15) of Schedule 9 to FA 1996.

Clause 367: Reduction of credits exceeding impairment losses

1159. This clause provides that where credits on loan relationships between the consortium member (or group company) and the consortium company exceed debits on those loans, the credits are reduced by debits previously reduced under clause 365. It is based on paragraph 5A(8) to (10) of Schedule 9 to FA 1996. The reduction compensates for the restrictions in an earlier period which would not have arisen had there not, in that period, been an excess of debits over credits.

1160. Paragraph 5A(8)(a) of Schedule 9 refers to related debt recovery credits brought into account "under paragraph 5 above". This is an incorrect reference and was overlooked in the consequential amendments to FA 2004 which removed paragraph 5(1) to (2A) of Schedule 9. This has been rewritten as if referring to the amounts brought into account in computing the "relevant net debits" (see paragraph 5A(5)(b)), which is the obvious meaning.

Clause 368: Reduction of claims where there are earlier net consortium debits

1161. This clause provides that claims for group relief surrendered by the consortium company to a consortium member (or group company) are reduced by the excess of debits over credits on loans to the consortium company in preceding years. It is based on paragraph 5A(11) to (13) of Schedule 9 to FA 1996.

Clause 369: Carry forward of claims where there are no net consortium debits

1162. This clause applies where there is a claim for group relief by a consortium company (or group member) but no net debit in respect of debts with the consortium company. It is based on paragraph 5A(14) of Schedule 9 to FA 1996. In these circumstances the group relief claim is carried forward and treated as increasing a group relief claim for the subsequent accounting period for the purposes of clause 365.

Clause 370: Group accounting periods

1163. This clause gives the meaning of "group accounting period" for the purposes of this Chapter. It is based on paragraph 5A(17) and (18) of Schedule 9 to FA 1996.

Clause 371: Interpretation

1164. This clause defines various terms used in this Chapter. It is based on paragraph 5A(2) to (5) and (19) to (21).

Chapter 8: Connected parties relationships: late interest

Overview

1165. This Chapter gives the rules for bringing into account debits for interest which is either not paid or paid late where the two parties to the loan are connected in some way.

Clause 372: Introduction to Chapter

1166. This clause explains the purpose of the Chapter and provides an overview. It is based on paragraph 2 of Schedule 9 to FA 1996.

Clause 373: Late interest treated as not accruing until paid in some cases

1167. This clause sets out the basic rule: where interest is not paid within 12 months after the end of the accounting period and corresponding credits are not brought into account the interest is allowed on a paid rather than an accruals basis where one of the circumstances set out in the following clauses applies. It is based on paragraph (1), (2) and (6) of Schedule 9 to FA 1996.

Clause 374: Connection between debtor and person standing in position of creditor

1168. This clause gives the first circumstance when clause 373 applies and this is where the debtor and creditor companies are connected under clause 466. It is based on paragraph 2(1A) of Schedule 9 to FA 1996.

Clause 375: Loans to close companies by participators etc

1169. This clause gives the second circumstance when clause 373 applies: where the company making the loan is a close company (other than a CIS-based close company or CIS limited partnership) and the creditor is a participator or similar. (CIS is an abbreviation of "collective investment scheme".) It is based on paragraph 2(1B) and (1E) to (1G) of Schedule 9 to FA 1996.

Clause 376: Interpretation of section 375

1170. This clause gives the meaning of various terms used in clause 375. It is based on paragraph 2(5) to (6) of Schedule 9 to FA 1996.

Clause 377: Party to loan relationship having major interest in other party

1171. This clause gives the third condition when clause 373 applies: where either the debtor or creditor has a major interest (defined in clause 473) in the other. It is based on paragraph 2(1C) of Schedule 9 to FA 1996.

Clause 378: Loans by trustees of occupational pension schemes

1172. This clause gives the fourth and final condition when clause 373 applies: where the loan is made by a trustee of an occupational pension scheme and there is a specified relationship between the debtor company and the employees benefiting from the scheme or their employing company. It is based on paragraph 2(1D) of Schedule 9 to FA 1996.

Clause 379: Persons indirectly standing in the position of creditor

1173. This clause provides that the preceding clauses on late interest which refer to the creditor company include companies which stand indirectly in that position as a result of a series of loan relationships or money debts. It is based on paragraph 2(3) and (4) of Schedule 9 to FA 1996.

Chapter 9: Partnerships involving companies

Overview

1174. This Chapter provides special rules for determining debits and credits on loan relationships where a money debt is owed by or to a partnership in which one or more of the members is a company.

Clause 380: Partnerships involving companies

1175. This clause gives the basic rule for computing the debits and credits where a money debt is owed by or to a partnership in which one or more of the members is a company. It is based on paragraph 19(1) and (2) of Schedule 9 to FA 1996.

1176. "Profession" in paragraph 19(1)(a) has not been rewritten on the grounds that a company cannot carry on a profession for corporation tax purposes either as a partner or otherwise.

Clause 381: Determinations of credits and debits by company partners: general

1177. This clause expands on the basic rule given in subsection (3) of the previous clause. It is based on paragraph 19(3) to (6) of Schedule 9 to FA 1996. Each company partner is treated as owing or being owed the debt and the credits and debits in relation to those debts are treated as those of the company partner in its profit-sharing ratio.

1178. "Gross" in paragraph 19(5) and (6) of Schedule 9 means that the total credits and debits are calculated notwithstanding that the debt is treated as owed to or by each company partner and this is brought out in *subsection (5)*.

Clause 382: Company partners using fair value accounting

1179. This clause provides that company partners using fair value accounting must bring debits and credits into account on the same basis. It is based on paragraph 19(11) of Schedule 9 to FA 1996. Without this provision it might be assumed that the deeming required by this Chapter did not require a company to adopt its normal accounting method.

Clause 383: Lending between partners and the partnership

1180. This clause provides the rules for determining whether a company partner controls a partnership in circumstances where a money debt exists between the partnership and a company partner. It is based on paragraph 19(7) to (9) and (14) of Schedule 9 to FA 1996. If there is such a money debt the rule in clause 349 applies under which debits and credits on a loan relationship are determined under the amortised cost basis.

Clause 384: Treatment of exchange gains and losses

1181. This clause disapplies, in certain circumstances, the rule on exchange gains and losses in clause 328 which disallows a credit or debit on an exchange gain or loss which is taken directly to a company's reserves. It is based on paragraph 19(12) of Schedule 9 to FA 1996. Only where the exchange gain or loss by-passes the partnership's profit and loss account will that clause apply.

1182. The words "subsection (3) of section 84A of this Act does not apply …. except to the extent that ….. exchange gains and losses are recognised" in paragraph 19(12) of Schedule 9 to FA 1996 are rewritten to clarify the meaning that the clause rewriting section 84A(3) applies *so far* as the exchange gains and losses` are recognised rather than the possible meaning that the clause applies only *if* they are recognised.

1183. *Subsection (2)* updates the references in paragraph 19(12) of Schedule 9 to FA 1996 to a company's statement of income and gains, etc in line with current accountancy practice.

1184. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals paragraph 19(12) of Schedule 9 to FA 1996 with effect from a day to be appointed. This clause, which rewrites that sub-paragraph, will therefore cease to have effect from an appointed day (see Part 8 (loan relationships) of Schedule 2 to the Bill).

Clause 385: Company partners' shares where firm owns deeply discounted securities

1185. This clause treats deeply discounted securities held by a partnership as if they were held by each company partner in its profit-sharing ratio. It is based on paragraph 19(13) of Schedule 9 to FA 1996.

1186. *Subsection (3)(b)* adopts the language ("in accordance with the firm's profit-sharing arrangements") of clause 1262 in Part 17 (partnerships) which rewrites section 114(2) of ICTA.

Chapter 10: Insurance companies

Overview

1187. This Chapter rewrites the provisions on insurance companies from Schedule 11 to FA 1996. These mainly deal with the treatment of deficits.

Clause 386: Overview of Chapter

1188. This clause sets out what is in the Chapter and gives signposts to other provisions specific to insurance companies. It is new.

Clause 387: Treatment of deficit on basic life assurance and general annuity business: introduction

1189. This is the first of five clauses providing special rules for the treatment of deficits on loan relationships of insurance companies which arise on basic life assurance and general annuity business. It is based on paragraph 4(1) of Schedule 11 to FA 1996.

Clause 388: Basic rule: deficit set off against income and gains of deficit period

1190. This clause gives the basic rule on set-off. It is based on paragraph 4(2) of Schedule 11 to FA 1996.

1191. *Subsection (1)* requires the deficit to be offset first against any income and gains relating to basic life assurance and general annuity business of the deficit period. This avoids the necessity of a claim. See *Change 58* in Annex 1.

1192. Paragraph 4(2)(a) of Schedule 11 requires the deficit to be set off to be against any income or gains of the deficit period referable to basic life assurance and general annuity business and arising or accruing otherwise than in respect of loan relationships. The words "arising or accruing otherwise than in respect of loan relationships" have not been rewritten. If a company has such income and gains they must be other than in respect of loan relationships since, by definition, the company has a loan relationship deficit and no non-trading income and gains on its loan relationships.

Clause 389: Claim to carry back deficit
1193. This clause provides for a claim to be made to carry back the excess if a deficit exceeds the income and gains of the deficit period. It is based on paragraph 4(3), (5) and (15) of Schedule 11 to FA 1996. The deficit must be set off against the company's "available profits", defined in the following clause.

1194. *Subsection (5)* replaces "the Board" in paragraph 4(15) with "an officer of Revenue and Customs". See *Change 1* in Annex 1.

Clause 390: Meaning of "available profits"
1195. This clause explains what is meant by "available profits" in the preceding clause. It is based on paragraph 4(7) to (11) of Schedule 11 to FA 1996.

Clause 391: Carry forward of surplus deficit to next accounting period
1196. This clause provides that the deficit should be carried forward to the next accounting period so far as it is neither set off against the deficit period nor carried back to a period before the deficit period. It is based on paragraph 4(4) of Schedule 11 to FA 1996.

Clause 392: Exclusion of loan relationships of members of Lloyd's
1197. This clause prevents this Part from applying to loan relationships of corporate members of Lloyds which are assets or liabilities of a premium trust fund. It is based on paragraph 7 of Schedule 11 to FA 1996.

Clause 393: General rules for some debtor relationships
1198. This clause provides rules for determining the credits and debits of a debtor loan relationship of an insurance company which is referable to any category of an insurance company's long-term insurance fund. It is based on paragraph 3A of Schedule 11 to FA 1996.

Clause 394: Special rules for some debtor relationships
1199. This clause provides special rules for referring credits and debits in respect of those debtor relationships which are liabilities of a long-term insurance fund to particular categories of the company's long-term business. It is based on paragraph 3A of Schedule 11 to FA 1996.

1200. *Subsections (4)*, *(5)* and *(6)* deal with deposit back arrangements. Deposit back arrangements arise where reinsurers of pension annuities deposit back all or a substantial proportion of the premium paid with the original insurer. The original insurer may then pay interest to the reinsurer on that deposit back. "Deposit back arrangements" are defined in section 431(2) of ICTA.

Chapter 11: Other special kinds of company
Overview
1201. This Chapter provides rules for determining the profits and losses on the loan relationships of particular types of companies: investment trusts, venture capital trusts and credit unions.

Clause 395: Investment trusts: profits or losses of a capital nature
1202. This clause excludes profits and losses of a capital nature on loan relationships from being taken into account by an investment trust. It is based on paragraph 1A of Schedule 10 to FA 1996 and the Investment Trusts and Venture Capital Trusts (Definition of Capital Profits, Gains or Losses) Order 2006 (SI 2006/1182). Before FA 1996 investment trusts were treated as exempt from profits arising on the disposal of investments and that position was preserved by the loan relationships regime.

1203. *Subsections (2)* and *(3)* rewrite article 3 of SI 2006/1182 rather than referring to the appropriate SI as does paragraph 1A(3).

1204. *Subsection (5)* allows orders to be made for "such incidental, supplemental, consequential and transitional provision and savings". This is the standard formulation in this Bill for the additional amendments that can be introduced under an order and regulation-making power. It is not considered a change in the law.

Clause 396: Venture capital trusts: profits or losses of a capital nature
1205. This clause excludes profits and losses of a capital nature on loan relationships from being taken into account by a venture capital trust. It is based on paragraphs 1B and 9(1) of Schedule 10 to FA 1996 and the Investment Trusts and Venture Capital Trusts (Definition of Capital Profits, Gains or Losses) Order 2006 (SI 2006/1182). Before FA 1996 venture capital trusts were treated as exempt from tax on profits arising from the disposal of investments and that position was preserved in the loan relationships regime.

1206. *Subsections (2)* and *(3)* rewrite article 3 of SI 2006/1182 rather than referring to the SI as does paragraph 1B(3).

1207. *Subsection (5)* allows orders to be made for "such incidental, supplemental, consequential and transitional provision and savings". This is the standard formulation in this Bill for the additional amendments that can be introduced under an order and regulation-making power. It is not considered a change in the law.

Clause 397: Credit unions
1208. This clause provides that credits and debits on loan relationships of credit unions with union members are not brought into account under this Part. It is based on section 487(1), (2) and (3A) of ICTA.

Chapter 12: Special rules for particular kinds of securities
Overview
1209. This Chapter brings together a number of loan relationship rules from within and outside Chapter 2 of Part 4 of FA 1996 on particular types of securities.

1210. Section 96 of FA 1996, which one might expect to be rewritten here, is not. That section prevents any rise in capital value of certain gilts from being brought into charge as credits on a loan relationship. The two gilts identified in the section are expressly protected from a capital gains charge and it was considered improper that a charge should arise on changes in capital value under the loan relationships legislation. Therefore the interest component only in any credit is taxed.

1211. 3½% Funding Stock 1999-2004 was redeemed in June 2003. Section 96 of FA 1996 is rewritten in Schedule 2 to this Bill.

Clause 398: Overview of Chapter
1212. This clause explains how the Chapter is organised. It is new.

Clause 399: Index-linked gilt-edged securities: basic rules
1213. This and the following clause provide special rules for dealing with index-linked securities. It is based on section 94(1), (2) and (7) of FA 1996. The clause contains the main rule that fair value accounting must be used and requires adjustments under the following clause. It also defines terms used in this and the following clause.

Clause 400: Index-linked gilt-edged securities: adjustments for changes in index
1214. This clause applies to remove a profit or loss arising on an index-linked gilt-edged security by adjusting the value of the security in the accounts by the change in the retail prices index. It is based on section 94(2) to (6) of FA 1996. The clause also provides for Treasury powers to amend the adjustments required under this clause.

Clause 401: Gilt strips
1215. This clause gives the rules that apply when a gilt-edged security is converted into strips and when strips are consolidated into a single security; in each case there is a deemed redemption and acquisition. It is based on section 95(1) to (3) of FA 1996.

1216. Section 95(1) of FA 1996, which *subsection (1)* rewrites, refer to “a gilt-edged security or a strip of a gilt-edged security”. Section 103(1) of FA 1996 (rewritten in clause 476(1)) adopts the definition of “gilt-edged security” in Schedule 9 to TCGA. Paragraph 1A of that Schedule brings strips within the definition of a gilt and subsection (1)(b) of this clause reflects this by referring to any *other* gilt-edged security.

Clause 402: Market value of securities

1217. This clause explains what is meant by the market value of a security in clause 401 and gives the Treasury power to amend that meaning. It is based on section 95(4) to (6) of FA 1996.

1218. *Subsection (3)* allows orders to be made for "such incidental, supplemental, consequential and transitional provision and savings". This is a standard formulation in this Bill for the additional amendments that can be introduced under an order and regulation-making power. It is not considered a change in the law.

Clause 403: Meaning of "strip"

1219. This clause gives the meaning of "strip" for this Chapter, rewriting in full the definition from FA 1942 instead of relying on a cross-reference to that section as does section 95(7) of FA 1996. It is based on section 47 of FA 1942 and section 95(7) of FA 1996.

Clause 404: Restriction on deductions etc relating to FOTRA securities

1220. This clause prevents debits arising on FOTRA securities where the profits are exempt under clause 1279. It is based on section 154(6) and (8) of FA 1996 and section 161(1), (4) and (7) of FA 1998.

Clause 405: Certain non-UK residents with interest on 3½% War Loan 1952 Or After

1221. This clause restricts a debit for borrowing costs where a non-UK resident company holds 3½% War Loan for use in a business of banking, insurance or dealing in securities. It is based on section 475 of ICTA. Interest on 3½% War Loan is paid without deduction of tax and is exempt in the hands of a non-UK resident company. Because a company may borrow to acquire these securities an allowable debit may arise on the cost of the borrowing but without giving rise to a taxable credit. Consequently the appropriate proportion of the costs of borrowing is disallowed as a loan relationships debit.

1222. Step 2 in *subsection (3)* makes reference only to "interest which is not brought into account … under this Part" (although section 475(2) and (4) of ICTA might be read as comprising other interest for corporation tax purposes) since interest can only be brought into account under loan relationships rules as a result of section 337A(2)(a) of ICTA.

1223. *Subsections (1), (3)* and *(4)* rewrite "3½% War Loan 1952 or after" as "3½% War Loan 1952 Or After" to prevent the reader attaching the words "or after" to any following words, thereby adopting the solution used in section 154(8)(b) of FA 1996.

Clause 406: Introduction

1224. This clause introduces the following six clauses which all deal with deeply discounted securities. It is based on paragraphs 17(3) and (4) and 18(2B) and (3) of Schedule 9 to FA 1996.

Clause 407: Postponement until redemption of debits for connected companies' deeply discounted securities

1225. This clause provides that debits on a deeply discounted security are, in certain circumstances, only brought into account under this Part on redemption where the debtor and creditor are connected. It is based on paragraph 17(1) to (3) and (5) of Schedule 9 to FA 1996.

Clause 408: Companies connected for section 407

1226. This clause explains what is meant by two companies being connected for the previous clause. It is based on paragraph 17(5) and (9) of Schedule 9 to FA 1996.

Clause 409: Postponement until redemption of debits for close companies' deeply discounted securities

1227. This clause provides that debits on a deeply discounted security can only be brought into account under this Part on redemption if the creditor is a participator, etc in the debtor company. It is based on paragraph 18(1) to (2B) of Schedule 9 to FA 1996.

Clause 410: Exceptions to section 409

1228. This clause provides exceptions to the preceding clause, where either credits equalling debits are brought into account under this Part or where the debtor company is a CIS-based close company or a CIS limited partnership. It is based on paragraph 18(1ZA) to (1C) and (4) of Schedule 9 to FA 1996.

1229. "The debtor company" in paragraph 18(1C)(c) of Schedule 9 has been rewritten for consistency in *subsection (4)* as "the issuing company", the term used elsewhere in that paragraph.

Clause 411: Interpretation of section 409

1230. This clause provides definitions and deals with other matters necessary to interpret clause 409. It is based on paragraph 18(3B) to (5) of Schedule 9 to FA 1996.

Clause 412: Persons indirectly standing in the position of creditor

1231. This clause enables clauses 407 and 409 to apply where there is a series of loan relationships or money debts between the company issuing the deeply discounted security and the person in the creditor relationship. It is based on paragraphs 17(8) and (8A) and 18(2C) and (2D) of Schedule 9 to FA 1996.

1232. Paragraph 18(2D) of Schedule 9 refers to the term "corresponding creditor relationship" in sub-paragraph (1A)(c). That sub-paragraph was repealed by FA 2002. The reference to paragraph (1A)(c) has been rewritten as if it referred to sub-paragraph (1A)(b), the sub-paragraph containing the reference to the person standing in the position of a creditor.

Clause 413: Issue of funding bonds

1233. This clause treats issues of funding bonds as interest payments. It is based on section 582(1) and (3) to (4) of ICTA. The corresponding rule for income tax is in section 380 of ITTOIA.

1234. *Subsection (2)* rewrites, for clarification, "value of the bonds at the time of their issue" in section 582(1)(a) as "market value of the bonds at their issue".

1235. For the rewrite of the Schedule D Case VI charge in section 582(2A) of ICTA see *Change 59* in Annex 1.

Clause 414: Redemption of funding bonds

1236. This clause prevents repayments of funding bonds from being a payment of interest if the issue was treated as such in the hands of an individual or company. It is based on section 582(1) and (4) of ICTA. The corresponding rule for income tax is in section 754 of ITTOIA.

Clause 415: Loan relationships with embedded derivatives

1237. Where GAAP requires separate treatment of a loan relationship and its embedded derivative, this clause enables the loan relationship to be treated separately for the purposes of this Part also. It is based on section 94A(1) and (2) of FA 1996.

1238. Clause 585 in Part 7 (derivative contracts) rewrites as much of section 94A of FA 1996 as deals with the treatment of embedded derivatives under Schedule 26 to FA 2002.

Clause 416: Election for application of sections 415 and 585

1239. This clause permits a company subject to old UK GAAP to make an election to apply the treatment allowed under clause 415 even though separate treatment of loan relationship and derivative does not apply under that accounting policy. It is based on paragraph 7(1), (1A), (3), (4), (6) and (7) of Schedule 6 to F(No 2)A 2005.

Clause 417: Further provisions about elections under section 416

1240. This paragraph makes further provisions about elections under clause 416. It is based on paragraph 7(2), (3) and (5) of Schedule 6 to F(No 2)A 2005.

Clause 418: Loan relationships treated differently by connected debtor and creditor

1241. This clause applies where connected companies are debtor and creditor to a loan relationship which is treated as bifurcated by the debtor but not by the creditor. It is based on section 94B(1) to (6) of FA 1996. Where the debits brought into account by the debtor exceed the credits brought into account by the creditor additional credits must be brought into account by the creditor.

Clause 419: Section 418: supplementary

1242. This clause explains terms used in clause 418. It is based on section 94B(7) to (10) of FA 1996.

Clause 420: Assumptions where options etc apply

1243. This clause deals with loan relationships accounted for under an amortised cost basis which are affected by options after the end of the accounting period. It is based on paragraph 3(1) and (2) of Schedule 9 to FA 1996. The debits and credits to be brought into account under this Part are those which would arise if the option were exercised in the way most favourable to the party to the loan relationship.

Chapter 13: European cross-border transfers of business

Overview

1244. This Chapter gives the rules that apply for loan relationships in the case of cross-border transfers of business within the European Community which is carried in the United Kingdom.

Clause 421: Introduction to Chapter

1245. This clause sets out the two conditions required for the Chapter to apply together with the claim requirement. It is based on paragraphs 12D(1) to (4), 12G(1) and (2), 12H(1) and 12J(1) of Schedule 9 to FA 1996.

1246. *Subsection (3)(c)* rewrites paragraph 12D(1)(d) – that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA – as “within the charge to corporation tax” since the effect is the same.

Clause 422: Transfer of loan relationship at notional carrying value

1247. This clause provides the rule that where either of the conditions in clause 421 applies, credits and debits on loan relationships which are transferred as part of the business transfer are brought into account by both the transferor and transferee as if the loan relationships had been transferred at the carrying value in the accounts of the transferor. It is based on paragraph 12D(1), (2) and (6) of Schedule 9 to FA 1996.

1248. The definition of “notional carrying value” is taken from paragraph 12(2) of Schedule 9 to FA 1996.

Clause 423: Transferor using fair value accounting

1249. This clause provides the rule to apply in place of clause 422 where the transferor company uses fair value accounting. It is based on paragraph 12D(7) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

Clause 424: Reorganisations involving loan relationships

1250. This clause provides for debits and credits to be brought into account as if the relevant loan relationships were disposed of at their carrying value where a reorganisation under sections 127 to 130 of TCGA arises as a result of a transfer of business within this Chapter. It is based on paragraph 12G(1), (2), (4) and (6) of Schedule 9 to FA 1996.

Clause 425: Original holder using fair value accounting
1251. This clause provides the rule to apply in place of the rule in clause 424 where fair value accounting is used by the original holder. It is based on paragraph 12G(5) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

Clause 426: Tax avoidance etc
1252. This clause disapplies the Chapter if the transfer of business is not effected for genuine commercial reasons unless the Commissioners for HMRC are satisfied, following an application, that the Chapter should apply. It is based on paragraph 12F(1) and (2) of Schedule 9 to FA 1996.

1253. In *subsection (1)(a)* "bona fide commercial reasons" is rewritten as "genuine commercial reasons".

Clause 427: Procedure on application for clearance
1254. This clause gives the rules that apply where a clearance application is made under clause 426 to the Commissioners for HMRC. It is based on paragraph 12F(3) of Schedule 9 to FA 1996.

1255. Paragraph 12F(3) applies the rules in section 138(2) to (5) of TCGA which this and the following clause write out in full.

Clause 428: Decision on application for clearance
1256. This clause gives the time limit within which HMRC must give a decision following a clearance application and procedures relating to appeals. It is based on paragraph 12F(3) of Schedule 9 to FA 1996.

Clause 429: Disapplication of Chapter where transparent entities involved
1257. This clause disapplies the Chapter under certain circumstances where transparent entities are involved in the transfer of business. It is based on paragraphs 12H(1) and (2) and 12J(1) of Schedule 9 to FA 1996.

1258. The last two words of paragraph 12H(2)(b) ("paragraph 12G does not apply in relation *to it*") are not rewritten in *subsection (2)* because it is not considered that they add anything to paragraph (b). These words do not appear in paragraph 12H(2)(a) which states simply that "paragraph … 12G [does] not apply to the transfer".

Clause 430: Interpretation
1259. This clause defines company and company residence in a member State for the purposes of the Chapter. It is based on paragraph 12J of Schedule 9 to FA 1996.

Chapter 14: European cross-border mergers

Overview

1260. This Chapter gives the rules that apply for loan relationships in the case of mergers where the merging companies are resident in different member States of the European Community.

Clause 431: Introduction to Chapter

1261. This clause sets out the conditions (which include the different categories of merger) under which the Chapter applies. It is based on paragraphs 12B(1) and (2) and 12I(1) of Schedule 9 to FA 1996.

1262. *Subsection (6)* rewrites paragraph 12B(2)(c) – that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA – as "within the charge to corporation tax" since the effect is the same.

Clause 432: Meaning of "the transferee" and "transferor"

1263. This clause gives the meaning of the two terms for the different categories of merger set out in clause 431(3). It is based on paragraph 12B(9) of Schedule 9 to FA 1996.

Clause 433: Transfer of loan relationship at notional carrying value

1264. This clause provides the rule that debits and credits on loan relationships transferred under the merger are brought into account as if the transfer had been for a consideration of an amount equal to the carrying value in the transferor company's or companies' accounts. It is based on paragraph 12B(3) of Schedule 9 to FA 1996.

Clause 434: Transferor using fair value accounting

1265. This clause provides the rule to apply in place of clause 433 where the transferor company uses fair value accounting. It is based on paragraph 12B(4) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

Clause 435: Reorganisations involving loan relationships

1266. This clause provides for continuity of treatment in respect of loan relationships where a reorganisation under sections 127 to 130 of TCGA arises as a result of a merger within this Chapter. It is based on paragraph 12G(1), (2), (4) and (6) of Schedule 9 to FA 1996. Credits and debits are brought into account as if the loan relationships within the reorganisation were disposed of at their carrying value in the accounts of the company which holds them.

Clause 436: Original holder using fair value accounting

1267. This clause provides the rule to apply in place of the rule in clause 435 where fair value accounting is used by the original holder. It is based on paragraph 12G(5) of Schedule 9 to FA 1996 (which applies paragraph 12(2A) of that Schedule).

Clause 437: Tax avoidance etc
1268. This clause disapplies the Chapter if the merger is not effected for genuine commercial reasons unless the Commissioners for HMRC are satisfied, following an application, that the Chapter should apply. It is based on paragraph 12B(6) to (8) of Schedule 9 to FA 1996.

Clause 438: Disapplication of Chapter where transparent entities involved
1269. This clause disapplies the Chapter under certain circumstances where transparent entities are involved in the merger. It is based on paragraphs 12I(1) and (2) and 12J(1) of Schedule 9 to FA 1996.

1270. Paragraph 12I(2)(b) provides that paragraph 12G shall not apply in relation to shares or debentures issued by the transparent entity. This has been rewritten in *subsection (3)* to the effect that clauses 435 and 436 do not apply to the new holding.

Clause 439: Interpretation
1271. This clause defines some terms used in the Chapter. It is based on paragraphs 12B(9) and 12J of Schedule 9 to FA 1996.

Chapter 15: Tax avoidance
Overview
This Chapter brings together provisions which counter avoidance, including avoidance which arises because transactions are not at arm's length.

Clause 440: Overview of Chapter
1272. This clause explains what the Chapter is about and the provisions it contains. It is new.

Clause 441: Loan relationships for unallowable purposes
1273. This clause prevents a company from bringing into account debits in respect of a loan relationship with an "unallowable purpose" (defined in the following clause) or exchange gains on such a loan relationship. It is based on paragraph 13(1) and (1A) of Schedule 9 to FA 1996. Once such debits or credits are disallowed they are not brought into account for any other tax purposes.

Clause 442: Meaning of "unallowable purpose"
1274. This clause gives the meaning of "unallowable purpose" for clause 441. It is based on paragraph 13(2) to (5) of Schedule 9 to FA 1996.

Clause 443: Restriction of relief for interest where tax relief schemes involved
1275. This clause prevents a company from bringing into account debits for interest paid as part of a scheme or arrangements, the sole or main benefit of which is the obtaining of the debit for that interest. It is based on section 787 of ICTA.

1276. Section 787 differs from paragraph 13 of Schedule 9 to FA 1996, rewritten in clauses 441 and 442, in the following ways:

- paragraph 13 covers all debits and not just interest;

- paragraph 13 looks at the purposes of a loan relationship and section 787 at the benefit that might be expected to accrue from a scheme or arrangements;

- where section 787 is in point the whole of the interest is disallowed whereas paragraph 13 restricts only so much of the debit on the loan relationship as on a just and reasonable apportionment is attributable to the unallowable purpose.

1277. For these reasons both paragraph 13 of Schedule 9 to FA 1996 and section 787 of ICTA are rewritten in full.

1278. Section 787(1A) of ICTA requires the reference in section 787(1) to giving relief in respect of a payment of interest to be read "as including" a debit for interest under Chapter 2 of Part 4 of FA 1996 (loan relationships). This must be interpreted as applying that subsection to loan relationships alone as debits for interest are only allowed under Chapter 2 of Part 4 of FA 1996 (section 337A(2)(a) of ICTA). *Subsection (1)* is worded accordingly.

Clause 444: Transactions not at arm's length: general

1279. This and the following seven clauses provide rules for where transactions in respect of a loan relationship are not on arm's length terms. It is based on section 103(1) of, and paragraph 11(1) to (3A) of Schedule 9 to, FA 1996. The clause requires debits and credits to be determined as if the related transaction in respect of which they arise were on arm's length terms. Exchange gains and losses are not affected. Schedule 28AA to ICTA (provision not at arm's length) has priority where it also applies (see clause 445).

1280. Paragraph 11(2) refers to debits arising from the acquisition of rights under a loan relationship. The 1996 notes on clauses read "…[paragraph 11] specifically does not affect the buyer when it has paid less than the market price – we are quite happy when it comes to sell the loan relationship, in computing the profit, it only gets the amount it actually paid taken into account at cost rather than market value". When the company comes to sell the loan relationship the transaction may not be at arm's length, but the arm's length value is clearly still intended to apply.

1281. It was therefore intended that the debits refer to the entries in the asset account on the acquisition of a loan relationship acquired at below market value.

1282. Paragraph 6204 of the Corporate Finance Manual reads:

> FA96/SCH9/PARA11(2) provides that the Para 11(1) adjustment does not apply to **debits** arising from the purchase of a loan relationship at less than market value.
>
> Although this rule is primarily aimed at cases where the vendor is not within the charge to corporation tax, it does apply in other cases too. So, when a company buys a debt at undervalue (not at arm's length), there is **no** adjustment in its accounts; it brings in the lower value and is taxed on the full

> amount of any resulting profit. Para 11(1) does apply to the vendor, however – where it sells a debt at undervalue (not at arm's length) it is taxed as if it had sold the loan relationship at the market value.

1283. Ghosh and Johnson's "Taxation of Loan Relationships and Derivatives", in referring to paragraph 11(2), agrees with this interpretation. Paragraph 6.351 reads:

> However, there is no market value uplift for the purpose of computing any debits arising from the acquisition of rights under a loan relationship at less than market value (para 11(2)). "Debit" here means an "expense", ie acquisition cost.

1284. In most instances transactions other than at arm's length are between group companies and Schedule 28AA to ICTA will apply. Schedule 28AA has precedence as a result of paragraph 11(1A) of Schedule 9 to FA 1996 and paragraph 11(1) of Schedule 9 will not then apply.

1285. A rewrite change has not been introduced to reflect this meaning of paragraph 11(2) because some non-HMRC specialists on loan relationship disagree with this interpretation.

Clause 445: Disapplication of section 444 where Schedule 28AA to ICTA applies

1286. This clause provides an exception to clause 444. Where Schedule 28AA to ICTA also applies in respect of the related transaction, clause 444 does not apply. It is based on paragraph 11(1A) and (1B) of Schedule 9 to FA 1996. The clause also excludes an adjustment to exchange gains and losses from any Schedule 28AA adjustments.

Clause 446: Bringing into account adjustments made under Schedule 28AA to ICTA

1287. This clause requires credits and debits under this Part to reflect adjustments made under Schedule 28AA of ICTA. It is based on paragraph 16(1) and (2) of Schedule 9 to FA 1996.

Clause 447: Exchange gains and losses on debtor relationships: loans disregarded under Schedule 28AA to ICTA

1288. This and the following four clauses provide rules for exchange gains and losses on loan relationships which are not on arm's length terms. It is based on paragraph 11A(1) to (3) of Schedule 9 to FA 1996 and paragraph 8(1) and (3) of Schedule 28AA to ICTA.

1289. The clause leaves exchange gains and losses, or a proportion of them, out of account where, under Schedule 28AA to ICTA, the whole or part of a loan representing a debtor relationship is ignored.

Clause 448: Exchange gains and losses on debtor relationships: equity notes where holder associated with issuer

1290. This clause applies where interest is to be treated as a distribution under section 209(2)(e)(vii) of ICTA. It is based on paragraph 11A(1) of Schedule 9 to

FA 1996. Exchange gains and losses on the security giving rise to that interest are left out of account in computing gains under this Part in respect of the debtor company.

Clause 449: Exchange gains and losses on creditor relationships: no corresponding debtor relationship
1291. This clause applies where a company is in a creditor relationship and the transaction giving rise to the loan would not have been made on arm's length terms. It is based on paragraph 11A(4) and (5) of Schedule 9 to FA 1996. The clause leaves exchange gains and losses out of account where there is no corresponding debtor relationship (explained in clause 450).

Clause 450: Meaning of "corresponding debtor relationship"
1292. This clause provides the meaning of "corresponding debtor relationship" for the purposes of clause 449. It is based on paragraph 11A(4) of Schedule 9 to FA 1996.

1293. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals the words "or would apart from section 84A(2) to (10) of this Act" in paragraph 11A(4)(c) of Schedule 9 to FA 1996 (rewritten in *subsection (6)*) with effect from a day to be appointed. This subsection will therefore cease to have effect from an appointed day (see Part 8 (loan relationships) of Schedule 2 to the Bill).

Clause 451: Exception to section 449 where loan exceeds arm's length amount
1294. Where a loan would, on arm's length terms, have been of an amount more than nil but less than the full amount this clause takes into account a suitable proportion of the exchange gains and losses for the purposes of this Part. It is based on paragraph 11A(5) and (6) of Schedule 9 to FA 1996.

Clause 452: Exchange gains and losses where loan not on arm's length terms
1295. This clause provides that, where a guarantor company is connected to the creditor company, a claim under paragraph 6D of Schedule 28AA to ICTA is assumed to apply to exchange gains and losses as well as interest. It is based on paragraph 11A(7) to (10) of Schedule 9 to FA 1996.

1296. Paragraph 6D of Schedule 28AA to ICTA applies where a company has an interest payment reduced by the transfer pricing rules of that Schedule and the loan on which that interest is paid is guaranteed by another company. The guarantor company may make a claim to be treated as if it had itself paid the interest. The guarantor company then obtains the deduction that was disallowed to the paying company. This is called a "compensating adjustment". The interest is allowed to the extent that an independent lender would take the guarantee into account in determining the borrower's debt capacity.

Clause 453: Connected parties deriving benefit from creditor relationships
1297. This clause provides that if a company receives less than a commercial return under a loan relationship and, in consequence, a connected company derives benefit as a result of that relationship, credits representing that benefit are brought into

account in computing the creditor company's gains. It is based on section 93C of FA 1996. This counters an avoidance device whereby a company arranges for the equivalent value of interest that would otherwise be received to be passed by the borrower to a connected company which is not a party to the relationship.

Clause 454: Application of fair value accounting: reset bonds etc

1298. This clause provides rules for debits and credits on loan relationships represented by bonds on which the terms change after issue, to be determined on the basis of fair value accounting. It is based on section 88A of FA 1996.

1299. Principally, this clause counters avoidance where companies subscribe for reset bonds which increase in value after issue and are transferred to another group company at cost under clause 340 onwards. That company is then sold outside the group at market value with the profit on the bond reflected in the capital gain on the sale of the subsidiary and not as a credit under this Part.

Clause 455: Disposals for consideration not fully recognised by accounting practice

1300. This clause provides that rights disposed of under a creditor relationship are to be brought into account where the disposal is not wholly recognised in the accounts and there is an intention to avoid tax. It is based on paragraph 11B of Schedule 9 to FA 1996.

Chapter 16: Non-trading deficits

Overview

1301. This Chapter provides the rules for deficits on loan relationships which are not used for the company's trade.

Clause 456: Introduction to Chapter

1302. This clause provides a general introduction to the Chapter. It is based on section 83(1) of, and paragraph 5 of Schedule 8 to, FA 1996.

Clause 457: Basic rule for deficits: carry forward to accounting periods after deficit period

1303. This clause provides that deficits which are neither surrendered as group relief nor set-off against profits of the loss period or earlier periods are carried forward and set against against the non-trading profits of the following accounting period. It is based on section 83(3A) of, and paragraph 4(1) to (3) and (6) of Schedule 8 to, FA 1996.

Clause 458: Claim to carry forward deficit to later accounting periods

1304. This clause allows a company to make a claim to carry forward the deficit from the period in which it arose without the need to set it against non-trading profits under clause 457. It is based on paragraph 4(3) to (5) of Schedule 9 to FA 1996.

1305. The deficit is then treated as if it arose in the "first later period" and falls to be carried forward to the subsequent period (ie it cannot be set against total profits of that first later accounting period). This rule also applies where no claim is made but the deficit cannot be set against non-trading profits of the first subsequent period.

Clause 459: Claim to set off deficit against profits of deficit period or earlier periods

1306. This clause allows a company (unless it is a charity) to claim that deficits which have not been surrendered as group relief may be set off against other profits of the deficit period or carried back against profits from loan relationships in an earlier accounting period. It is based on section 83(2) and (5) of FA 1996.

1307. Section 83(2)(a) of FA 1996 (set-off against other profits of the deficit period) allows the deficit to be set off against "any profits….(of whatever description)". "Profits of any description" are the "total profits" in section 9(3) of ICTA and this is reflected in *subsection (1)(a)*.

1308. Section 83(2)(c) of FA 1996 (set-off carried back to earlier periods) refers only to set-off "against profits". Paragraph 3(4) of Schedule 8 to FA 1996 makes it clear that the profits in section 83(2)(c) are only profits on non-trading loan relationships. This restriction has been brought out in *subsection (1)(b)*. Full details of the profits against which a deficit can be set under subsection (1)(b) are given in clause 463 (signposted in *subsection (6)*).

1309. Section 83(5) of FA 1996 has been rewritten in *subsection (3)* and excludes charities from making a claim under subsection (1) of this clause. Before its repeal in FA 2002 section 83(2)(b) of FA 1996 allowed deficits to be surrendered as group relief. Section 83(5) was not consequentially amended when section 83(2)(b) was repealed and continues to refer to group relief.

1310. The reference to group relief is unnecessary since section 403(2) of ICTA, which allows non-trading deficits for the purposes of group relief, only provides for deficits to which section 83 of FA 1996 applies (see section 403ZC of ICTA). So all that is necessary to prevent the deficit of a charitable company from being surrendered as group relief is to provide that claims under this clause may not be made in respect of the deficits of a charitable company and this is what subsection (3) does.

Clause 460: Time limits and procedure for claims under section 459(1)

1311. This clause provides the time limit for a claim under clause 459. It is based on section 83(6) to (8) of FA 1996.

1312. *Subsection (1)(b)* rewrites "the Board" as "an officer of Revenue and Customs". See *Change 1* in Annex 1.

Clause 461: Claim to set off deficit against other profits for the deficit period
1313. This clause provides that, following a claim under clause 459(1), the deficit is set off against the profits identified in the claim but after trade losses and before certain other reliefs. It is based on paragraph 1(1) to (4) of Schedule 8 to FA 1996.

1314. Although the set-off against profits of the deficit period is against total profits, the general rule in *subsection (2)* is that the set-off is against the profits of the company identified in the claim. In the figure of total profits any management expenses will already have been deducted under clause 1219. The profits identified in the claim will therefore be after management expenses. If the company has more than one source of income together with a reduction for management expenses, an officer of Revenue and Customs will agree the amount of income specified in the claim on a just and reasonable basis.

Clause 462: Claim to carry back deficit to earlier accounting periods
1315. This clause explains how a claim to carry back a deficit to an earlier period under clause 459(1)(b) applies, allowing the deficit to be set against profits of later accounting periods before earlier ones. It is based on paragraph 3(1) to (3) of Schedule 8 to FA 1996.

1316. *Subsection (2)* does not rewrite paragraph 3(2)(a)(ii) of Schedule 8 to FA 1996, which refers to section 83(4) of FA 1996, as section 83(4) has been repealed.

Clause 463: Profits available for relief under section 462
1317. This clause sets out which profits may be reduced by a deficit carried back against profits of an earlier period under clause 459. It is based on paragraph 3(4) to (7) of Schedule 8 to FA 1996.

1318. The reliefs in *subsection (5)* are set against the profits before the apportionment required by *subsection (3)* to give the “amount available for relief”.

Chapter 17: Priority rules
Overview
1319. This Chapter gives the basic boundary rule for loan relationships in clause 464 and excludes debits and credits on distributions.

Clause 464: Priority of this Part for corporation tax purposes
1320. This clause provides the main boundary provision applying to loan relationships. It is based on section 80(5) of, and paragraph 1(2) of Schedule 9 to, FA 1996.

Clause 465: Exclusion of distributions except in tax avoidance cases
1321. This clause excludes distributions from being brought into account under this Part unless they arise in consequence of avoidance arrangements. It is based on paragraph 1(1), (1A) and (2) of Schedule 9 to FA 1996.

Chapter 18: General and supplementary provisions
Overview
1322. This Chapter explains when companies are connected for the purposes of Parts 5 and 6 as well as providing definitions of "control", "major interest" and other expressions used in those Parts.

Clause 466: Companies connected for an accounting period
1323. This clause explains when two companies are connected for an accounting period for the purposes of any provisions that apply it. It is based on sections 87(3) and (4) and 87A(1) of FA 1996.

Clause 467: Connections where partnerships are involved
1324. This clause explains when loan relationships are taken to be between connected companies in the case of debts owed by or to a partnership. It is based on section 87(5A) and (5B) of FA 1996.

1325. *Subsection (4)* adopts the language ("in accordance with the firm's profit-sharing arrangements") of clause 1262 in Part 17 (partnerships) which rewrites section 114(2) of ICTA.

Clause 468: Connection between companies to be ignored in some circumstances
1326. This clause provides that a connection between a company in a creditor relationship and the company in the debtor relationship is ignored in certain circumstances. It is based on section 88(1), (5) and (6) of FA 1996. The circumstances are set out in clauses 469 and 471. The clause also provides that a company is treated for these purposes as being in a debtor relationship when the debt is "dog-legged" through intermediaries.

1327. Section 88(1) and (5) of FA 1996 refer to persons standing in a debtor relationship. "Persons" here has been rewritten as applying to companies only. See *Change 56* in Annex 1.

Clause 469: Creditors who are financial traders
1328. This clause sets out the circumstances under which connectedness between a company in a creditor relationship and one in a debtor relationship is ignored under clause 468. It is based on section 88(2) and (3) of FA 1996. The clause allows financial traders who buy and sell debt of connected companies in the same way that they buy and sell debt of non-connected companies to be exempt from the connectedness rules.

1329. Section 88(2)(f) of FA 1996 provides the condition that, for a three month period, the equivalent of 30% or more of the assets should not be in the beneficial ownership of "connected persons". This has been rewritten as "connected companies". See *Change 56* in Annex 1.

Clause 470: Section 469: supplementary provisions

1330. This clause explains terms used in the preceding clause. It is based on section 88(4) of FA 1996.

1331. "Person" in section 88(4) has been rewritten as "company" only. See *Change 56* in Annex 1.

Clause 471: Creditors who are insurance companies carrying on BLAGAB

1332. This clause stops the connectedness rules from applying to insurance companies carrying on basic life assurance and general annuity business where certain conditions are met. It is based on section 88(3) of FA 1996.

Clause 472: Meaning of "control"

1333. This clause explains the meaning of control for the purposes of any provisions that apply it, for example clause 466. It is based on section 87A(1) to (3) of FA 1996.

1334. *Subsection (6)(b)* adopts the language ("in accordance with the firm's profit-sharing arrangements") of clause 1262 in Part 17 (partnerships) which rewrites section 114(2) of ICTA.

Clause 473: Meaning of "major interest"

1335. This clause gives the meaning of "major interest". It is based on paragraphs 2(7), 17(10) and 20(1), (3) and (8) to (10) of Schedule 9 to FA 1996.

Clause 474: Treatment of connected companies and partnerships for section 473

1336. This clause explains how the rule in clause 473(2) (meaning of "major interest") on rights and powers is applied to partnerships with company members. It is based on paragraph 20(4) to (7) of Schedule 9 to FA 1996.

Clause 475: Meaning of expressions relating to exchange gains and losses

1337. This clause explains what is meant by a company's exchange gains and losses and gives the Treasury powers to make regulations as to how such gains and losses are to be calculated where fair value accounting is used. It is based on section 103(1A) to (1B) of FA 1996.

1338. *Subsection (3)* does not rewrite section 103(1AA)(b) of FA 1996 ("any other profit or gains or losses") because the regulations are in respect of the manner in which exchange gains and losses in section 103(1A)(a) are to be calculated and a reference to other profits and losses is superfluous.

Clause 476: Other definitions

1339. This clause gives a number of definitions used in this Part. It is based on section 103(1) and (4) of FA 1996.

CORPORATION TAX BILL

EXPLANATORY NOTES

[VOLUME IV]

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

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