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 II]

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 2
(SECTIONS 477 TO 906)

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1357. The definition is by reference to sections 468A(2) to (4) of ICTA because the definition in section 468A(2), read with section 468A(3) and (4), is in substance the same as that in paragraph 8(7A)(b), read with paragraph 8(7B) and (7D) of Schedule 10 to FA 1996 and any differences are negligible.

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1358. This clause gives a definition of "offshore fund" and also for "a material interest in such a fund" for this Chapter. It is based on paragraphs 7(1) and (2) and 8(7F) of Schedule 10 to FA 1996.

1359. The definition of "offshore fund" in paragraph 7 of Schedule 10 to FA 1996 has been applied throughout the Chapter. See *Change 60* in Annex 1.

Clause 490: Holdings in OEICs, unit trusts and offshore funds treated as creditor relationship rights

1360. This clause provides the basic rule: if at any time in an accounting period an OEIC, unit trust scheme or offshore fund fails the qualifying investments test, a company's holdings in such entities are treated as rights under a creditor relationship and the credits and debits are to be brought into account on the basis of fair value. It is based on paragraphs 4(1) to (4) and 7(1) of Schedule 10 to FA 1996, section 48B(5) of FA 2005 and regulation 95(2) of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).

1361. *Subsection (1)(a)(i)* refers to ownership of "shares" in an open-ended investment company. Paragraph 4(1) of Schedule 10 to FA 1996, as modified by regulation 95 of the above regulations, refers to a company holding "rights" in an open-ended investment company. The term "shares" has been used in this clause because regulation 93 of those Regulations provides that the modification made by regulation 95 is in relation to "shareholders" in authorised investment funds. Referring to shares in an open-ended investment company also aligns this clause with clause 587.

1362. In *subsection (5)*, the meaning of "interest distributions" is provided by regulation 18(3) of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).

Clause 491: Holding coming within section 490: opening valuations

1363. This clause provides the opening valuation for holdings of a company in an OEIC, unit trust scheme or offshore fund when clause 490 first applies. It is based on paragraphs 5(1) and 6 of Schedule 10 to FA 1996.

1364. The words "the value of that asset" in paragraph 6 of Schedule 10 to FA 1996 have been rewritten as the "value of the holding" since the words in paragraph 6 refer directly back to "valuation of the holding" in sub-paragraph (b) of that paragraph.

Clause 492: Disregard of investments made and liabilities incurred with avoidance intention etc

1365. This clause provides that in determining credits and debits to be brought into account by any company in respect of its holding ("the relevant holding") under the deemed creditor relationship, there shall be left out of account amounts relating to any investment or liability of the collective investment scheme or fund where the

investment was made or the liability was incurred, or any transaction (or series of transactions) relating to the investment or liability was entered into, with a "relevant avoidance intention". It is based on paragraph 4(5) and (6) of Schedule 10 to FA 1996 and regulation 95(2) of the Authorised Investment Funds (Tax) Regulations 2006.

Clause 493: The qualifying investments test

1366. This clause explains what is meant by the qualifying investment test and how "qualifying investment" is to be interpreted when applied to OEICs, unit trust schemes or offshore funds. It is based on paragraph 8(1), (5), (5A), (7A), and (7C) of Schedule 10 to FA 1996 and regulation 95(3) of the Authorised Investment Funds (Tax) Regulations 2006.

1367. *Subsection (2)(b)* explains the meaning of references to investments of OEICs for cases where under section 468A(3) of ICTA parts of umbrella companies are themselves regarded as separate OEICs. This involves rewriting the reference in paragraph 8(5A) of Schedule 10 to FA 1996 to "investments comprised in the scheme property of that company" with the changes made by paragraph 8(7B) to (7D) for such parts. Paragraph 8(7C)(a) converts these words to a reference to such of the investments of the umbrella company as form part of the separate pool in question. But for paragraph 8(7C)(a), paragraph 8(7C)(b) would operate on the reference in paragraph 8(5A) to scheme property in the case of such parts, but once paragraph 8(7C)(a) has applied, there are no references to scheme property on which paragraph 8(7C)(b) can operate and so it is otiose and has not been rewritten.

Clause 494: Meaning of "qualifying investments"

1368. This clause lists the investments which constitute "qualifying investments". It is based on paragraph 8(2), (7) and (7E) of Schedule 10 to FA 1996, paragraph 1 of Schedule 2 to FA 2005 and regulation 95(3) of the Authorised Investment Funds (Tax) Regulations 2006.

1369. Paragraphs 1 and 9 of Schedule 2 to FA 2005 require the reference to "money placed at interest" in paragraph 8(2)(a) of Schedule 10 to FA 1996 to include a reference to arrangements falling within section 47, 48A, 49 or 49A of FA 2005 (rewritten in Chapter 6 of this Part). It does not include diminishing shared ownership arrangements under section 47A of FA 2005.

1370. The Unit Trust Schemes and Offshore Funds (Non-qualifying Investments Test) Order, SI 2006/981 also added a new paragraph 8(2)(h) to the list of qualifying investments in Schedule 10 to FA 1996 to cover "alternative finance arrangements". They are defined in paragraph 8(7I) of that Schedule by reference to section 46(1) of FA 2005 as arrangements within section 47, 47A, 48A, 49 or 49A of FA 2005.

1371. Therefore, diminishing shared ownership arrangements (section 47A of FA 2005) are included as qualifying investments. However, paragraph 8(2)(e) of Schedule 10 to FA 1996 provides that derivative contracts are only included where the underlying subject matter consists of investments within paragraph 8(2)(a) to (d) of

that Schedule. Therefore derivative contracts that consist mainly of diminishing shared ownership arrangements (section 47A) are not included, and hence the exclusion of these arrangements under *subsection (1)(f)(i).*

1372. The definition of "derivative contract" in paragraph 8(7E) of Schedule 10 to FA 1996 has not been rewritten. If a contract is treated as a derivative contract in Part 7 then it is also treated as a derivative contract for the purposes of this clause because the definition of "derivative contract" in section 834(1) of ICTA (which refers to Schedule 26 to FA 2002 and is consequentially amended to refer to Part 7) applies for the purposes of the Corporation Tax Acts.

Clause 495: Qualifying holdings

1373. This clause explains what is meant by "qualifying holdings" in an OEIC, unit trust scheme or offshore fund within the qualifying investments list in the preceding clause. It is based on paragraph 8(3), (3A), (4), (6) and (7C) of Schedule 10 to FA 1996.

1374. Paragraph 8(3)(b) of Schedule 10 to FA 1996 has been rewritten to make it clear that "the same accounting period" refers to the accounting period of the company holding the investment in the unit trust scheme etc and not the accounting period of the unit trust scheme etc.

1375. Paragraphs 8(6A) and (6B) of that Schedule have not been rewritten because they are considered unnecessary and add nothing to the operation of paragraph 8(6)(c). It does not matter for the purposes of paragraph 8(6)(c) whether the shares are of different denominations; all that matters is their value.

Clause 496: Meaning of "hedging relationship"

1376. This clause provides the meaning of "hedging relationship". It is based on paragraph 8(7G) and (7H) of Schedule 10 to FA 1996.

Clause 497: Power to change investments that are qualifying investments

1377. This clause gives the Treasury power to amend this Chapter. It is based on paragraphs 8(8) and 9 of Schedule 10 to FA 1996.

1378. *Subsection (1)* includes a change that allows the Treasury to amend the descriptions of qualifying investments of an open-ended investment company. See *Change 61* in Annex 1.

1379. *Subsection (2)* allows orders to be made for such "incidental, supplemental, consequential and transitional provision and savings". This is a standard formulation for this Bill for the extra things that can be done under an order and regulation-making powers. It is not considered a change in the law.

Chapter 4: Building societies

Overview

1380. This Chapter brings payments in respect of shares in building societies into the loan relationship regime. It provides that dividends and interest payable in respect of shares in, or deposits with, or loans to, a building society should be treated as a liability arising under a loan relationship of the building society.

Clause 498: Building society dividends and interest

1381. This clause brings dividends and interest payable by building societies into the loan relationship regime so far as they would not otherwise be within it. It is based on section 477A(3), (4), (9) and (10) of ICTA. The corresponding provision for income tax is section 372 of ITTOIA.

Chapter 5: Industrial and provident societies

Overview

1382. This Chapter brings payments in respect of shares in industrial and provident societies and agricultural or fishing co-operatives into the loan relationship regime. It does not treat the shares themselves as a loan relationship other than to allow dividends etc on shares held for the purposes of a trade to be treated as trading income.

Clause 499: Industrial and provident society payments treated as interest under loan relationship

1383. This clause treats certain payments by an industrial and provident society and agricultural or fishing co-operatives as payments of interest on a loan relationship. It is based on section 486(1), (4), (9) and (12) of ICTA. The corresponding provision for income tax is section 379 of ITTOIA.

1384. *Subsection (2)* treats dividends, bonuses and other sums payable on shareholdings held for the purposes of a trade or for other purposes as if that shareholding were a loan relationship so held. See *Change 62* in Annex 1.

Clause 500: Exclusion of interest where failure to make return

1385. This clause disallows a debit for interest paid by industrial and provident societies where returns under section 887 of ITA are not made within the specified period. Section 887 requires such companies to make returns of interest paid without deduction of tax. It is based on section 486(1), (7) and (12) of ICTA.

Chapter 6: Alternative finance arrangements

Overview

1386. This Chapter treats arrangements that comply with Shari'a law as falling within the loan relationships regime. Shari'a law prohibits transactions that involve interest, and arrangements for the borrowing or lending of money will usually involve some form of risk sharing instead. The rules are not limited to Shari'a compliant products but also apply to any finance arrangement that falls within their terms. In this Chapter these arrangements are known as "alternative finance arrangements".

1387. The rules covering alternative finance arrangements do not change the nature of the finance arrangements, nor do they in any way impute interest, or deem interest to arise where there is none. What they do is bring certain types of finance arrangements and the returns from those arrangements, into the same tax rules as those that apply to interest, providing a level playing field for tax between certain types of economically equivalent, but differently structured, finance arrangements.

1388. The Chapter sets out the nature of the five types of alternative finance arrangements in clauses 503 to 507. Clauses 509 to 513 explain which elements of the arrangements are treated as if they were loan relationships.

1389. Sections 48(1), 48B(4), 51, 51A and 56(3) of FA 2005 are not relevant for corporation tax purposes and therefore have not been rewritten in this Bill. They remain in FA 2005 for non-corporation tax purposes.

Clause 501: Introduction to Chapter
1390. This clause provides an introduction to the Chapter by explaining what it does and provides definitions for the Chapter. It is based on paragraph 8(7I) of Schedule 10 to FA 1996 and section 46(1) of FA 2005 and is new in part.

Clause 502: Meaning of "financial institution"
1391. This clause gives the meaning of "financial institution". It is based on section 46(2) and (3) of FA 2005.

Clause 503: Purchase and resale arrangements
1392. This clause deals with the first type of alternative finance arrangement, whereby an asset is purchased by a financial institution and then sold to another person with the payment by that second person left on credit. It is based on section 47(1) to (3) of FA 2005. The price paid by that second person exceeds the price paid by the financial institution. The difference between the two prices equates to the return from an investment at interest and is treated as an alternative finance return (see clause 511).

Clause 504: Diminishing shared ownership arrangements
1393. This clause deals with a second type of alternative finance arrangement. It is based on section 47A(1) to (4) of FA 2005. Two persons, at least one of them a financial institution, acquire an interest in an asset. The financial institution receives payments from the other party for that party's use of the financial institution's share as well as (usually leasing) payments, with the ownership of the asset passing by degrees to the other party. The other party in the arrangement has full use of the asset being acquired and may grant rights in the asset. Payments made by the other party in excess of the payments for the beneficial interest being acquired are treated as an alternative finance return.

Clause 505: Deposit arrangements
1394. This clause deals with a third type of alternative finance arrangement whereby deposits are made with a financial institution and payments are made to the depositor out of profits earned by the use of the money. It is based on section 49(1) of FA 2005. The payments must equate to a return from an investment at interest. The return is treated as an alternative finance return.

Clause 506: Profit share agency arrangements
1395. This clause deals with a fourth type of alternative finance arrangement. It is based on section 49A(1) of FA 2005. Here the investor appoints an agent to whom a sum of money is given to be invested at a specified return. Any additional sum above that specified return is retained by the agent as an incentive fee.

Clause 507: Investment bond arrangements
1396. This clause deals with a fifth type of alternative finance arrangement and sets out the conditions that must be present for arrangements to be treated as an investment bond arrangement. It is based on section 48A(1) and (2) of FA 2005. Investment bond arrangements are a new variety of alternative finance arrangement that share some characteristics of a bond.

1397. An investment bond arrangement exists where the "bond-issuer" uses the subscription proceeds to acquire assets, which are specified in the arrangement, and are held for the benefit of the "bond-holder". Income generated from the assets is distributed to the bond-holder and, on maturity of the bond, the assets are sold under pre-existing arrangements and the proceeds returned to the bond-holder.

Clause 508: Provision not at arm's length: exclusion of arrangements from sections 503 to 507
1398. This clause excludes arrangements from clauses 503 to 507 where the parties are connected persons within the transfer pricing legislation in Schedule 28AA of ICTA, the arrangements are not at arm's length and the recipient of the alternative finance return is not subject to income or corporation tax or a similar non-United Kingdom tax. It is based on section 52(1) to (3) of FA 2005.

1399. In *subsection (2)(c)(ii)* "an amount representing relevant return" covers back to back arrangements where there is an intermediary between the two parties to the arrangements.

Clause 509: Application of Part 5: general
1400. This clause applies Part 5 to the five kinds of alternative finance arrangements. It is based on section 50(1) to (3) of FA 2005.

Clause 510: Application of Part 5 to particular alternative finance arrangements
1401. This clause provides, for each of the five alternative finance arrangements, the rules for what is to be treated as interest under that deemed loan relationship. It also

provides some definitions for terms used in this clause. It is based on section 50(1) to (2A) and (4) of FA 2005 and paragraph 7 of Schedule 2 to that Act.

Clause 511: Purchase and resale arrangements

1402. This clause explains the meaning of "alternative finance return" in relation to the purchase and resale arrangements in clause 503. It is based on section 47(4), (6), (7) and (8) of FA 2005. It provides for where the second purchase price is paid either immediately or in instalments.

Clause 512: Diminishing shared ownership arrangements

1403. This clause explains the meaning of "alternative finance return" in relation to the diminishing shared ownership arrangements in clause 504. It is based on section 47A(5) of FA 2005.

1404. "Costs and expenses" in section 47A(5) has been reduced to "expenses" in *subsection (3)* to avoid tautology.

Clause 513: Other arrangements

1405. This clause explains the meaning of "alternative finance return" in relation to deposit arrangements, profit share agency arrangements and investment bond arrangements. It is based on sections 48B(1), 49(2) and 49A(2) of FA 2005.

1406. In FA 2005 the return on some alternative investment arrangements is called "alternative finance return", but the return on deposit arrangements and profit share agency arrangements is called "profit share return". However, there is no material difference in the returns on these arrangements to justify different terminology. So "profit share return" has been replaced with "alternative finance return" in relation to deposit arrangements (clause 505) and profit share agency arrangements (clause 506). These are then consistent with purchase and resale arrangements, diminishing shared ownership arrangements and investment bond arrangements.

1407. Chapter 5 of Part 2 of FA 2005 is being amended to remove the term "profit share return" for income tax purposes.

Clause 514: Exclusion of alternative finance return from consideration for sale of assets

1408. This clause excludes the profits dealt with as interest under a loan relationship in relation to the arrangements under clauses 503, 504 and 507 from determining the sale or purchase price for other tax purposes (eg trading or capital gains). It is based on section 53(1) to (3) of FA 2005. It does not prevent other tax provisions applying which substitute a different sum for a sale or purchase amount.

Clause 515: Diminishing shared ownership arrangements not partnerships

1409. This clause provides that diminishing shared ownership arrangements are not treated as a partnership for the purposes of the Corporation Tax Acts. It is based on section 47A(6) of FA 2005.

Clause 516: Treatment of principal under profit sharing agency arrangements
1410. This clause ensures that in the case of profit sharing arrangements the deposit-taker is taxable in respect of all of the profit resulting from the use of the money – both the depositor's share of profit made under the arrangements and also the amount that the deposit-taker can retain. It is based on section 49A(3) of FA 2005. The deposit-taker is entitled to relief for the depositor's share of profit.

Clause 517: Treatment of bond-holder under investment bond arrangements
1411. This clause provides that whatever the documentation accompanying investment bond arrangements may say, for tax purposes the bond-holder is not treated as having a legal or beneficial interest in the assets, and so is not entitled to capital allowances, nor is the bond-issuer treated as a trustee, or as making payments in a fiduciary or representative capacity. It is based on section 48B(2) of FA 2005.

Clause 518: Investment bond arrangements: treatment as securities
1412. This clause provides that alternative finance investment bonds are securities for the purposes of the Corporation Tax Acts. It is based on section 48B(3) of FA 2005.

Clause 519: Investment bond arrangements: other provisions
1413. This clause provides the rules about how investment bond arrangements impact on the regimes for securitisation companies, close companies and group relief. It is based on section 48B(6) to (8) of FA 2005.

Clause 520: Provision not at arm's length: non-deductibility of relevant return
1414. This clause prevents any deduction in calculating profits for corporation tax purposes as a result of alternative finance arrangements where the arm's length rule in clause 508 applies. It is based on section 52(4) and (5) of FA 2005.

Clause 521: Power to extend this Chapter to other arrangements
1415. This clause provides the Treasury with powers to introduce further arrangements into this Chapter and make consequential amendments to the Tax Acts as necessary. It is based on section 98 of FA 2006.

Chapter 7: Shares with guaranteed returns etc
Overview
1416. The rules in this Chapter counter avoidance through the use of shares which function in a similar way to loan relationships but which fall outside the definition. The schemes making use of these shares exploit the fact that increases in value and gains from the disposal of shares are subject only to the rules for corporation tax on chargeable gains, if at all. The schemes use derivatives in conjunction with shares, or deferred subscription agreements to create what is in form a share but in economic substance a deposit or loan. In most of them the risks associated with equity investments, as well as the rewards, are removed or significantly reduced, leaving the share giving a return, either by the payment of "dividends" or by a wholly predictable increase in value, which is the type of return expected from debt.

Clause 522: Introduction to Chapter
1417. This clause sets out what the Chapter does, how it is arranged and some useful cross-references. It is based on sections 91A(1), (10) and (11), 91B(1), (7) and (8), 91C(7), 91D(13) and 91E(4) of FA 1996.

1418. *Subsection (6)* provides that the full definition of "share" in clause 476 does not apply for the purposes of this Chapter. The part of the definition that does apply to this Chapter is that the meaning of "share" does not include a share in a building society.

Clause 523: Application of Part 5 to certain shares as rights under creditor relationship
1419. This clause treats rights in shares as loan relationships and distributions from such shares as debits or credits under this Part where either clause 524 or 526 applies. It is based on sections 91A(1), (2) and (2A) and 91B(1), (2), (2A) and (6A) of FA 1996.

Clause 524: Shares subject to outstanding third party obligations
1420. This clause deals with the first type of shares to fall within clause 523: shares which increase in value in a similar way to an investment return as a result of an obligation by a third party. It is based on section 91A(1) and (5) to (6) of FA 1996.

Clause 525: Meaning of "interest-like investment"
1421. This clause explains a term used in the previous clause. It is based on section 91A(7) to (9) of FA 1996.

Clause 526: Non-qualifying shares
1422. This clause deals with the second type of shares to fall within clause 523: shares ("non-qualifying shares") which produce predictable gains because of the nature of the assets underlying them. It is based on section 91B(1) and (6) of FA 1996. One of three conditions, dealt with in clauses 527 and 529 to 532, must be met for shares to fall within this category.

Clause 527: The increasing value condition
1423. This clause gives the first of the conditions necessary for a share to be a non-qualifying share within clause 526. It is based on section 91C(1) to (3) and (6) of FA 1996. This is where the assets of the company in which the shares are held increase at a rate similar to commercial interest but which are not income-producing.

Clause 528: Regulations about income-producing assets
1424. This clause gives powers to the Treasury to add to the list of income-producing assets in clause 527. It is based on section 91C(4) and (5) of FA 1996.

Clause 529: The redemption return condition
1425. This clause gives the second of the conditions necessary for a share to be a non-qualifying share within clause 526. It is based on section 91D(1) to (2A) of

FA 1996. This is where a redeemable share (with certain exceptions) produces a return similar to commercial interest.

Clause 530: The redemption return condition: excepted shares
1426. This clause explains which redeemable shares are excluded from being shares which may meet the condition dealt with by clause 529. It is based on section 91D(3) to (8) and (11) of FA 1996.

1427. "Independent person" in section 91D has been rewritten in this clause as "persons not connected with the company" which is the definition in section 91D(11). Given that the definition in section 839 of ICTA applies, "persons" here refers to both companies and individuals. Section 839 is not separately referred to in this Part as the definition of "connected persons" in clause 1316 applies for the purposes of the Bill. The use of "independent person" appears twice in Chapter 2 of Part 4 of FA 1996 with two quite different definitions. The other definition is in section 103 of FA 1996. The use of both terms has been replaced by their definitions.

Clause 531: The redemption return condition: unallowable purposes
1428. This clause explains what is meant by an unallowable purpose to ascertain whether a share is a qualifying publicly issued share for the purposes of clause 530 and thus excluded from the redemption return condition as an excepted share. It is based on section 91D(9) to (11) of FA 1996.

Clause 532: The associated transactions condition
1429. This clause gives the third and final condition necessary for a share to be a non-qualifying share within clause 526. It is based on section 91E(1) to (3) of FA 1996. This is where neither of the other conditions is met but there is a scheme or arrangement under which the combined effect of the shares and another transaction produce a return similar to a commercial rate of interest.

Clause 533: Power to change conditions for non-qualifying shares
1430. This clause gives the Treasury the power to vary the conditions to be met under which shares may be "non-qualifying shares" for the purposes of clause 526. It is based on section 91F of FA 1996.

Clause 534: Amounts to be brought into account where section 523 applies
1431. This clause sets out rules concerning the amounts to be brought into account for the purposes of this Part by the company holding the shares. It is based on section 91A(3), (4) and (9) and section 91B(3), (4) and (6A) of FA 1996.

1432. *Subsection (7)* overrides the requirement for amortised cost basis where both this clause and clause 349 apply. See *Change 57* in Annex 1.

Clause 535: Shares ceasing to be shares to which section 523 applies
1433. This clause treats shares which cease to fall within section 523 as having been disposed of and reacquired. It is based on section 91G(2) of FA 1996.

Chapter 8: Returns from partnerships

Overview

1434. This Chapter deals with arrangements involving firms that are intended to give rise to interest-like returns. It brings into the loan relationship provisions those arrangements that function in a similar way to loan relationships but which fall outside the definition. It is based on sections 91H and 91I of FA 1996 (inserted by paragraph 17 of Schedule 22 to FA 2008).

Clause 536: Introduction to Chapter

1435. This clause sets out what the Chapter does and how it is arranged. It is based on sections 91H(1), (2) and (6), and 91I(1), (2) and (7) of FA 1996.

Clause 537: Payments in return for capital contribution to partnership

1436. This clause deals with arrangements under which a company obtains a return by acquiring an interest in a firm for an amount which will increase in value in a similar way to interest. It is based on section 91H(1) to (4) of FA 1996.

1437. In accordance with the Partnership Act 1890, in this Bill reference to the relationship between the partners is a "partnership", but the collection of partners is a "firm".

Clause 538: Change of partnership shares

1438. This clause deals with arrangements under which a company invests money in a firm in the form of capital contributions, initially receiving a share of the firm's profits that is smaller than would be received by reference to that contribution but with a compensating greater entitlement to capital of the firm later on. It is based on section 91I(1) to (5) of FA 1996.

Chapter 9: Manufactured interest etc

Overview

1439. This Chapter treats "manufactured interest" (payments representing interest under a stock-lending arrangement) as interest under a loan relationship.

Clause 539: Introduction to Chapter

1440. This clause explains when a company has a "manufactured interest relationship". It is based on section 97(1) and (4) of FA 1996.

Clause 540: Manufactured interest treated as interest under loan relationship

1441. This clause provides the main rule that the manufactured interest is treated as if it were interest under a loan relationship and the manufactured interest relationship is treated as if it were a loan relationship. It is based on section 97(2), (2A) and (4B) of FA 1996. It also ensures that debits and credits in respect of related transactions can still be taken into account after the company no longer has the right to receive manufactured interest (to prevent the sale of rights to receive such interest to third parties).

Clause 541: Debits for deemed interest under stock lending arrangements disallowed

1442. This clause disallows a debit under the loan relationship provisions for representative payments under section 736B(2) of ICTA. It is based on section 97(4A) of FA 1996.

Chapter 10: Repos

Overview

1443. The rules in this Chapter provide for the tax treatment of repo transactions to follow their accounting treatment under generally accepted accounting practice (GAAP). These rules have been rewritten from Schedule 13 to FA 2007.

Clause 542: Introduction to Chapter

1444. This clause sets out the purpose of the Chapter and how it is arranged. It is based on paragraph 1(1) of Schedule 13 to FA 2007.

1445. The purpose of the Chapter is that arrangements involving the sale and subsequent purchase of securities that equate in substance to the lending of money by or to a company (with the securities in substance acting as collateral) are to be taxed in accordance with their economic substance and accounting treatment.

Clause 543: Meaning of creditor repo

1446. This clause provides the definition of creditor repo - that is, a repo from the point of view of the lender, the company that purchases the securities as collateral. It is based on paragraph 7 of Schedule 13 to FA 2007.

1447. The securities are purchased with cash that, although legally a purchase price, equates in substance to a loan. Commercially this is known as a "reverse repo". It is intended to cover normal repos executed under standard market documentation (although since it does not require the lender to sell the securities back to "the borrower" it goes wider than this).

Clause 544: Meaning of creditor quasi-repo

1448. This clause provides the definition of creditor quasi-repo. It is based on paragraph 8 of Schedule 13 to FA 2007. A creditor quasi-repo is intended to cover arrangements that are economically equivalent to standard creditor repos but are on non-standard terms.

Clause 545: Ignoring effect on lender etc of sale of securities

1449. This clause contains the first of two operative rules that apply when a company ("the lender") has a creditor repo or creditor quasi-repo. It is based on paragraph 9 of Schedule 13 to FA 2007.

1450. The rule is intended to secure that the lender is not taxed on any income that arises on the securities during the period of the repo and does not obtain tax relief for any manufactured payments made, so long as neither is recognised in determining the

lender's profit or loss. This rule reflects the fact that for accounts purposes neither the income nor the payment will generally be recognised.

Clause 546: Charge on lender for finance return in respect of the advance

1451. This clause contains the second operative rule for creditor repos and creditor quasi-repos. It is based on paragraph 10 of Schedule 13 to FA 2007. It treats the financial asset as a loan relationship and the finance charge reflected in the accounts as deemed interest on that loan.

Clause 547: Repo under arrangement designed to produce quasi-interest: tax avoidance

1452. This clause is an anti-avoidance provision. It is based on paragraph 12 of Schedule 13 to FA 2007.

Clause 548: Meaning of debtor repo

1453. This clause introduces the concept of "debtor repo" – that is, a repo from the point of view of the borrower, the company that sells securities as collateral. It is based on paragraph 2 of Schedule 13 to FA 2007. It is intended to cover normal repos executed under standard market documentation (although since it does not require the borrower to buy the securities back from "the lender" it goes slightly wider than this).

Clause 549: Meaning of debtor quasi-repo

1454. This clause is the counterpart of clause 544 and introduces the concept of "debtor quasi-repo" which is intended to cover arrangements that are economically equivalent to standard debtor repos but are on non-standard terms. It is based on paragraph 3 of Schedule 13 to FA 2007.

Clause 550: Ignoring effect on borrower of sale of securities

1455. This clause contains the first of two operative rules that apply when a company ("the borrower") has a debtor repo or debtor quasi-repo. It is based on paragraph 4 of Schedule 13 to FA 2007. It also contains a special rule that applies where a person has entered into a "relevant arrangement".

1456. It provides for the sale of securities by a company and the manufactured payment made by the other company in respect of the securities to be ignored. The borrower is taxed on the interest (or dividends) from the securities the borrower is selling and any manufactured interest the borrower receives representing that income is ignored.

Clause 551: Relief for borrower for finance charges in respect of the advance

1457. This clause sets out the second operative rule for debtor repos and debtor quasi-repos which is that the borrower obtains relief for any finance charge shown in its accounts that represents its cost of borrowing. It is based on paragraph 5 of Schedule 13 to FA 2007.

Clause 552: General provisions about arrangements
1458. This clause provides a number of rules for the purpose of applying other clauses in this Chapter. It is based on paragraph 14(5) to (7) of Schedule 13 to FA 2007.

Clause 553: Persons buying or selling for others
1459. This clause ensures that where the sale or purchase of securities is made by a person for the benefit of another, the rules operate by reference to beneficial ownership. It is based on paragraph 14(3) of Schedule 13 to FA 2007.

Clause 554: Power to modify this Chapter
1460. This clause contains a power to modify some of the provisions of the Chapter to deal with non-standard repos or cases involving redemption arrangements. It is based on paragraph 15(1), (6), (7) and (9) of Schedule 13 to FA 2007.

Clause 555: Cases where section 554 applies: non-standard repos
1461. This clause sets out the situations when the powers under clause 554 may be used. It is based on paragraph 15(2) to (5) of Schedule 13 to FA 2007.

Clause 556: Meaning of securities and similar securities
1462. This clause explains the meaning of "securities" for the other clauses. It is based on paragraph 14 of Schedule 13 to FA 2007.

Clause 557: Meaning of person receiving an asset
1463. This clause provides that receiving an asset or payments in respect of an asset includes obtaining the value of, or a benefit from, an asset, whether directly or indirectly. It is based on paragraph 14(2) of Schedule 13 to FA 2007.

Clause 558: Interpretation of accounting expressions
1464. This clause explains accounting expressions used in the Chapter. It is based on paragraph 14(9) and (11) of Schedule 13 to FA 2007.

Clause 559: Minor definitions
1465. This clause provides further definitions for expressions used in this Chapter. It is based on paragraph 14(1) of Schedule 13 to FA 2007.

Chapter 11: Investment life insurance contracts
Overview
1466. This Chapter contains provisions that treat investment life insurance contracts as falling within the loan relationship rules. It is based on Schedule 13 to FA 2008.

Clause 560: Introduction to Chapter
1467. This clause sets out the purpose of the Chapter, how it is arranged and provides definitions for the Chapter. It is based on paragraph 1(1) and (2) of Schedule 13 to FA 2008.

Clause 561: Meaning of "investment life insurance contract"
1468. This clause defines "investment life insurance contract", and also states the types of policies that are excluded from that definition. It is based on paragraph 1(1) to (3) of Schedule 13 to FA 2008.

Clause 562: Contract to be loan relationship
1469. This clause treats the investment life insurance contract as a creditor relationship of the company for the loan relationship provisions. It is based on paragraph 2(1) and (2) of Schedule 13 to FA 2008.

1470. *Subsections (3) and (4)* provide that credits representing the excess of any lump sum payout on death, or the onset of critical illness, over the policy's surrender value at that time are exempt from tax under the loan relationship rules.

Clause 563: Increased non-trading credits for BLAGAB and EEA taxed contracts
1471. This clause provides a special rule within the loan relationships legislation for company-held investment policies. It is based on paragraphs 3(1) to (3) and 4(1) of Schedule 13 to FA 2008.

1472. The rule applies where the contract is a BLAGAB contract or is subject to a comparable "EEA tax charge". In general, such policies will simply follow the normal rules, but this clause recognises that in many cases the insurance company will have borne tax on the income and gains which are building up within the company in order to provide the benefits under the policy.

1473. This clause provides that where a company has to bring in a non-trading credit representing a profit from a related transaction, then that credit is increased and the amount of the increase is set off against corporation tax assessable on the company for the accounting period.

Clause 564: Section 563: interpretation
1474. This clause provides the meaning of "BLAGAB contract" and provides the conditions for when a relevant comparable EEA tax charge has applied. It is based on paragraph 3(4) to (6) of Schedule 13 to FA 2008.

Clause 565: Relevant amount where the relevant company uses fair value accounting
1475. This clause provides a special rule where the policy is accounted for on the basis of fair value accounting. It is based on paragraphs 3(3) and 4(1) to (4) of Schedule 13 to FA 2008.

1476. The rule ensures that the whole profit, and not just the credit calculated by reference to the opening fair value at the start of the accounting period of sale etc, is used in calculating the additional credit and giving relief for the whole of the relevant I minus E tax.

Clause 566: Introduction

1477. This clause introduces the following three clauses that deal with the charges on future gains of investment life insurance contracts that existed immediately before the beginning of the first accounting period of the company beginning on or after 1 April 2008. It is based on paragraphs 6(1), 7(1) and 8(1) of Schedule 13 to FA 2008.

1478. Although these clauses are transitional, they have been placed in the body of this Part, rather than in the Schedules, because those contracts will be the majority for some time.

1479. The part of paragraph 6(1) providing that there was a deemed surrender of the rights under the contract immediately before 1 April 2008 is spent and has not been rewritten.

Clause 567: Gains on deemed surrenders to be brought into account on related transactions

1480. This clause provides that gains that accrued as a result of that deemed surrender are brought into account in the accounting period in which there is a related transaction. It is based on paragraphs 6(2) to (4) of Schedule 13 to FA 2008.

1481. The deemed gain that is brought into account is apportioned where the company is still party to the contract after the related transaction.

Clause 568: Restriction on credits on old contracts: fair value accounting cases

1482. This clause applies where the company uses fair value accounting and the cost of the contract at the start of the first accounting period beginning on or after 1 April 2008 is greater than the fair value of that contract at that time. It is based on paragraph 7(1) to (3) of Schedule 13 to FA 2008.

1483. Subsequent credits are not brought into account until they exceed the amount by which cost exceeded fair value at the start of that period.

Clause 569: Restriction on debits on old contracts: non-fair value accounting cases

1484. This clause applies where the company does not use fair value accounting and the carrying value of the contract at the start of the first accounting period beginning on or after 1 April 2008 is greater than the fair value of that contract at that time. It is based on paragraph 8(1) and (2) of Schedule 13 to FA 2008.

1485. Subsequent debits are not brought into account until they exceed the amount by which that carrying value exceeded that fair value.

1486. This rule prevents amounts being brought into account where the drop in value of the policy occurred before the start of the initial period.

Part 7: Derivative contracts

Overview

1487. This Part deals with profits and losses arising to a company from its derivative contracts. It is based on Schedule 26 to FA 2002.

1488. In most cases, the company's accounts treatment of its derivatives is followed in identifying and quantifying the credits and debits which make up profits and losses in respect of its derivative contracts for tax purposes.

1489. If the contract is held for the purposes of a company's trade, credits and debits arising from it are treated as receipts and expenses in calculating the profits of the trade under Part 3 of this Bill. If it is not so held, the credits and debits are brought into account under Part 5 of this Bill (loan relationships) in determining whether the company has non-trading profits or a non-trading deficit from its loan relationships. But, in a number of cases (primarily if the underlying subject matter of the derivative contract is land or shares), credits and debits are instead treated as giving rise to chargeable gains or allowable losses for the purposes of TCGA.

1490. There are similarities between many of the core rules for derivative contracts and those for loan relationships. The arrangement and drafting of the provisions for such common rules in Parts 5 and 6 and this Part is matched so far as appropriate. There are also rules for the interaction of the two regimes if a loan relationship includes a derivative contract (see clause 700).

1491. Secondary legislation modifies the effect of these clauses. See in particular the Exchange Gains and Losses (Bringing into Account Gains or Losses) Regulations 2002 (SI 2002/1970), as amended, the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256), as amended, and the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (SI 2004/3271), as amended. The modifications in secondary legislation have not been rewritten in these clauses.

1492. The Part uses a number of defined terms. The more important are those in clauses 576 to 583 (meaning of "derivative contract" and other basic definitions) in Chapter 2, clause 596 (meaning of "related transaction") in Chapter 3 and clauses 702 to 710 (other general definitions) in Chapter 13.

1493. Part 10 of Schedule 2 contains a number of transitional rules affecting the application of this Part. The commentary draws attention where relevant to particular paragraphs. But see particularly the paragraphs headed "contracts which became derivative contracts on 16 March 2005", "contracts which became derivative contracts on 28 July 2005" and "plain vanilla contracts which became derivative contracts before 30 December 2006" which have more general effect.

Chapter 1: Introduction

Clause 570: Overview of Part

1494. This clause contains a brief description of the Part and includes a signpost to the key definition for the Part, that of "derivative contract". It is new.

Clause 571: General rule: profits chargeable as income

1495. This clause provides that profits arising to a company from its derivative contracts are chargeable to corporation tax as income. It is based on paragraph 1(1) of Schedule 26 to FA 2002.

1496. Profits arising to a company from its derivative contracts are generally chargeable to corporation tax as income, even if they would otherwise be regarded as capital profits under accounting rules. But some such profits are charged instead to corporation tax as chargeable gains. *Subsection (2)* signposts this exception to the general rule.

1497. Profits are so chargeable "in accordance with this Part". That is, this Part contains all the necessary rules for identifying and quantifying the amount to be charged to tax. These rules take priority over any rule that might otherwise apply. See in particular clause 699 (priority of this Part for corporation tax purposes).

Clause 572: Profits and losses to be calculated using credits and debits given by this Part

1498. This clause sets out how profits and losses from derivative contracts are calculated. It is based on paragraph 14(1) of Schedule 26 to FA 2002.

1499. The terms "credit" and "debit" are used in accounting practice. The Part operates by reference to accounts drawn up in accordance with generally accepted accounting practice (see clause 595 (general principles about the bringing into account of credits and debits)).

1500. Chapter 3 contains the main rules for finding the relevant credits and debits. *Subsection (2)* indicates that in some cases profits and losses are calculated using other factors (the clauses in question all give rise to amounts to be charged to corporation tax as chargeable gains).

Clause 573: Trading credits and debits to be brought into account under Part 3

1501. This clause provides for the treatment of credits and debits if the company is a party to the derivative contract for the purposes of a trade it carries on. It is based on paragraph 14(2) and (4) of Schedule 26 to FA 2002.

1502. Credits and debits are treated respectively as receipts and expenses of the company's trade. Profits and losses in respect of the derivative contract are therefore charged under Part 3 (trading income).

1503. The provisions referred to in *subsection (4)* are those that would otherwise prevent a debit being taken into account as an expense of the trade.

1504. The provisions referred to in *subsection (5)* disapply this clause, either because the contract in question is taken outside the scope of this Part or because credits and debits are taken into account instead in computing chargeable gains.

Clause 574: Non-trading credits and debits to be brought into account under Part 5

1505. This clause provides for credits and debits to be brought into account under Part 5 (loan relationships) if clause 573 does not apply to them. It is based on paragraph 14(3) of Schedule 26 to FA 2002.

1506. Credits and debits are treated as non-trading credits and non-trading debits for the purposes of Part 5 and lumped in with any non-trading credits and non-trading debits arising on the company's loan relationships to determine whether there is an amount to charge (or to relieve as a deficit) under that Part. Profits and losses in respect of such credits and debits arising from the derivative contract are therefore charged under Part 5.

1507. *Subsection (3)* has the same function for non-trading credits and debits as does clause 573(5) for trading credits and debits. The paragraphs in Part 10 of Schedule 2 headed "existing assets representing creditor relationships: options", "existing assets representing creditor relationships: contracts for differences" and "disapplication of section 658" also disapply this clause.

Chapter 2: Contracts to which this Part applies

Clause 575: Overview of Chapter

1508. This clause describes the purpose and content of the Chapter. It is new.

Clause 576: "Derivative contract"

1509. This clause sets out the conditions under which a contract of a company is a derivative contract. It is based on paragraph 2(1) of Schedule 26 to FA 2002.

1510. The first condition, that it is a "relevant contract" (defined in clause 577), limits the application of the term "derivative contract" to contracts that derive their value from underlying subject matter (defined in clause 583) which is subject to changes in market prices or other factors.

1511. The second condition, that it meets the "accounting conditions" in clause 579, means that the contract either:

- is treated by the relevant accounting standards as a derivative or as a financial asset or liability; or

- has underlying subject matter within certain categories.

1512. The third condition, that clause 589 (contracts excluded because of underlying subject matter: general) or "any other provision of the Corporation Tax Acts" does not prevent it being a derivative contract, cuts down the scope of this Part, particularly in relation to contracts whose underlying subject matter is land or shares. Section 226(3) of FA 1994 (Lloyd's underwriters: relevant contract forming part of a premium trust fund not to be a derivative contract) is an example of such another provision.

Clause 577: "Relevant contract"
1513. This clause defines the term "relevant contract". It is based on paragraph 2(2) of Schedule 26 to FA 2002.

1514. In this Part, the term is used to refer generically to a contract within one of the three categories of contract listed here. In many contexts it is immaterial whether the relevant contract is an option, a future or a contract for differences.

1515. See also clauses 584 to 586, under which some of the rights and liabilities under a contract are themselves *treated* as a relevant contract. The deemed relevant contract is a derivative contract if it meets the other conditions in clause 576(1).

Clause 578: Relevant contracts of a company and being party to such contracts
1516. This clause explains what references in this Part to a company's relevant contracts, or to a company being a party to such a contract, mean. It is based on paragraphs 2(2A) and 53(1) and (2) of Schedule 26 to FA 2002.

1517. A relevant contract is "of" a company if that company has entered into or acquired the contract. A reference to a company being a party to a contract means the company has entered into or acquired the contract.

1518. *Subsection (2)* explains what "acquires" means in relation to a contract for the purposes of this Part. The words "whether by assignment or otherwise" in the source legislation have not been reproduced as they add nothing.

Clause 579: The accounting conditions
1519. This clause sets out the conditions mentioned in clause 576(1)(b). It is based on paragraph 3 of Schedule 26 to FA 2002.

1520. Most derivative contracts meet the first of the conditions in *subsection (1)*, that the relevant contract is treated for accounting purposes as a derivative. *Subsections (3)* and *(5)* explain when a relevant contract is treated for accounting purposes as a derivative. Financial Reporting Standard 25 ("FRS 25") deals with the presentation of financial instruments in accounts.

1521. The second condition has two legs. The first covers a contract that does not meet a particular requirement of Financial Reporting Standard 26 (measurement in accounts of financial instruments) ("FRS 26") that must be satisfied if the contract in question is to be treated as a derivative under FRS 25. Paragraph 9(b) of FRS 26

prescribes that the "financial instrument or other contract within the scope of this Standard… requires no initial net investment or an initial net investment that is smaller than would be required for other types of contract that would be expected to have a similar response to changes in market factors".

1522. The second leg of the second condition is that the contract is nevertheless treated for accounting purposes as a financial asset or financial liability. *Subsections (4)* and *(5)* have the same function in relation to the second condition as have subsections (3) and (5) in relation to the first condition.

1523. The third condition brings in contracts that fail the first or second condition but have underlying subject matter within one of the categories prescribed in *subsection (2)*. If the underlying subject matter is commodities, it does not matter what category of relevant contract the contract is. But only a contract for differences can meet the condition by reference to the other prescribed categories of underlying subject matter. So an option or future whose underlying subject matter is one or more of the categories in subsection (2)(b) is only a derivative contract if it meets one of the other accounting conditions.

Clause 580: "Option"

1524. This clause defines the term "option". It is based on paragraph 12(1), (8) and (10) of Schedule 26 to FA 2002.

1525. Subject to the non-exhaustive definition in *subsection (1)* and the limitation in *subsection (2*) (itself limited by *subsection (3)*), the word takes its ordinary meaning. "Warrant", in subsection (1), is defined in clause 710 (other definitions).

1526. The limitation in subsection (2) excludes cash-settled options from the meaning of "option". Contracts so excluded fall within the definition of contracts for differences and are therefore subject to the rules applying to relevant contracts generally and those applying specifically to contracts for differences.

1527. *Subsection (4)* lists a number of provisions that dispense with this limitation and so do not exclude cash-settled options from the meaning of "option" in that context.

Clause 581: "Future"

1528. This clause defines the term "future". It is based on paragraph 12(1), (6), (7) and (10) of Schedule 26 to FA 2002.

1529. *Subsections (3)* and *(4)* exclude cash-settled futures from the scope of the definition in the same way that clause 580(2) and (3) does for cash-settled options in relation to the definition of "option". Contracts so excluded also fall within the definition of contracts for differences.

Clause 582: "Contract for differences"

1530. This clause defines the term "contract for differences". It is based on paragraph 12(1), (3), (4) and (5) of Schedule 26 to FA 2002.

1531. This is the broadest category of relevant contract and the definition is expressed initially in wide-ranging terms. *Subsection (2)* therefore excludes a number of categories of contract from the scope of the definition, in particular an option and a future, but also a loan relationship and a number of other types of financial instrument. Clause 710 has definitions of "contract of insurance" and "capital redemption policy". For the meaning of "loan relationship", see clause 302.

1532. *Subsection (3)* emphasises the wide-ranging nature of the indices or factors that may be designated in a contract for differences. The words in the source legislation "and, for those purposes, a numerical value may be attributed to any variation in a matter", have not been rewritten as they add nothing. It is of the essence of any index or factor used in a contract for differences that it has such a numerical value.

Clause 583: "Underlying subject matter"

1533. This clause defines the term "underlying subject matter" for each category of relevant contract. It is based on paragraph 11 of Schedule 26 to FA 2002.

1534. *Subsection (5)* echoes clause 579(2)(b) in explaining that certain factors may be the underlying subject matter of a contract for differences. One of those factors is interest rates. *Subsection (6)* provides that interest rates are not regarded as the underlying subject matter of a contract for differences if such rates are only used incidentally in determining the variable amount of a payment due under the contract at a variable date. That is, in such a case an interest rate or rates are a factor in the operation of the contract but are not themselves what its outcome depends on.

1535. *Subsection (7)* applies to all categories of relevant contract. It stops certain types of property from being regarded as the underlying subject matter of the contract just because *income* from that property is included in that underlying subject matter. Contracts to which this provision applies are therefore, as regards this aspect of their underlying subject matter, not excluded as derivative contracts under clause 589.

Clauses 584 to 586: Cases where companies treated as parties to relevant contracts

Overview

1536. These three clauses treat certain rights and liabilities under a contract (an "embedded derivative") as themselves constituting a relevant contract independent of the remaining rights and liabilities under the main contract. The deemed relevant contract is a derivative contract if it meets the conditions in clause 576(1)(b) and (c).

1537. All three cases cater for the provision in accounting standards for a financial or other instrument to be treated as divided between:

- the rights and liabilities that constitute one or more derivatives or one or more derivative financial instruments or equity instruments; and

- the remaining rights and liabilities under the instrument.

1538. All three cases provide for the deemed relevant contract to be treated as an option, future or contract for differences if that is what a contract having only the rights and liabilities of the deemed relevant contract would be. So references in this Part to an option, future or contract for differences include a reference to the deemed relevant contract unless the context requires otherwise. And provisions dealing with a "relevant contract" or "derivative contract" apply to an embedded derivative that is treated as a relevant contract or qualifies as a derivative contract unless the context requires otherwise.

1539. A number of provisions in this Part make special provision for one or other category of embedded derivative (see in particular Chapters 7 and 8 (chargeable gains arising in relation to derivative contracts)).

Clause 584: Hybrid derivatives with embedded derivatives
1540. This clause treats a relevant contract divided in accordance with generally accepted accounting practice between one or more embedded derivatives and a host contract as a number of relevant contracts for the purposes of this Part. It is based on paragraph 2B of Schedule 26 to FA 2002.

1541. It applies if a relevant contract that is not itself a derivative for accounting purposes is so divided into one or more embedded derivatives and the remaining rights and liabilities ("the host contract") which by themselves amount to a relevant contract.

1542. The host contract is also treated as a relevant contract with the same consequences as for the embedded derivative (in this respect, this clause differs from its two successors).

1543. A relevant contract which may be treated as containing such deemed relevant contracts is called a "hybrid derivative" (*subsection (4)*). *Subsection (5)* lists the provisions which apply in relation to a hybrid derivative.

Clause 585: Loan relationships with embedded derivatives
1544. This clause treats the embedded derivative or embedded derivatives in a company's loan relationship as relevant contracts. It is based on section 94A of FA 1996.

1545. It applies if a loan relationship is treated under generally accepted accounting practice as divided between rights and liabilities under one or more derivative financial instruments or equity instruments (the embedded derivative(s)) and the remaining rights and liabilities which by themselves constitute a loan relationship.

1546. For the meaning of "equity instrument", see clause 710 (that is, it has the meaning it has for accounting purposes). It is defined in paragraph 11 of International Accounting Standard 32 as follows: "an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities".

1547. *Subsection (4)* is a signpost to clause 415 in Part 5 (loan relationships) which deals with the remaining rights and liabilities which by themselves constitute a loan relationship.

1548. *Subsection (5)* includes a signpost to clause 416 which provides for a company to elect that certain of its loan relationships shall be split as mentioned in clause 415 and this clause, if they would not be so split under the accounting practice the company uses.

Clause 586: Other contracts with embedded derivatives

1549. This clause provides for the embedded derivative or embedded derivatives in a contract that is neither a hybrid derivative nor a loan relationship to be treated as relevant contracts. It is based on paragraph 2A of Schedule 26 to FA 2002.

1550. It applies if such a contract is divided under generally accepted accounting practice between one or more embedded derivatives and the remaining rights and liabilities under the contract.

1551. *Subsection (2)(a)* is written in terms of the rights and liabilities of the embedded derivative rather than, as in the source legislation, simply referring to the embedded derivative. This aligns the rule here with the expression of the similar rule in the preceding two clauses.

1552. The source legislation for subsection (2)(b) refers at the equivalent point to a contract "whose rights and liabilities consist only of one of the *non-financial* embedded derivatives". "Non-financial" is part of the label "non-financial embedded derivative" in paragraph 2A of Schedule 26 to FA 2002, which applies to the relevant contract to which the company is deemed to be a party under this provision. It is not appropriate to the embedded derivative itself by virtue of which the company is treated as a party to a relevant contract. That is, the embedded derivative has first to be identified before there is a deemed relevant contract to which such a label can be applied. "Non-financial" has therefore not been rewritten in subsection (2)(b).

Clause 587: Contract relating to holding in OEIC, unit trust or offshore fund

1553. This clause treats as a derivative contract a relevant contract that is not otherwise such a contract if its underlying subject matter consists wholly or partly of a holding in a collective investment scheme and that scheme fails to meet a "qualifying investments test". It is based on paragraph 36(1), (2), (3) and (4) of Schedule 26 to FA 2002.

1554. A number of the contracts to which this clause would appear to apply are in fact already derivative contracts because their underlying subject matter does not qualify as "excluded property" under clause 589. This clause therefore sweeps up any relevant contract that fails to meet the conditions for a derivative contract despite its underlying subject matter consisting wholly or partly of a "relevant holding".

1555. The words "but for this section", at the end of paragraph (a) in *subsection (1)*, avoid conflict between the effect of the clause (the contract is a derivative contract) and the condition for the clause to apply (the contract is not a derivative contract).

1556. If *subsection (2)* applies to treat the relevant contract as a derivative contract in a particular accounting period, that treatment persists for so long as the contract is a relevant contract of the company (even if the circumstances that first led to it being treated as a derivative contract no longer apply).

1557. *Subsection (3)* describes what a "relevant holding" is for the purposes of the clause. It is drafted in terms of the underlying subject matter of the contract rather than, as in the source legislation, referring to a relevant holding of a "person". This corrects a misfiring of the provision that arose from adapting a similar provision for loan relationships (see paragraph 4(1) of Schedule 10 to FA 1996, rewritten in clause 490 of this Bill). See *Change 63* in Annex 1. (This Change also applies to clause 601; see the signpost to that clause in *subsection (6)*.)

1558. The meaning of "material interest in an offshore fund" in subsection (3)(a)(iii) is provided by reference to Chapter 3 of Part 6 of this Bill, where the definition is based on paragraph 7 of Schedule 10 to FA 1996, to which the source legislation for this clause refers. But that definition pleads into the meaning given to "offshore fund" in clause 489(1), which is slightly wider in scope than that given in section 756A of ICTA. See *Change 60* in Annex 1.

1559. *Subsection (5)* refers to the power to amend the definition of "relevant holding", by regulations under section 17 of F(No 2)A 2005, in relation to the source legislation for both this clause and its loan relationships equivalent (clause 490 in Part 5). The power has not yet been exercised.

1560. The provisions mentioned in *subsections (6)* and *(7)* are those that deal specifically with contracts to which this section applies. But a contract treated as a derivative contract by this clause is subject to other provisions that operate on derivative contracts so far as the context permits.

Clause 588: Associated transaction treated as derivative contract

1561. This clause treats an "associated transaction" in respect of shares held by an "investing company" as either a derivative contract or a transaction in respect of a derivative contract, if it would not already be such a contract or transaction. It is based on section 91B(5) of FA 1996.

1562. If the clause does so, credits and debits arising from the associated transaction are then brought into account under this Part under clause 603.

1563. Chapter 7 of Part 6 (shares with guaranteed returns etc) deals with certain shares which in substance are equivalent to loan relationships. It provides that the same consequences follow for tax purposes as if the company's holding of shares were a loan relationship.

1564. Clause 523 (which is also based on section 91B of FA 1996) applies to "non-qualifying shares". A share is "non-qualifying" if one of various conditions is met. One of those conditions (see clause 532) is that there is a scheme or arrangement under which the share and "one or more associated transactions" are designed to equate to an investment yielding a commercial rate of interest. An "associated transaction" is one of entering into, or acquiring rights and liabilities under, a derivative contract or contracts having some similarity to a derivative contract or a contract of insurance or indemnity.

1565. *Subsection (4)* applies if there is such an associated transaction (the "associated transactions condition").

Clause 589: Contracts excluded because of underlying subject matter: general

1566. This clause, supplemented by the next four, provides that a relevant contract is not a derivative contract if its underlying subject matter falls wholly into certain categories (or is treated as doing so) and one or more conditions applies. It is based on paragraph 4(1), (2), (2ZA) and (4) of Schedule 26 to FA 2002.

1567. Profits and losses arising in relation to such contracts are therefore not brought into account under this Part but are taxed as appropriate under other provisions, primarily as chargeable gains.

1568. *Subsection (1)* introduces the term "excluded property" to describe underlying subject matter that causes the relevant contract not to be a derivative contract. *Subsection (2),* supplemented by *subsections (3)* to *(6)* defines the term, with further detail appearing in clauses 590 to 592.

1569. Intangible fixed assets are excluded property, but only in the case of an option or future. Profits and losses in respect of such a contract are dealt with primarily under Part 8.

1570. The major categories of excluded property, in relation to any type of relevant contract, are (a) shares in a company and (b) rights of a unit holder under a unit trust scheme. But in such cases the relevant contract must both satisfy one of the conditions in clause 591 and not have the characteristics of a commercial investment.

1571. Subsection (3) takes certain types of share out of the excluded category. These are:

- shares dealt with by Chapter 7 of Part 6 (shares with guaranteed returns etc); and

- shares in an open-ended investment company if that company fails to meet the qualifying investments test for the purposes of the loan relationships provisions.

1572. For more on the qualifying investments test, see the commentary on clause 587.

Clause 590: Disregard of subordinate or small value underlying subject matter
1573. This clause provides that the parts of a relevant contract's underlying subject matter that are subordinate or of small value are ignored in determining for the purposes of clause 589 whether its underlying subject matter consists wholly of excluded property. It is based on paragraph 9 of Schedule 26 to FA 2002.

1574. A relevant contract may contain a number of minor elements in addition to its main purpose. For example, there may also be an option to settle the contract in one or more currencies by reference to a particular exchange rate or there may be some minor leeway as to the settlement date.

1575. *Subsection (3)* provides that any question of whether part of the underlying subject matter is "subordinate" or of "small value" is determined by reference to the time the company enters into or acquires the contract. But the clause does not otherwise provide any definition of "subordinate" or "small value". Paragraph CFM13120 of HMRC's Corporate Finance Manual (and the examples in CFM13120a) provides guidance.

1576. See also clause 593 which deals with the case of an option or future where the part of the underlying subject matter that is not excluded property is neither subordinate nor of small value.

Clause 591: Conditions A to E mentioned in section 589(5)
1577. This clause provides the conditions mentioned in clause 589(5)(a) which govern whether shares in a company or rights of a unit holder under a unit trust scheme are excluded property under that clause. It is based on paragraphs 4(2A) to (2D) and 12(1) and (11A) of Schedule 26 to FA 2002.

1578. Condition A applies to certain relevant contracts entered into or acquired by life insurers that are an "approved derivative" within the meaning of Rule 3.2.5 of the Insurance Prudential Sourcebook issued by the Financial Services Authority on 25 October 2006 or, in the case of an overseas life insurance company which is a European Economic Area firm or a "treaty firm", are derivative instruments falling within article 23.3 of the EC Consolidated Life Directive (EC/2002/83).

1579. Rule 3.2.5 of the Insurance Prudential Sourcebook sets out a number of conditions to do with the purposes for which the derivative is held, how the risk under the derivative is managed and the circumstances in which it is entered into or acquired. See the definition of "Insurance Prudential Sourcebook" in section 431(2) of ICTA.

1580. Condition A does not apply to a relevant contract that meets the condition in clause 579(1)(b) (one that is treated by accounting standards as a financial asset or liability, but is not treated as a derivative by accounting standards because of the size of the initial outlay).

1581. The source legislation for condition A applies only to cases where the contract is "entered into" by the company. But the source legislation for conditions B to D in this clause applies if the company enters into *or acquires* the contract. This condition has been brought into line with those conditions. See *Change 64* in Annex 1.

1582. See also clause 592 which extends the application of condition A to certain rights and liabilities that are treated as a relevant contract by clause 584.

1583. Condition B applies if the company is not a party to the relevant contract for the purposes of its trade and there is a "hedging relationship" (defined in clause 707) between the relevant contract and either (a) shares or rights of a unit holder in a unit trust scheme or (b) the company's share capital or related liability.

1584. Condition B does not apply if the relevant contract is one treated as such by clause 585 (that is, it is an embedded derivative in a loan relationship).

1585. Condition C applies if the company is not a party to the relevant contract for the purposes of its trade and the contract is a quoted option to subscribe for shares.

1586. Condition D deals with a relevant contract that relates to the acquisition by company A of a major investment in the share capital of company B other than for the purposes of core activities of company A's trade. The reference to "activities forming an integral part of a trade" ensures that the condition is not disapplied in the case of, say, a financial trader. For a financial trader, the particular contract may be relevant to its structural assets, which might be regarded as held in the course of its trade, but may not actually be relevant to its core trading activities. The contract must be an option or future for the acquisition or delivery of shares. As with condition B, condition D does not apply if the relevant contract is one treated as such by clause 585.

1587. Condition E applies if there is a hedging relationship between the relevant contract and an asset or liability representing a loan relationship to which clause 585 applies. The second leg of condition E is that each of the relevant contracts to which the company is treated as a party under that clause is a derivative contract to which one of the provisions specified in paragraph (b) of *subsection (6)* applies. Under the

provisions listed in *subsection (7)*, credits and debits are brought into account in calculating chargeable gains rather than as income. Part 10 of Schedule 2 extends that list in respect of certain rules in that Part.

1588. The clause does not rewrite those parts of paragraph 4(2B)(a), (2C)(a) and (2CA)(a) of Schedule 26 to FA 2002 that refer to the trading activities of an insurance company or mutual trading company. They are redundant following changes in the source legislation for clauses 633 and 634.

Clause 592: Embedded derivatives treated as meeting condition in section 591 etc

1589. This clause extends the ability to satisfy one of the conditions in clause 591 to certain embedded derivatives within the meaning of clause 584. It is based on paragraphs 2B(3), 45M and 54(1) of Schedule 26 to FA 2002.

1590. If this clause applies, the underlying subject matter of the embedded derivative may satisfy the definition of "excluded property" in clause 589(2). The embedded derivative may thereby not be a derivative contract for the purposes of this Part.

1591. The clause applies only if the "hybrid derivative" (within the meaning of clause 584) is a relevant contract within clause 579(1)(b). That is one that is not treated as a derivative by accounting standards because of the size of the initial outlay (for example, a prepaid equity forward) but is treated as a financial asset or liability. Also, the "host contract" (*subsection (5)*) must be treated for accounting purposes as (or as part of) a financial asset.

1592. The embedded derivative must itself satisfy clause 579(1)(a) (a relevant contract that is treated for accounting purposes as a derivative). And its underlying subject matter must be wholly shares in a company or rights of a unit holder in a unit trust scheme. *Subsection (4)* indicates that clause 590 applies if appropriate to determine whether the "wholly" test in paragraph (c) of *subsection (1)* is met.

1593. If the clause applies, the embedded derivative is treated as satisfying one of the conditions in clause 591, and therefore meets one element of the meaning of "excluded property" in clause 589(2). In the source legislation the embedded derivative is treated as meeting condition A in clause 591 because this rule is expected to be relevant primarily (although not exclusively) to insurance companies (and condition A specifically applies to such companies). But it is sufficient to deem the embedded derivative to meet any one of the conditions in clause 591 for the purposes of clause 589(2).

1594. The clause does two more things. First, it treats the embedded derivative (which in all likelihood is not now a derivative contract, because of clause 589) as a "chargeable asset" for the purposes of this Part and TCGA. See the definition of that term in clause 703.

1595. Second, the host contract is treated as a "creditor relationship" of the company for the purposes of the Corporation Tax Acts. That primarily affects the operation of Parts 5 and 6 (loan relationships). But it also affects those clauses in this Part that operate by reference to a creditor relationship (for example, clause 631(4)). See the definition of "creditor relationship" in clause 704.

Clause 593: Contracts where part of underlying subject matter is excluded property

1596. This clause provides for an option or future to be treated in certain cases as divided between a relevant contract whose underlying subject matter consists wholly of excluded property within the meaning of clause 589 and one whose underlying subject matter consists wholly of other underlying subject matter. It is based on paragraph 46 of Schedule 26 to FA 2002.

1597. See the commentary on clause 589 for the significance of the underlying subject matter of a contract being or not being "excluded property".

Chapter 3: Credits and debits to be brought into account: general

Clause 594: Overview of Chapter

1598. This clause describes the purpose and content of the Chapter. It is new.

1599. The Chapter provides in particular for the application of generally accepted accounting practice in determining the profits and losses to be brought into account under this Part. In some cases, it provides for departure from generally accepted accounting practice for that purpose. Chapter 4 contains provisions about credits and debits for a number of special situations.

Clause 595: General principles about the bringing into account of credits and debits

1600. This clause specifies for the identification of the credits and debits to be brought into account under this Part. It is based on paragraphs 15(1), (4) and (9) and 17A(1) of Schedule 26 to FA 2002.

1601. *Subsections (1)* and *(2)* make general statements on the part played by accounts prepared in accordance with generally accepted accounting practice in identifying credits and debits for the purposes of this Part. "Generally accepted accounting practice" is defined by section 832(1) of ICTA by reference to section 50(1) of FA 2004. If a company prepares accounts in accordance with international accounting standards, those standards constitute generally accepted accounting practice. Otherwise UK generally accepted accounting practice applies.

1602. The general statement in subsection (2) refers to credits and debits which are amounts "recognised in determining the company's profit or loss" for the period. For the meaning of "recognised" in this context, see clause 597.

1603. But that statement is qualified by the more specific rule in *subsection (3)* that those credits and debits must "fairly represent" profits, losses and expenses that arise in respect of the derivative contract or arise from certain transactions in respect of the contract (labelled "related transactions").

1604. There is a further significant rule in *subsection (7)* that makes both the general statement in subsection (2) and the rule in subsection (3) subject to the qualifying effect of "the following provisions of this Part".

Clause 596: Meaning of "related transaction"
1605. This clause provides the meaning of "related transaction" for the purposes of this Part. It is based on paragraph 15(7) and (8) of Schedule 26 to FA 2002.

1606. The term is used extensively in this Part in provisions which may apply to or involve consideration of the acquisition or disposal of a derivative contract.

Clause 597: Amounts recognised in determining a company's profit or loss
1607. This clause explains what "an amount recognised in determining a company's profit and loss" means. It is based on paragraph 17B of Schedule 26 to FA 2002.

1608. The various statements listed in paragraphs (a) and (b) of *subsection (1)* are those mentioned in UK generally accepted accounting practice or international accounting standards. But subsection (1)(c) caters for amounts recognised in any accounting statement not among those listed.

1609. The statements listed in paragraphs (a) and (b) of subsection (1) include a "statement of comprehensive income", "statement of recognised income and expense" and "statement of income and retained earnings". These statements are not mentioned in the source legislation but are the equivalents in more recently applying accounting standards of the statements listed there.

1610. So far as the terms in those paragraphs derive from accounting standards, they are defined in clause 710 as having the meaning they have for accounting purposes.

1611. *Subsection (2)* brings in prior period adjustments for this purpose but *subsection (3)* excludes amounts recognised "by way of correction of a fundamental error". Such amounts are brought into account in the prior period affected by the error (so that the amounts so brought into account "fairly represent" profits and losses etc in respect of the contract in that period).

1612. See also clauses 613 to 615 for the treatment of adjustments shown in accounts on a change of accounting policy.

Clause 598: Regulations about recognised amounts
1613. This clause provides powers for regulations that amend the amounts regarded as "recognised" in one or other of the various statements mentioned in clause 597(1).

It is based on paragraph 17C of Schedule 26 to FA 2002 and paragraph 52 of Schedule 4 to FA 2005.

1614. For regulations made under this power, see the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256), as amended, and the Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 (SI 2004/3271), as amended.

Clause 599: Meaning of "amounts recognised for accounting purposes"

1615. This clause defines "amounts recognised for accounting purposes" by reference to the case of a company that has not prepared accounts in accordance with generally accepted accounting practice. It is based on paragraph 17A(2), (3) and (4) of Schedule 26 to FA 2002.

1616. This clause is particularly relevant to the application of clause 595 and the interpretative provision in clause 597.

1617. See the commentary on clause 595(2) for the relevance of "generally accepted accounting practice". Unless a company uses international accounting standards for a period, the default meaning of "generally accepted accounting practice" is UK generally accepted accounting practice (see section 50(1) of FA 2004). When this clause applies, it therefore uses UK generally accepted accounting practice (as defined in section 50(4) of FA 2004).

Clause 600: Contract which is or forms part of financial asset or liability

1618. This clause provides that fair value accounting is used in the case of certain contracts for the purposes of the general rule in clause 595(2). It is based on paragraph 17A(1A) of Schedule 26 to FA 2002.

1619. The contracts to which this clause applies are those that are not treated as a derivative for accounting purposes because they fail the requirement of the relevant accounting standard as regards the initial net investment required by the contract but are nevertheless treated as a financial asset or liability. See the commentary for clause 579.

Clause 601: Contract relating to holding in OEIC, unit trust or offshore fund

1620. This clause applies fair value accounting in determining the credits and debits to be brought into account in respect of a contract that is treated as a derivative contract because of clause 587. It is based on paragraph 36(1) and (2A) of Schedule 26 to FA 2002.

1621. Clause 587 applies if the underlying subject matter of a contract includes a holding in a collective investment scheme that fails to meet a "qualifying investments" test. Because this clause operates by reference to clause 587, *Change 63* in Annex 1 (reference to a "relevant holding" is to a holding which is the underlying

subject matter of the contract rather than a holding of the company which is a party to the contract) applies here as well.

Clause 602: Contract becoming one relating to holding in OEIC, unit trust or offshore fund

1622. This clause determines the opening valuation of a derivative contract for the purposes of clause 601. It is based on paragraph 37(1), (2), (3), and (4) of Schedule 26 to FA 2002.

1623. The accounting period to which this clause applies is that in which a relevant contract is treated as a derivative contract because of clause 587 if that period immediately follows another in which it was not so treated. The clause applies only if the relevant contract was a "chargeable asset" (defined in clause 703) at the end of the earlier period.

1624. For the meaning of "market value" for the purposes of corporation tax on chargeable gains, see in particular section 272 of TCGA.

Clause 603: Associated transaction treated as derivative contract

1625. This clause applies fair value accounting in determining the credits and debits to be brought into account by virtue of clause 588 in respect of an "associated transaction" that is treated as a derivative contract because of that clause. It is based on section 91B(5) of FA 1996.

1626. For the circumstances in which clause 588 applies and for the meaning of "associated transaction", see the commentary on that clause.

1627. *Subsection (1)* provides that this clause must be construed as if it were part of Chapter 7 in Part 6 (shares with guaranteed returns etc). That Chapter rewrites sections 91A to 91G of FA 1996.

Clause 604: Credits and debits treated as relating to capital expenditure

1628. This clause brings a credit or debit that is treated in the accounts as part of a fixed capital asset or project into account under this Part in the same way as a credit or debit that is brought into account in determining the company's profit or loss. It is based on paragraph 25 of Schedule 26 to FA 2002.

1629. Generally accepted accounting practice may permit a credit or debit of an income nature to be included in the value of a fixed capital asset or project. If this happens, the credit or debit bypasses the statements mentioned in clause 597. This clause overrides that treatment, except in the cases mentioned in *subsections (3)* and *(5)*.

1630. Subsection (5) prevents any debit being taken into account under this Part that writes down the value of the asset or project in question, or creates a reserve for amortisation or depreciation of that asset or project, so far as the write down etc is

attributable to a debit brought into account under this clause. As this clause overrides the accounts treatment of the capitalised debit, this rule in this subsection prevents a double deduction should the asset or project be written down, or a reserve created for its amortisation or depreciation, whether in the same or a later period, if the amount taken to profit and loss is attributable to the amount brought into account under this clause.

1631. The source legislation for subsection (5) refers to "so much of any amortisation or depreciation as represents *a writing off of the interest component of the asset*". The rule is identical to that in the equivalent rule for loan relationships (clause 320(6)). But the "interest component" of the asset refers to something that is dealt with by the loan relationships provisions and has no relevance to the derivative contracts provisions. The emphasised words have therefore not been reproduced in this clause. See *Change 65* in Annex 1.

Clause 605: Credits and debits recognised in equity

1632. This clause brings a credit or debit that is recognised in equity or shareholders' funds, rather than in one of the statements mentioned in clause 597(1), into account for the purposes of this Part in the same way as a credit or debit that is brought into account in determining the company's profit or loss. It is based on paragraph 25A of Schedule 26 to FA 2002.

1633. As in the case of clause 604, this clause overrides the accounts treatment.

Clause 606: Exchange gains and losses

1634. This clause provides that exchange gains and losses arising from a derivative contract are included in the profits and losses mentioned in clause 595(3). It is based on paragraph 16 of Schedule 26 to FA 2002.

1635. *Subsection (1)* does not rewrite the words "and related transactions" in paragraph 16(1) of Schedule 26 to FA 2002. They are not considered to add to the effect of this provision.

1636. *Subsection (3)* excludes exchange gains and losses arising in two circumstances from the basic rule in subsection (1) if those gains and losses are recognised in the company's "statement of total recognised gains and losses", "statement of recognised income and expense", "statement of changes in equity" or "statement of income and retained earnings". Those terms are defined in clause 710 as having the meaning they have for accounting purposes. Some are taken from UK generally accepted accounting practice and the others from international accounting standards, but are otherwise equivalent terms. This subsection is subject to the effect of any regulations made under the power in *subsection (5)*.

1637. The clause contains two regulatory powers. The first is in *subsection (4)*. It concerns exchange gains and losses from a derivative contract whose underlying subject matter is wholly or partly currency. Regulations may exclude such gains from

the scope of subsection (1). For regulations made under this power, see the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256), as amended.

1638. The second is in subsection (5). Regulations may countermand the effect of the rule in subsection (3) or of regulations made under subsection (4). Where the regulations apply, the affected amounts are brought into account under this Part as credits or debits arising from a company's derivative contracts or for the purposes of corporation tax on chargeable gains. (The Exchange Gains and Losses (Bringing into Account Gains or Losses) Regulations 2002 (SI 2002/1970), as amended, are made partly under the power rewritten in subsection (5). But, as amended by regulation 5 of SI 2005/2013, SI 2002/1970 now has no direct impact on the source legislation for this clause.)

1639. The source legislation for this clause was repealed by paragraph 9 of Schedule 6 to F(No 2)A 2005, subject to the making of an order for the repeal to have effect. That prospective repeal is preserved by the paragraph "repeal of provisions concerning exchange gains and losses from derivative contracts" in Part 10 of Schedule 2.

Clause 607: Pre-contract or abortive expenses

1640. This clause adds pre-contract and abortive expenses to the expenses that are taken into account under clause 595(3) in determining a company's profits and losses under this Part. It is based on paragraph 15(5) of Schedule 26 to FA 2002.

Clause 608: Company ceasing to be party to derivative contract

1641. This clause brings into account amounts recognised in accounts in respect of a derivative contract after the accounting period in which the company ceases to be a party to that contract. It is based on paragraph 53(3), (4), (5) and (6) of Schedule 26 to FA 2002.

1642. The accounting policies of a company may treat part of the profit or loss in respect of a contract as deferred income or loss to be brought into account in accounting periods later than that in which the company ceased to be a party to the contract. This clause identifies amounts to be treated as credits and debits in subsequent periods until all the deferred income or loss has been brought into account under this Part.

1643. *Subsections (3)* to *(6)* set out how certain conditions in this Part may be treated as satisfied in respect of the former derivative contract. Those are conditions that may need to be satisfied for a particular provision to apply in respect of post-cessation credits or debits. For examples of the conditions to which subsection (3) or (5) may apply, see clauses 573 and 690.

1644. *Subsection (7)* makes clear that the deeming effect of subsections (3) to (6) carries through for any question of what a company's derivative contracts are or whether a company is a party to a derivative contract (see clause 578).

Clause 609: Company ceasing to be UK resident

1645. This clause and the next apply if a derivative contract moves out of the scope of corporation tax because the company holding it is no longer within the charge to tax in respect of it. This clause treats a company as making a deemed disposal and reacquisition of the contract at its fair value immediately before the company ceases to be UK resident. It is based on paragraph 22A(1), (2) and (3) of Schedule 26 to FA 2002.

1646. "Fair value" is defined in clause 710.

1647. *Subsection (1)* provides that the company is treated for the purposes of this Part as reacquiring the derivative contract for the same amount. This deemed value will be taken into account should the derivative contract re-enter the scope of corporation tax because of a further change in the residence status of the company or otherwise.

1648. *Subsection (2)* has an exception to the general rule. This applies if a company moves abroad but leaves behind such a business operation as amounts to a permanent establishment and that operation includes at least some of the rights and liabilities under the derivative contract. In effect, the contract has not left the scope of corporation tax. ("Permanent establishment" is defined in section 832(1) of ICTA by reference to the meaning provided by section 148 of FA 2003.)

1649. *Subsection (3)* provides an order of priority if this clause would apply in relation to the same circumstances as trigger clause 631 or 632. There is an equivalent order of priority in clause 333 in Part 5. There is no reason for the two sets of provisions to differ in this respect. This subsection brings the provisions for loan relationships and derivative contracts into line. See *Change 66* in Annex 1.

Clause 610: Non-UK resident company ceasing to hold derivative contract for UK permanent establishment

1650. This clause treats a non-UK resident company as making a deemed disposal and reacquisition of a derivative contract at its fair value if and to the extent that some or all of the rights or liabilities under a contract held or owed for the purposes of a permanent establishment of that company cease to be so held or owed. The clause is based on paragraph 22A(1) and (4) of Schedule 26 to FA 2002.

1651. The circumstances in which this clause applies include where the contract is now held for the purposes of another part of the company's business (which is not a permanent establishment) or where the permanent establishment ceases to be such. In those cases the derivative contract has left the scope of corporation tax.

1652. A significant difference between the conditions for the application of this clause and those for the preceding clause is that this clause does not apply if the rights and liabilities under the contract cease to be held or owed for the purposes of the permanent establishment because of a "related transaction" (defined in clause 596). That is, it does not apply when the contract ceases to be held because it is disposed of. That disposal is itself an occasion leading to amounts being brought into account under this Part.

1653. *Subsection (3)* introduces the same priority rule as is introduced in the preceding clause. See again *Change 66* in Annex 1.

Clause 611: Release under statutory insolvency arrangement of liability under derivative contract

1654. This clause exempts from the scope of this Part any credit arising on the release of a company's liability to pay an amount under a derivative contract, if the release is part of a statutory insolvency arrangement. It is based on paragraph 22(5) of Schedule 26 to FA 2002.

1655. A "statutory insolvency arrangement" is defined in section 834(1) of ICTA by reference to the Insolvency Act 1986 and other provisions having a similar effect.

Chapter 4: Further provision about credits and debits to be brought into account

Clause 612: Overview of Chapter

1656. This clause describes the purpose and content of the Chapter. It is new.

Clause 613: Introduction to sections 614 and 615

1657. This clause sets out when clauses 614 and 615 apply. It is based on paragraph 50A(1) and (1A) of Schedule 26 to FA 2002 and paragraph 7(6) of Schedule 6 to F(No 2)A 2005.

1658. A company may decide to apply a different set of standards to the presentation of the company's results. Regulatory rules may also require that a company switches to a different set of standards. If there is such a change of accounting policy, the value of the company's assets and liabilities at the start of the first period of account to which the change applies are restated in accordance with the standards adopted.

1659. This clause applies only if the change is from an accounting policy that "accords with the law and practice applicable" in relation to the earlier period to another such policy in relation to the next. The law and practice in question is that provided in particular by the Companies Acts and the Accounting Standards Board (or their equivalents in its country of residence if the company is non-UK resident but within the charge to corporation tax in respect of a derivative contract).

1660. Clauses 614 and 615 prescribe the credit or debit to be brought into account on a change of accounting policy, according to whether the value of the company's assets and liabilities increases or decreases on the change.

1661. *Subsection (4)* treats a particular situation as a change of accounting policy although there is no change in the actual accounting policy used by the company from one period to the next. International accounting standards and new UK generally accepted accounting practice require a company, in certain circumstances, to divide a loan relationship between rights and liabilities under a loan relationship and rights and liabilities under one or more derivative financial instruments or equity instruments (see clause 585(1)).

1662. Clause 416 allows a company subject to old UK generally accepted accounting practice (which does not permit it to divide a loan relationship in that way) to elect that a loan relationship is treated as divided as mentioned in clause 415(1) (the equivalent for loan relationships of clause 585(1)), if division would be permitted under new UK generally accepted accounting practice or international accounting standards. Clause 416 applies an election made under it for the purposes of this Part as well as for Part 5.

1663. The result of such an election is a change in accounting policy for the purposes of clauses 614 and 615, but only in relation to all the derivative financial instruments or equity instruments in the company's affected loan relationships. This rule applies from the date the election has effect. Broadly, the election has effect from the beginning of the period of account in which the first loan relationship is acquired to which an election can apply.

Clause 614: Change of accounting policy involving change of value

1664. This clause treats the increase or decrease in the carrying value of a derivative contract on a change of accounting policy as a credit or debit to be brought into account in the later period. It is based on paragraph 50A(2), (3) and (5) of Schedule 26 to FA 2002.

1665. "Carrying value" is defined in clause 702.

1666. *Subsection (3*) makes an exception to the general rule in so far as a credit or debit arising from the change of accounting policy is brought into account for the purposes of this Part under another provision. For example, a prior period adjustment brought into account under clause 597(2) would be excepted from the general rule in this clause.

Clause 615: Change of accounting policy after ceasing to be party to derivative contract

1667. This clause requires a credit or debit to be brought into account, similarly to clause 614, in a case where clause 608(2) applies. It is based on paragraph 50A(3C), (3D) and (5) of Schedule 26 to FA 2002.

1668. Clause 608 applies if profits and losses arising to a company from a derivative contract for the accounting period in which the company ceases to be a party to the

contract are not wholly reflected in credits and debits brought into account under this Part for that period. In effect, it is a "post-cessation receipts" provision.

1669. Because the derivative contract from which the income or loss derived is either no longer in existence or no longer held by the company, clause 613 cannot apply in this case. Clause 615 deals with the amount by which the value of the residual deferred income or loss in respect of the former contract alters as a result of the change of accounting policy affecting a subsequent period.

1670. *Subsection (4)* corresponds to the rule in clause 614(3).

1671. *Subsection (6)* corrects a minor error in the source legislation. Paragraph 50A(3D) of Schedule 26 to FA 2002, in defining the "amount outstanding", refers to an amount recognised "in respect of the profits, gains or losses that arose from that *relationship* or a related transaction in the cessation period (within the meaning of *section 103(6)*)". The words with emphasis are of course appropriate to the loan relationships provisions and not to those for derivative contracts. They reflect the wording of paragraph 19A(4C) and (4D) of Schedule 9 to FA 1996 (rewritten as clause 318 in Part 5), on which paragraph 50A(3C) and (3D) of Schedule 26 to FA 2002 was modelled. More appropriate wording has been substituted.

Clause 616: Disapplication of fair value accounting

1672. This clause reverses the effect of clauses 584 and 586 if certain conditions are met by reference to an embedded derivative identified by either of those clauses. It is based on paragraphs 45L(1), (1A), (1B), (1C), (2) and (3) of Schedule 26 to FA 2002.

1673. Because the contract out of which the embedded derivative arose is treated as one that is not split in accordance with clause 584 or 586, the clause disapplies clauses 573 and 574 to that derivative.

1674. It also sets aside fair value accounting as an accounting basis in calculating profits and losses on the contract in question. For contracts to which this clause applies, splitting of the contract under clause 584 or 586, or the use of fair value accounting, may produce unacceptably volatile results for tax purposes.

1675. The clause does not apply to an embedded derivative within clause 584 that comes within clause 592 (so that it may meet the "excluded property" conditions in clause 589). Nor does it apply if regulation 9 of the Disregard Regulations applies (SI 2004/3256, as amended). That regulation prescribes credits and debits, in the case of derivative contracts that are interest rate contracts, for the purposes of paragraph 17B of Schedule 26 to FA 2002 (rewritten in clause 597).

1676. Nor does the clause apply if an election is made under clause 617 for this clause not to apply. A company may choose to make such an election if it prefers to retain fair value accounting for contracts within clause 584 or 586.

1677. *Subsection (3)* treats the relevant contract that was divided under clause 584 as not so divided. It is therefore treated as a single derivative contract for the purposes of this Part. But again the contract is treated as one to which fair value accounting does not apply.

1678. *Subsections (4)* and *(5)* treat the contract that was divided under clause 586 as not so divided. The contract is therefore outside the scope of this Part. It is dealt with for tax purposes according to what sort of contract it is. Subsection (5) also provides that clause 46 in Part 3 of this Bill (calculation of trade profits in accordance with generally accepted accounting practice) applies as if fair value accounting was not generally accepted accounting practice for that company.

1679. Subsections (3) and (4) apply to the "original contract" (defined in *subsection (7)*) rather than (as in the source legislation) the "contract" to avoid confusion with the relevant contract referred to in subsection (1)(a).

Clause 617: Election for section 616 not to apply

1680. This clause allows a company to elect that clause 616 does not apply to its contracts. It is based on paragraph 45L(2A), (2B) and (2C) of Schedule 26 to FA 2002.

1681. For some companies the benefit afforded by clause 616 may be disproportionate to the administrative and accounting burden of distinguishing and tracking affected contracts. Or the degree of volatility in the tax consequences of splitting the contract or using fair value accounting may be acceptable to the company holding the contract.

1682. An election under this clause applies to all of a company's contracts. Clause 618 contains further provisions modifying or extending the effect of an election made by a member of a group of companies.

1683. *Subsection (2)* excludes two types of contract from an election. They are, first, a "contract of long-term insurance" (defined in section 431(2) of ICTA) and, second, a contract where the embedded derivative identified by clause 584 or 586 has commodities as its underlying subject matter.

1684. Subsection (2)(b) says "embedded derivative" rather than "embedded derivative contract". The Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006, SI 2006/3269 omitted the definition of "embedded derivative contract" from the source legislation. But the use of the term in paragraph 45L(2A) of Schedule 26 to FA 2002 was missed. "Embedded derivative" matches the amendments introduced in this respect by that Order. See in particular clauses 584 and 586.

1685. Unlike the source legislation, the clause does not specify how the election must be made. See *Change 1* in Annex 1.

Clause 618: Elections under section 617: groups of companies

1686. This clause applies or disapplies the effect of an election under clause 617 in a number of cases where a party to a contract is a member of a group of companies. It is based on paragraph 45LA of Schedule 26 to FA 2002.

1687. In the first case, *subsection (1)* treats the group member who is a counterparty to a contract to which a fellow group member is a party as having made an election in relation to that contract if that fellow group member has made an election. This rule ensures parity of treatment of the contract within the group.

1688. In the second case, s*ubsection (2)* provides that a group member to whom a fellow group member has transferred a contract is treated as having made an election in relation to that contract if the fellow group member makes an election. This rule applies even if that fellow group member makes the election at a time after the transfer has been made or at a time when the companies are no longer members of the same group. This rule ensures that a company cannot exclude some of its contracts from the effect of an election by first transferring them to another group member.

1689. The reference in subsection (2) to a contract "to which section 584… or section 586… applies" corrects a missed consequential amendment to paragraph 45LA(3)(b) of Schedule 26 to FA 2002. The reference there to "paragraph 2(3)" is otiose following the replacement of that provision by paragraph 2(2A) of Schedule 26 to FA 2002 (by article 3 of the Finance Act 2002, Schedule 26, (Parts 2 and 9) (Amendment) Order 2006, SI 2006/3269) and the insertion of paragraphs 2A and 2B of Schedule 26 to FA 2002 (by article 4 of that Order). Clauses 584 and 586 apply to the types of contract to which paragraph 2(3) of Schedule 26 to FA 2002 applied.

1690. The third case is if:

- B becomes a party in place of A to a relevant contract treated as such by clause 584 or 586, at a time when they are members of the same group;

- that contract was within clause 616 in A's hands (that is, A had not made an election); and

- B's other contracts are outside clause 616 by virtue of an election B has made (whether an election made before B has succeeded A as a party to the contract or one made later).

1691. *Subsection (4)* ring-fences the contract in question, so that any existing or later election by B is ineffective in relation to that contract. This rule ensures that a contract cannot be selected for preferential treatment under another group member's election if the member who is the original party to the contract does not otherwise wish to make an election. This rule is however disapplied if A makes an election in respect of its contracts subsequent to B becoming a party to the contract in place of A.

Clause 619: Partnerships involving companies
1692. This clause and the next two set out how a company partner brings into account credits and debits in respect of its share of a firm's derivative contracts. This clause provides that each company partner, not the firm, brings credits and debits into account in calculating its profits chargeable to tax. It is based on paragraph 49(1) and (2) of Schedule 26 to FA 2002.

1693. Paragraph (c) in *subsection (1)* requires that the firm is a party to a contract that "is a derivative contract or would be a derivative contract if the firm were a company". A firm is not a company. So a contract held by a firm would not meet any test under which a contract is or is treated as a derivative contract because it is held by a company.

1694. *Subsection (2)* switches off the normal rule in clause 1259 (which rewrites section 114(1) of ICTA) under which the profits of the firm's trade etc are calculated, in accordance with the partners' interests in the firm, as if the firm were a company.

Clause 620: Determination of credits and debits by company partners
1695. This clause determines the credits and debits to be brought into account under clause 619(3) by each company partner in a firm. It is based on paragraph 49(3), (4), (5) and (6) of Schedule 26 to FA 2002.

1696. *Subsections (2)* to *(4)* attribute the actions of the firm to the partner for the purposes of applying the rules that determine the credits and debits to be brought into account in accordance with this Part.

1697. "Profit-sharing arrangements", in relation to a partnership, is defined in clause 710. A firm's "profit-sharing arrangements" are described in clause 1262, in the clauses rewriting section 114 of ICTA, as "the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade".

Clause 621: Company partners using fair value accounting
1698. This clause applies fair value accounting, in determining under clause 620 the company partner's share of the credits and debits arising in respect of the firm's derivative contracts, if that company partner uses fair value accounting in relation to its interest in the firm. It is based on paragraph 50 of Schedule 26 to FA 2002.

Clause 622: Contracts ceasing to be derivative contracts
1699. This clause provides that, if a relevant contract to which the company continues to be a party ceases to be a derivative contract, there is a deemed disposal of the contract at the time of that cessation. It is based on paragraphs 43A(5) and 43B of Schedule 26 to FA 2002.

1700. *Subsection (2)* deems the company to have disposed of the contract in a "related transaction" (defined in clause 596) for consideration equal to the "notional carrying value" of the contract at the time it ceases to be a derivative contract.

Depending on the amount of the consideration attributed to that disposal under this subsection, a credit or debit arises to be brought into account under this Part. That credit or debit is additional to any other credit or debit that arises in relation to the contract, while it was a derivative contract, for the accounting period in which the deemed disposal occurs. "Carrying value" is defined in clause 702.

1701. The source legislation for *subsection (4)* refers to the amount that would have been the carrying value of the contract in the accounts of the company "if an accounting period had ended immediately before that time". The source legislation for the equivalent definition in clause 625(6), paragraph 28(3) of Schedule 26 to FA 2002, refers to the value found "if a period of account had ended immediately before" the requisite time. But, if a period of account comes to an end, that is the end of an accounting period under clause 10. The two definitions have been brought into line using "period of account".

1702. After the contract ceases to be a derivative contract, it is likely to be a chargeable asset for the purposes of corporation tax on chargeable gains. *Subsection (5)* therefore signposts clause 662 which prescribes the acquisition cost of the contract for that purpose.

Clause 623: Index-linked gilt-edged securities with embedded contracts for differences

1703. This clause provides that credits and debits arising in respect of an embedded derivative in an index-linked gilt-edged security are not brought into account under this Part if conditions are met. It is based on paragraphs 12(1), (11A) and (11B) and 45I of Schedule 26 to FA 2002.

1704. If the embedded derivative is closely related to the host contract, generally accepted accounting practice does not in fact require the company to divide the security as mentioned in clause 585. In that case, clauses 399 and 400 in Part 5 (loan relationships) apply. But, for example, a company whose functional currency is not sterling may be required to divide its index-linked securities between an embedded derivative and a host contract, in which case this clause may apply.

Chapter 5: Continuity of treatment on transfers within groups

Clause 624: Introduction to Chapter

1705. This clause describes the purpose of the Chapter. *Subsection (3)* is based on paragraph 28(6) of Schedule 26 to FA 2002 but otherwise the clause is new.

Clause 625: Group member replacing another as party to derivative contract

1706. This clause and the next three deal with the case where one member of a group of companies replaces another as a party to a derivative contract as the result of a related transaction or similar transactions. This clause determines the credits and debits to be brought into account by the transferor company and the transferee company. It is based on paragraph 28(1), (3), (3ZA), (3A) and (7) of Schedule 26 to FA 2002.

1707. "Notional carrying value" is defined in *subsection (6)* on the model of the similar definition in clause 622(4). "Carrying value" is defined in clause 702.

1708. Should any "discount" arise in respect of the related transaction or the equivalent series of transactions, it is added to the amount treated as consideration by the transferor under *subsection (3)* (but not to the amount treated as consideration given by the transferee under *subsection (4)*).

1709. "Discount" is defined in subsection (6) by reference to clause 480 in Part 5 (loan relationships). A discount arises if payment of part of the consideration for a disposal is deferred and the consideration is accordingly increased to recognise the delay.

1710. *Subsection (7)* disapplies Schedule 28AA to ICTA in a case where credits and debits are determined under *subsection (2)*. Schedule 28AA to ICTA might otherwise substitute market value for the amounts agreed between the parties, which amounts would give rise to credits and debits for the purposes of this Part. Such a substitution is unnecessary given that this clause requires both parties to use the notional carrying value of the contract rather than amounts shown in the accounts (the amounts "recognised for accounting purposes").

Clause 626: Transactions to which section 625 applies

1711. This clause defines the related transaction or series of transactions which acts or act as a trigger for the application of clause 625. It is based on paragraph 28(2) of Schedule 26 to FA 2002.

Clause 627: Meaning of company replacing another as party to derivative contract

1712. This clause gives a particular example of what the reference in clause 625(1) to one company replacing another as a party to a derivative contract means. It is based on paragraph 28(4) of Schedule 26 to FA 2002.

1713. The commonest way in which one company may replace another as a party to a derivative contract is by the assignment of the rights and liabilities under the contract. But there may be other types of transaction that have the same effect.

1714. This clause ensures that, if the company referred to as the transferee in clause 625 becomes a party to a contract whose rights and liabilities are equivalent to those of the contract to which the company referred to as the transferor in that clause has ceased to be a party, the transferee is treated as having replaced the transferor in respect of the derivative contract. A novation is an example of this.

1715. This clause still applies in the event of the transferor again becoming a party to the original contract (that is, a contract to which it had previously ceased to be a party).

Clause 628: Transferor using fair value accounting

1716. This clause substitutes rules based on fair value accounting for those in clause 625, in a case to which that clause applies, if the transferor uses fair value accounting in respect of the derivative contract in question. It is based on paragraph 30 of Schedule 26 to FA 2002.

1717. As regards the transferee, this clause treats it as having acquired the derivative contract at the fair value of the contract as at the time of the transfer for the purposes of determining the credits and debits brought into account under this Part, regardless of whether it itself uses fair value accounting as respects the contract. This treatment continues to apply for any accounting period in which the transferee is a party to the contract.

1718. As in clause 625, any "discount" is added to the amount treated as consideration by the transferor (only).

Clause 629: Tax avoidance

1719. This clause disapplies clause 625 in two cases where avoidance of tax is involved. It is based on paragraph 28(3ZB), (3ZC) and (3ZD) of Schedule 26 to FA 2002.

1720. The first case (*subsection (1)*) is if the transferor is a party to arrangements for tax avoidance purposes under which the derivative contract will be transferred on by the transferee. The second case (*subsection (4)*) is if another provision countering tax avoidance (clause 698) applies to a disposal which would otherwise be within clause 625.

Clause 630: Introduction to sections 631 and 632

1721. This clause and the next two provide for a deemed assignment of the derivative contract in question if a transferee within clause 625 ceases to be a member of the group of companies mentioned in clause 626(2) or (3). This clause sets out when clauses 631 and 632 apply and defines terms used in this and those clauses. It is based on paragraph 30A(1), (5A) and (8) of Schedule 26 to FA 2002.

1722. If clause 625 applies because of a series of transactions within clause 626(3), the relevant time limit in respect of the transferee leaving the relevant group of companies before the end of a six year period begins with the *last* of the transactions in the series of transactions. This contrasts with the rule in clause 625(3) which determines the consideration to be brought into account by the transferor by reference to the *first* transaction in the series.

1723. The rules in these clauses take priority if the rules in clause 609 or 610 would apply in the same circumstances (see the commentary on those clauses).

Clause 631: Transferee leaving group otherwise than because of exempt distribution

1724. This clause deems the transferee within clause 625 to have assigned (and immediately reacquired) the rights and liabilities under the derivative contract, immediately before it left the group, for a consideration equal to their fair value at that time. It is based on paragraph 30A(2), (3), (4), (5) and (8) of Schedule 26 to FA 2002.

1725. One of the conditions for this clause to apply is that the company ceases to be a member of the group of companies in question for reasons which are not just that it does so because of an "exempt distribution" under section 213(2) of ICTA. That section provides for a distribution arising from the demerger of the trading activities of a single company or group of companies to a number of companies or groups to be disregarded for certain purposes.

1726. The second condition is that a credit would be brought into account under either this Part (condition A in *subsection (3)*) or Part 5 (loan relationships) (condition B in *subsection (4)*). The credit in question, as regards this Part, is the credit that would be brought into account under this Part on the deemed assignment under this clause of the rights and liabilities under the derivative contract.

1727. As regards Part 5, the credit in question is the credit brought into account under that Part because of clause 345(2)(a) and (b) in a case where the transferee has a "hedging relationship" between the derivative contract and a creditor relationship That clause makes matching provision for loan relationships to that made by this clause for derivative contracts.

1728. In either case, the second condition is not satisfied if the assignment would give rise to a debit. So the clause cannot give rise to a reduction of the transferee's liability to corporation tax.

1729. "Hedging relationship" is described in clause 707 in a number of ways. Broadly, these relate to cases where the derivative contract is entered into to shelter the company from risks associated with holding or owing the hedged asset or liability (such as a fluctuation in values because of movement in a relevant market, such as a stock or commodities exchange).

Clause 632: Transferee leaving group because of exempt distribution

1730. This clause deems the transferee within clause 625 to have assigned (and immediately reacquired) the rights and liabilities under the derivative contract at the time a "chargeable payment" is made, for a consideration equal to the fair value of the rights and liabilities at the time of that payment, if it left the group solely because of an exempt distribution. It is based on paragraph 30A(3), (4), (5), (6), (7) and (8) of Schedule 26 to FA 2002.

1731. A "chargeable payment" is broadly a payment made in connection with tax avoidance or otherwise than for genuine commercial reasons.

1732. Conditions A and B, in *subsections (3)* and *(4)*, are the same as the conditions in clause 631(3) and (4). See the commentary on that clause.

Chapter 6: Special kinds of company

Overview

1733. This Chapter contains rules that modify the application of this Part to mutual trading companies or insurance companies. The Chapter does not rewrite paragraph 41 of Schedule 26 to FA 2002 as it is merely introductory.

Clause 633: Mutual trading companies

1734. This clause treats the activities of a mutual trading company as not being those of a trade. It is based on paragraph 43 of Schedule 26 to FA 2002.

1735. Because of this clause, any credits and debits arising to a mutual trading company do not fall within clause 573 (trading credits and debits to be brought into account under Part 3). And any provision that operates in part by reference to whether the company is a party to a contract for the purposes of a trade (or a type of business which constitutes a trade) does not apply to a mutual trading company in that respect.

Clause 634: Insurance companies

1736. This clause treats certain activities of an insurance company as not being those of a trade. It is based on paragraphs 41A and 43 of Schedule 26 to FA 2002.

1737. This clause has the same effect, in relation to the activities specified in paragraphs (a) and (b), as the preceding clause has for mutual trading companies.

1738. For the meaning of "life assurance business" and "basic life assurance and general annuity business", see section 431(2) of ICTA.

Clause 635: Creditor relationships: embedded derivatives which are options

1739. This clause requires a life assurance company to treat a creditor relationship as mentioned in clause 585(1) despite the fact that it accounts for that relationship at fair value through profit and loss. It is based on paragraph 45D(3A) of Schedule 26 to FA 2002.

1740. Under generally accepted accounting practice, a company that accounts for a creditor relationship at fair value through profit and loss would not divide the relationship between embedded derivatives and the remaining rights that are a loan relationship. This clause overrules that accounting rule for the purposes of both this Part and Part 5 (loan relationships).

Clause 636: Modifications of Chapter 5

1741. This clause makes modifications of Chapter 5 (continuity of treatment on transfers within groups) in respect of insurance companies. It is based on paragraphs 28(1) and (2) and 29 of Schedule 26 to FA 2002.

1742. Clause 625 deals with the case where one member of a group of companies replaces another as a party to a derivative contract as the result of a related transaction or similar transactions. It determines the credits and debits to be brought into account by the transferor company and the transferee company by treating both as using the same consideration in relation to that transaction or transactions.

1743. This clause first adds two further cases to the list in clause 626 of transactions that trigger the operation of clause 625. They are cases involving the transfer of classes of insurance business between two companies where the transfer does not already fall within clause 625.

1744. *Subsection (4)* then disapplies clause 625, in respect of a triggering transaction falling within the original categories listed in clause 626, in relation to the transfer of derivative contracts moving into or out of a company's long-term insurance fund.

1745. *Subsection (5)* disapplies clause 625 in respect of a triggering transaction falling within the categories treated as added to clause 626 by subsection (3), if derivative contracts are in one of the categories set out in section 440(4) of ICTA before the transfer and in a different category after the transfer.

1746. For the meaning of "contract of long-term insurance", "insurance business transfer scheme", "qualifying overseas transfer" and "overseas life insurance company", see section 431(2) of ICTA (as modified, in relation to the meaning of "qualifying overseas transfer", by regulation 6(5) of the Overseas Life Insurance Companies Regulations 2006 (SI 2006/3271)). Because the meaning of "overseas life insurance company" is provided by that section "for the interpretation of the life assurance provisions of the Corporation Tax Acts" (and this clause is such a provision), it is unnecessary to rewrite paragraph 29(4) of Schedule 26 to FA 2002.

Clause 637: Investment trusts: profits or losses of a capital nature

1747. This clause and the next except certain capital profits and losses of an investment trust or venture capital trust from the scope of this Part so that credits and debits in respect of such profits or losses do not fall within clause 595. This clause deals with investment trusts. It is based on paragraph 38 of Schedule 26 to FA 2002 and articles 2 and 3 of The Investment Trusts and Venture Capital Trusts (Definition of Capital Profits, Gains or Losses) Order 2006 (SI 2006/1182).

1748. *Subsection (1)* refers to "profits or losses" rather than "profits, gains and losses" as in the source legislation. But there is no difference in the meaning of the two phrases in the context of an investment trust's transactions of a capital nature.

1749. *Subsection (2)* uses the meaning of profits or losses of a capital nature given by SI 2006/1182 for both trusts using UK generally accepted accounting practice and those using international accounting standards. It does not rewrite the meaning given in paragraph 38(3) of Schedule 26 to FA 2002 as the relevant Statement of Recommended Practice uses terms from international accounting standards (and

accordingly does not rewrite the part of paragraph 38(2)(a) of that Schedule which refers to that meaning).

1750. *Subsection (4)* contains powers for the amendment by Treasury order of the meaning of "profits or losses of a capital nature" in this clause. This rewrites the powers in paragraph 38(2) of Schedule 26 to FA 2002 used to make the order in SI 2006/1182 applying to investment trusts and venture capital trusts that use international accounting standards.

1751. There were similar rules in relation to "capital profits, gains and losses" of authorised unit trusts and open-ended investment companies in paragraphs 32 and 33 of Schedule 26 to FA 2002 with regulatory powers in paragraph 34 of that Schedule. The first two of those paragraphs were omitted by F(No 2)A 2005. Paragraph 34 of that Schedule is now omitted and not rewritten as it is redundant.

1752. Schedule 1 to this Bill inserts section 842(2D) and (2E) of ICTA (investment trusts: net excess of relevant credits over relevant credits under this Part treated as income derived from shares or securities for the purposes of approval of a company under that section, so far as the credits and debits are brought into account under clause 574). This insertion is based on paragraph 39 of Schedule 26 to FA 2002.

Clause 638: Venture capital trusts: profits or losses of a capital nature

1753. This clause excepts certain capital profits and losses of a venture capital trust from the scope of this Part. It is based on paragraph 38A of Schedule 26 to FA 2002 and articles 2 and 3 of the Investment Trusts and Venture Capital Trusts (Definition of Capital Profits, Gains or Losses) Order 2006 (SI 2006/1182).

1754. This clause has the same effect for venture capital trusts as clause 637 has for investment trusts. See the commentary for that clause.

1755. This clause does not rewrite paragraph 38A(2)(a)(part) and (3) of Schedule 26 to FA 2002 for the same reasons as those mentioned in the commentary for clause 637 in relation to not rewriting paragraph 38(3) of Schedule 26 to FA 2002.

Chapter 7: Chargeable gains arising in relation to derivative contracts

Overview

1756. This Chapter sets out when profits and losses in relation to derivative contracts are dealt with as chargeable gains or allowable losses for the purposes of the charge to corporation tax on chargeable gains rather than being taken into account as income under Part 3 (trading income) or Part 5 (loan relationships).

Clause 639: Overview of Chapter

1757. This clause gives an overview of the contents of the Chapter. It is new.

1758. Clauses 640 and 651 switch off respectively clause 574 and both that clause and clause 573, under which credits and debits are brought into account as income, so

that the credits and debits in question may be used instead to give rise to chargeable gains or allowable losses.

1759. Clause 641 (to which there are exceptions in clause 642) brings credits and debits on four types of derivative contract into account as chargeable gains or allowable losses. The four types are:

- derivative contracts relating to land and certain tangible movable property (clause 643, with a supplementary rule in clause 644);

- embedded derivatives in a creditor relationship that are options (clause 645, to which there are exceptions in clause 646);

- embedded derivatives in a creditor relationship that are exactly tracking contracts for differences (clause 648); and

- property based total return swaps (clause 650).

1760. The remaining provisions of the Chapter (other than various interpretative clauses) provide bespoke chargeable gains rules for a number of cases:

- embedded derivatives in a debtor relationship that are options (the affected derivative contract is defined in clause 652 and the rules that apply are set out in clauses 653 to 655); and

- embedded derivatives in a debtor relationship that are contracts for differences (the affected derivative contract is defined in clause 656 and the rules that apply are set out in clause 658).

1761. Chapter 8 contains further rules for a miscellany of situations in which chargeable gains rules are applied or modified.

Clause 640: Credits and debits not to be brought into account under Part 5
1762. This clause disapplies clause 574 to "relevant credits and debits" in respect of a derivative contract to which one of the provisions listed in *subsection (2)* applies. It is based on paragraph 45A(1) and (2) of Schedule 26 to FA 2002.

Clause 641: Derivative contracts to be taxed on a chargeable gains basis
1763. This clause treats a chargeable gain or allowable loss as arising in respect of a contract to which one of the provisions listed in *subsection (2)* applies. It is based on paragraph 45A(1), (4) and (5) of Schedule 26 to FA 2002.

1764. Whether there is such a gain or loss depends on whether the relevant credits arising in respect of the contract exceed such relevant debits or those debits exceed those credits.

Clause 642: Exception from section 641

1765. This clause provides an exception to the general rule in clause 641 for a contract to which clause 645 (embedded derivatives in a creditor relationship that are options) applies if a condition is met. It is based on paragraph 45A(4) and (6) of Schedule 26 to FA 2002.

1766. The condition is that paragraph 2 of Schedule 7AC to TCGA would apply to a gain arising on the disposal of the option represented by the rights and liabilities under the embedded derivative. Schedule 7AC to TCGA provides exemptions from the charge to corporation tax on chargeable gains for disposals of a company's substantial shareholdings in another company. Paragraph 2 of that Schedule extends the exemption to most disposals of assets relating to shares if a disposal of the shares themselves would qualify for exemption.

1767. The condition applies on the assumptions given in *subsection (2)*, which deem the embedded derivative to be a separate contract that is an option which is disposed of at the end of the accounting period in question and the disposal results in a gain.

Clause 643: Contracts relating to land or certain tangible movable property

1768. This clause sets out the type of derivative contract it applies to (so that clause 641 may then apply to credits and debits in respect of the contract). It is based on paragraph 45C(1) and (4) of Schedule 26 to FA 2002.

1769. As with a number of similar clauses in this Chapter which define the derivative contracts to which they apply, condition B in *subsection (3)* is that the company does not hold the derivative contract for the purposes of a trade it carries on. This subsection does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45C(2) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in clauses 633 and 634.

1770. Condition C, in *subsection (4)*, an equally common element in such clauses, is that the company in question is not an "excluded body". That term is defined in clause 706 for the purposes of this Part and refers to various types of collective investment scheme.

1771. Condition A, in *subsection (2)*, is the distinguishing characteristic of this type of derivative contract. The underlying subject matter of the contract is either or both of land and certain tangible movable property. *Subsection (5)* contains a signpost to an additional rule in clause 644 that modifies what the underlying subject matter of the contract is taken to consist of.

Clause 644: Income to be left out of account in determining whether section 643 applies

1772. This clause provides for underlying subject matter that is income from property of the type or types mentioned in condition A in clause 643 to be disregarded

in determining whether that condition is met. It is based on paragraph 45C(5) and (6) of Schedule 26 to FA 2002.

1773. This clause is substantially similar to clause 590, which performs the same function in relation to the definition of "excluded property" in clause 589.

Clause 645: Creditor relationships: embedded derivatives which are options

1774. This clause sets out the type of derivative contract it applies to (so that clause 641 may then apply to credits and debits in respect of the contract). It also disapplies a chargeable gains provision in TCGA. It is based on paragraphs 12(1) and (11A) and 45D(1), (2), (3), (8) and (9) of Schedule 26 to FA 2002.

1775. Condition C in *subsection (4)* sets out the main distinguishing characteristic of the type of derivative contract to which this clause applies. It is that the underlying subject matter of the contract is "qualifying ordinary shares" (broadly, fully participating shares in a listed company, holding company or trading company) or "mandatorily convertible preference shares" (shares that have to be converted into qualifying ordinary shares within 24 hours of acquisition).

1776. *Subsection (7)* provides that the creditor relationship, by virtue of which there is a deemed derivative contract to which this clause applies, is itself not treated as a "qualifying corporate bond" although section 117(A1) of TCGA would otherwise treat it as such. That section defines a qualifying corporate bond as "any asset representing a loan relationship of a company". This subsection effectively switches off for the creditor relationship those provisions in TCGA or elsewhere that apply to qualifying corporate bonds.

1777. Condition D, in *subsection (5)*, does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45D(3) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in clauses 633 and 634.

1778. See also Part 10 of Schedule 2 which disapplies this clause and applies other rules if the asset representing the creditor relationship is an asset in relation to which paragraph 9(2) of Schedule 10 to FA 2004 has effect.

Clause 646: Exclusions from section 645

1779. This clause makes two exclusions from the scope of clause 645. It is based on paragraph 45E(1), (3) and (4) and 12(11C) of Schedule 26 to FA 2002.

1780. The exclusions apply in circumstances where the holder is not sharing in the equity risk that is a part of the creditor relationship in which the derivative contract is an embedded derivative. The circumstances are where the holder of the deemed derivative contract may get a predetermined cash amount (condition A) or where cash payable instead of the shares differs significantly from the value of the shares (condition B).

Clause 647: Meaning of certain expressions in section 645

1781. This clause provides definitions of "mandatorily convertible preference shares" and "qualifying ordinary shares" for the purposes of clause 645 and contains signposts to other relevant definitions. It is based on paragraph 45D(4), (5), (6) and (7) of Schedule 26 to FA 2002.

1782. "Shares" is defined in clause 710. "Recognised stock exchange", in condition B of the definition of "qualifying ordinary shares", has the meaning given by section 841 of ICTA.

Clause 648: Creditor relationships: embedded derivatives which are exactly tracking contracts for differences

1783. This clause sets out the type of derivative contract it applies to (so that clause 641 may then apply to credits and debits in respect of the contract). It also disapplies a chargeable gains provision in TCGA. It is based on paragraphs 12(1) and (11A) and 45F(1), (2), and (8) of Schedule 26 to FA 2002.

1784. Condition C, in *subsection (4)*, and condition D, in *subsection (5)*, set out the distinguishing characteristics of this type of derivative contract. They are that the underlying subject matter of the contract is qualifying ordinary shares listed on a recognised stock exchange and that the derivative contract is an "exactly tracking contract".

1785. "Exactly tracking contract" is defined in clause 649(2) by reference to a formula. Such a contract is one under which the amount to be paid to discharge the rights and liabilities under the contract varies according to a percentage figure applied to the cost of the asset representing the creditor relationship when that asset comes into existence. The percentage figure is equal to the movement in the value of the assets (that is, the listed shares) which are the underlying subject matter of the contract (or an index of that value). The period over which the movement in the value of the assets is tracked is the period from when the asset representing the creditor relationship came into existence to the date the corresponding debtor relationship comes to an end. (Paragraph (b) of clause 649(3) provides a minor amount of leeway in measuring that period for the case where a valuation date in respect of the assets in question is not exactly coterminous with either the beginning or end of the period.) In such a case, the discharge amount tracks the value of those assets exactly.

1786. Condition E, in *subsection (6)*, does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45F(3) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in clauses 633 and 634.

1787. *Subsection (8)* provides that that creditor relationship is itself not treated as a "qualifying corporate bond" although section 117(A1) of TCGA would otherwise treat it as such. See the commentary on the similar provision in clause 645(7).

1788. *Subsection (9)* contains a signpost to clause 672, which modifies the rules for acquisition costs in section 38 of TCGA if the asset representing the creditor relationship mentioned in this clause is disposed of.

1789. See also Part 10 of Schedule 2 which disapplies this clause and applies other rules if the asset representing the creditor relationship is an asset in relation to which paragraph 11(2) of Schedule 10 to FA 2004 has effect.

Clause 649: Meaning of certain expressions in section 648

1790. This clause provides definitions for the interpretation of clause 648. It is based on paragraph 45F(4), (5), (6) and (7) and 12(11C) of Schedule 26 to FA 2002.

1791. See the commentary on clause 648 in relation to the meaning of "exactly tracking contract".

1792. "Shares" is defined in clause 710.

Clause 650: Property based total return swaps

1793. This clause sets out the type of derivative contract it applies to (so that clause 641 may then apply to credits and debits in respect of the contract). It is based on paragraph 45G(1) and (1A) of Schedule 26 to FA 2002.

1794. Conditions A to D, in *subsections (2)* to *(5)*, set out the distinguishing characteristics of this type of derivative contract. It is, first, a contract for differences whose underlying subject matter includes interest rates (in addition to other underlying subject matter). Second, one or more indices are specified in the contract including an index of changes in the value of land (a "capital value index").

1795. Condition E, in *subsection (6)*, does not rewrite the disapplication of the condition to life assurance and mutual trading companies that is provided by paragraph 45G(1B) of Schedule 26 to FA 2002. That disapplication is obsolete by virtue of the rules in clauses 633 and 634.

1796. By virtue of the special meaning of "relevant debits and credits" in this clause, provided by clause 659(3), only part of the credits and debits found under clause 595 is brought into account under clause 641 as a chargeable gain or allowable loss.

Clause 651: Credits and debits not to be brought into account under Part 3 or Part 5

1797. This clause disapplies clause 573 to "relevant credits and debits" from a derivative contract to which one of the provisions listed in *subsection (2)* applies. It is based on paragraphs 45J(3) and 45K(3) of Schedule 26 to FA 2002.

Clause 652: Introduction to sections 653 to 655

1798. This clause sets out the type of derivative contract it applies to (so that clause 653, 654 or 655 may then apply in respect of the contract). It is based on paragraphs 12(1) and (11A) and 45J(1), (2), and (10) of Schedule 26 to FA 2002.

1799. It applies to a derivative contract that comprises the rights and liabilities treated by clause 585 as a relevant contract, because of a debtor relationship of the company, if that relevant contract is also treated as an option by that clause. For the purposes of this clause, the definition of "option" in clause 580 is shorn of its usual limiting conditions (that a cash-settled option is not an option).

1800. The paragraph "issuers of securities with embedded derivatives: deemed options" in Part 10 of Schedule 2 disapplies the rules in clauses 653 and 655, and modifies the application of the rule in clause 654 if the company was a party to the debtor relationship before its first accounting period to begin on or after 1 January 2005.

1801. For other rules that apply if a company is a party to an embedded derivative because of a debtor relationship of the company and the embedded derivative is treated as an option, see clauses 665 and 666 in Chapter 8. They apply if the embedded derivative is an equity instrument and the company pays an amount to the creditor in the loan relationship in discharge of obligations under the relationship.

Clause 653: Shares issued or transferred as a result of exercise of deemed option

1802. This clause determines for the purposes of section 144(2) of TCGA the value of the consideration given for the option represented by the derivative contract within clause 652 if shares are issued or transferred as a result of the exercise of the option. It is based on paragraph 45J(3), (4A) and (5) of Schedule 26 to FA 2002.

1803. Section 144(2) of TCGA treats the grant of an option and the transaction under which the grantor fulfils the obligation under the option as a single transaction. The consideration for the option is regarded as part of the consideration for the sale. This clause determines the amount of the consideration for the grant of the option for the purposes of that section. It does so by reference to the carrying value of the option at the time the company became a party to the relevant debtor relationship. "Carrying value" is defined in clause 702.

1804. The source legislation for this rule, paragraph 45J(5)(a) of Schedule 26 to FA 2002, refers to "the amount treated in accordance with section 94A(2) of the Finance Act 1996 as the carrying value of the option". That section makes no direct reference to the carrying value of any item. But paragraph 50A(3B) of Schedule 26 to FA 2002 refers to that section in the course of setting out what the carrying value of a contract is. That reference is rewritten in clause 702, but in terms of clause 585. It would be superfluous to add any such reference to the present clause, so the words "in accordance with section 94A(2) of the Finance Act 1996" have not been rewritten here.

Clause 654: Payment instead of disposal on exercise of deemed option

1805. This clause provides for a chargeable gain or allowable loss in the same circumstances as those applying in clause 653, except that an amount is paid in fulfilment of the company's obligations under the debtor relationship (and there is no issue or transfer of shares). It is based on paragraphs 12(1) and (11B) and 45J(3), (6), (7), (8) and (9B) of Schedule 26 to FA 2002.

1806. In a number of circumstances it may suit one or other or both parties to a debtor relationship containing an option for the issue or transfer of shares not to go ahead when the option is exercised. Instead the matter is settled by a monetary payment. Such a cash settlement would fall foul of the limiting conditions in the definition of an "option" in clause 580, so those conditions are disapplied for the purposes of the present clause by clause 652.

1807. There is a chargeable gain if the carrying value of the derivative contract at the time the company became a party to the debtor relationship exceeds the amount paid in fulfilment of the company's obligations under the debtor relationship. For this purpose that amount is first reduced, but not below nil, by the fair value of the host contract at the time the option is exercised. But if that amount (as so reduced) exceeds that carrying value, an allowable loss arises. The gain or loss, as the case may be, is the amount of the excess.

Clause 655: Ceasing to be party to debtor relationship when deemed option not exercised

1808. This clause deems there to be an acquisition and disposal of an asset for the purposes of corporation tax on chargeable gains if a company ceases to be a party to a debtor relationship within clause 652 at a time when the option has not been exercised. It is based on paragraphs 12(1) and (11B) and 45J(3), (8), (9), (9A) and (9B) of Schedule 26 to FA 2002.

1809. A company may cease to be a party to a debtor relationship by redeeming or repaying the liability in question or by some other means (such as assigning the rights and liabilities under the relationship).

1810. *Subsection (2)* treats the company as having acquired an asset for consideration equal to the amount paid to cease to be a party to the relationship. It also treats the company as having disposed of that asset for consideration equal to the carrying value of the relationship when acquired. But the carrying value is first reduced, as in respect of clause 654, by the fair value of the host contract at the time the option was acquired. The deemed disposal may give rise to a chargeable gain or allowable loss.

Clause 656: Introduction to section 658

1811. This clause sets out the type of derivative contract it applies to (so that clause 658 may then apply in respect of the contract). It is based on paragraphs 12(1) and (11A) and 45K(1) and (2) of Schedule 26 to FA 2002.

1812. *Subsection (3)(b)* provides that this clause does not apply to a derivative contract that falls within clause 652. The definition of "option" in clause 580 is shorn for the purposes of that clause of its usual limiting conditions (by virtue of which a cash-settled option is not an option). A contract which is an option under the modified definition is a contract for differences and would otherwise fall also within this clause.

1813. The distinguishing characteristic of this clause, condition C in *subsection (4)*, is that the derivative contract is an "exactly tracking contract", as defined in clause 657. That term has a similar meaning to that in clause 648, as defined in clause 649. But what is being tracked here is the amount regarded in accordance with generally accepted accounting practice as the proceeds of issue of the liability which represents the debtor relationship in this case. And, as this clause deals with a debtor relationship (while clause 648 deals with a creditor relationship), the period over which the tracking takes place is measured from the date the liability representing the debtor relationship begins to the date the corresponding creditor relationship ends.

Clause 657: Meaning of "exactly tracking contract" in section 656
1814. This clause defines "exactly tracking contract" for the purposes of clause 656. It is based on paragraph 45K(2A), (2B) and (2C) of Schedule 26 to FA 2002.

Clause 658: Chargeable gain or allowable loss treated as accruing
1815. This clause provides for a chargeable gain or allowable loss to arise when a debtor relationship within clause 656 comes to an end if an amount is paid to discharge a company's obligations under that relationship. It is based on paragraphs 12(1) and (11B) and 45K(3), (3A) and (3B) of Schedule 26 to FA 2002.

1816. The gain or loss is calculated on the assumptions that:

- there is a disposal of an asset which is the contract for differences in clause 656;

- the cost of that asset is the amount paid to discharge the company's obligations; and

- the consideration for the disposal is the amount of the proceeds of the issue of the security representing the debtor relationship (or, if the company became a party to that relationship at a time after it was created, the carrying value of the host contract at that time).

1817. See the paragraph headed "disapplication of section 658" in Part 10 of Schedule 2 which applies if the liability representing the debtor relationship was owed by the company immediately before its first accounting period to begin on or after 1 January 2005.

Clause 659: Meaning of "relevant credits" and "relevant debits"

1818. This clause provides the meaning of "relevant credits" and "relevant debits" for the purposes of this Chapter. It is based on paragraphs 45A(3), 45G(2), (3) and (4), 45J(3) and 45K(3) of Schedule 26 to FA 2002.

1819. For all but one case the meaning is the same as that of credits and debits within clause 595(3) and (4).

1820. The exception is the meaning of the terms in the case of a derivative contract to which clause 650 (property based total return swaps) applies. For the purposes of clause 641, as it applies to derivative contracts within clause 650, the credits and debits found by clause 595(3) and (4) are relevant credits and debits only to the extent they are also amounts found by applying the calculation formula in *subsection (4)*.

1821. Clause 650 applies to contracts for differences in which there is a specified "capital value index" (see the commentary on that clause). Subsection (4) finds an amount of credits and debits by calculating the percentage change ("R%") in the value of that index over the relevant accounting period (or part of that period, if the company is not a party to the contract throughout) and applying R% to the "notional principal amount". That term is not defined but is used in relation to derivative contracts to describe the notional amount of capital by reference to which payments are due between the parties to the contract (see the reference to interest rates in condition D in clause 650).

1822. The R% x N rule may give a credit but the accounts show a debit, or may give a larger credit (or debit) than the accounts credit (or debit). See the example in paragraph CFM13540a of HMRC's Corporate Finance Manual.

Chapter 8: Further provision about chargeable gains and derivative contracts

Clause 660: Contract relating to holding in OEIC, unit trust or offshore fund

1823. This clause provides for a chargeable gain or allowable loss to arise when a company ceases to be a party to a relevant contract that is treated as a derivative contract because of clause 587. It is based on paragraph 37(1), (2), (3) and (5) of Schedule 26 to FA 2002.

1824. Clause 587 applies if the underlying subject matter of a relevant contract is an interest in a collective investment scheme and that scheme fails to meet a "qualifying investments test" in the relevant accounting period. The relevant contract is treated as a derivative contract for that accounting period and later periods.

1825. Clause 602 provides for value to be attributed to the deemed derivative contract by reference to its market value when it is so deemed. Clause 601 sets out the credits and debits to be brought into account for the purposes of this Part.

1826. This clause deals with the profit and loss latent in the contract immediately before it is deemed to be a derivative contract. It applies if the contract was then a

"chargeable asset". That term is defined in clause 703 as an asset on whose disposal any gain would be a chargeable gain for the purposes of corporation tax on chargeable gains. The charge on that accrued gain or loss is in effect deferred until the company ceases to be a party to the contract.

1827. The consideration for the disposal equals any value given to the relevant contract in the company's accounts for the period immediately preceding that in which it is deemed to be a derivative contract. This value may be the same as or different from that found under clause 602.

Clause 661: Contract which becomes derivative contract

1828. This clause provides for a chargeable gain or allowable loss to arise when a company ceases to be a party to a relevant contract that, not having been a derivative contract, became a derivative contract. It is based on paragraph 43A(1), (2), (4) and (5) of Schedule 26 to FA 2002.

1829. There are a number of ways in which a relevant contract that was not a derivative contract may become one. For example, if the terms of the contract change (without creating a new contract) in such a way that the accounting conditions in clause 579 are now met, the contract may become a derivative contract. Or it may be that the contract no longer meets the "excluded property" rule in clause 589 by virtue of which it was not a derivative contract. See for example the circumstances described in the paragraph "contracts which became derivative contracts on 16 March 2005" in Part 10 of Schedule 2.

1830. If this clause applies, it operates similarly to clause 660. Again, bringing into account the gain or loss latent in the relevant contract (which is also a chargeable asset) is deferred until the company ceases to be a party to the relevant contract.

1831. "Notional carrying value" has the same meaning as in clause 622(4), that is, the carrying value the contract would have had in the books of the company had a period of account ended immediately before the deemed disposal. See the commentary on that clause as regards the use of "period of account" rather than "accounting period" in that definition.

1832. See also the paragraph headed "disapplication of section 661" in Part 10 of Schedule 2 which applies if the relevant contract became a derivative contract before 30 December 2006.

Clause 662: Contracts ceasing to be derivative contracts

1833. This clause provides that, if a relevant contract to which the company continues to be a party ceases to be a derivative contract, the company is treated as acquiring the contract for an amount equal to its notional carrying value at the time it ceases to be a derivative contract. It is based on paragraph 43B of Schedule 26 to FA 2002.

1834. This clause is the companion to clause 622 which deals with the deemed disposal of the relevant contract for the purposes of this Part at the time it ceases to be a derivative contract. See the commentary on that clause.

Clause 663: Contracts to which section 641 applies

1835. This clause provides that, if a company makes a claim, allowable losses deemed to arise for an accounting period may be carried back and set against chargeable gains deemed to arise in accounting periods in the previous 24 months. It is based on paragraph 45B(1), (2) and (3) of Schedule 26 to FA 2002.

1836. The gains and losses deemed to arise are those given by clause 641 (chargeable gains basis substituted for income basis in charging credits and debits from certain types of derivative contract).

1837. The gains eligible for relief in an earlier period are the total clause 641 gains for that period less the total of allowable losses under that clause for that period. Those gains are further reduced by any other allowable losses for that period so far as those other allowable losses could not be deducted, within the meaning of section 8(1) of TCGA, from other chargeable gains. That is, any allowable losses for the purposes of corporation tax on chargeable gains, other than losses under clause 641, are notionally deducted from the clause 641 gains if they cannot be set against any chargeable gains, other than gains under clause 641, to find the amount of gains against which the losses carried back under this clause can be set. The amount found under this rule is called "net section 641 gains".

1838. *Subsection (3)* provides that, to the extent the losses for a period are carried back and relieved under this clause, they are used up and cannot otherwise be relieved under the provisions for corporation tax on chargeable gains by set off or carry forward.

Clause 664: Meaning of certain expressions in section 663

1839. This clause provides the meaning of some terms used in clause 663. It is based on paragraph 45B(4), (5), (6), (7) and (8) of Schedule 26 to FA 2002.

Clause 665: Introduction to section 666

1840. This clause sets out the type of contract it applies to for the purposes of the relief provided by clause 666. It is based on paragraphs 12(1) and (11A) and 45JA(1), (2) and (5) of Schedule 26 to FA 2002.

1841. For the purposes of this clause, the definition of "option" in clause 580 is shorn of its usual limiting conditions (that a cash-settled option is not an option).

1842. "Equity instrument" is defined in clause 710 as having the meaning it does for accounting purposes. (See the commentary on clause 585 for further detail.)

1843. For other rules that apply if a company is a party to an embedded derivative because of a debtor relationship of the company and the embedded derivative is treated as an option, see clauses 652 to 655 in Chapter 7. They apply if the underlying subject matter of the embedded derivative is shares.

Clause 666: Allowable loss treated as accruing

1844. This clause deems there to be an allowable loss for the purposes of corporation tax on chargeable gains if a company pays an amount to discharge obligations under the debtor relationship to which clause 665(2) refers. It is based on paragraphs 12(1) and (11B) and 45JA(3) and (4) of Schedule 26 to FA 2002.

1845. The allowable loss equals any excess of that payment (as first reduced by the fair value of the host contract at that time) over the carrying value of the equity instrument that is treated as a derivative contract under clause 585 as at the time the company became a party to the debtor relationship.

1846. "Fair value" is defined in clause 710.

1847. The definition of "B" in *subsection (2)* does not rewrite the words "in accordance with section 94A(2) of the Finance Act 1996" for the same reasons as given in the commentary on clause 653.

1848. See also the paragraph headed "disapplication of section 666" in Part 10 of Schedule 2 which applies if the liability representing the debtor relationship was owed by the company immediately before its first accounting period to begin on or after 1 January 2005.

Clause 667: Shares acquired on exercise of non-embedded option

1849. This clause and the next modify the amounts otherwise allowable as acquisition costs under section 38 of TCGA on the disposal of shares acquired under an option or future. This clause deals with shares acquired as the result of the exercise of rights under an option. It is based on paragraph 45HA(1), (2) and (3) of Schedule 26 to FA 2002.

1850. This clause applies only if the derivative contract is a "plain vanilla contract" (defined in clause 708). That is, it does not apply to the exercise of rights within rights and liabilities treated as a derivative contract under clause 584, 585 or 586. Although the provision normally operates on the terminal exercise of the option, it is theoretically possible for it to apply to each instalment of a staged exercise of the option. Paragraph (e) of *subsection (1)* is therefore in terms of the exercise of "any of" the rights under the option.

1851. *Subsection (2)* provides for allowable acquisition costs under section 38(1)(a) of TCGA to be increased (or reduced) when there is a disposal of the shares acquired as a result of the exercise of rights under the option. The increase or reduction in effect reverses the earlier treatment of credits and debits in respect of the option, so

far as referable to the shares which were the subject of the option, as non-trading credits and debits for the purposes of Part 5 (loan relationships).

1852. Subsection (2) also provides that, if there is only a part disposal of those shares, section 42(2) of TCGA applies. That provision deals with the calculation of costs allowable under section 38 of TCGA if there is a part disposal of an asset. It uses an A divided by A+B formula which takes into account the consideration for the part disposal ("A") and the value of the remainder of the asset ("B").

1853. Clause 669 sets out the amount of the credits and debits to be used in calculating the amount of the adjustment to expenditure allowable under section 38 of TCGA.

1854. In a case where the adjustment reduces allowable expenditure and exceeds the amount that can be so reduced, the excess reduction is instead treated under *subsection (3)* as additional consideration for the disposal of the shares.

Clause 668: Shares acquired on running of future to delivery

1855. This clause makes provision equivalent to that in clause 667 if shares are disposed of following their acquisition as the result of the delivery of those shares under the terms of a future. It is based on paragraph 45HA(1A), (2) and (3) of Schedule 26 to FA 2002.

1856. See the commentary on clause 667.

Clause 669: Meaning of G and L in sections 667 and 668

1857. This clause determines the amounts used under clause 667 or 668 to modify the amounts allowable as acquisition costs under section 38 of TCGA on the disposal of shares acquired as mentioned in either clause. It is based on paragraph 45HA(4) and (5) of Schedule 26 to FA 2002.

1858. The credits and debits relevant to the calculation under clause 667(2) or 668(2) are those brought into account under clause 574. That is, they are amounts which are treated as non-trading credits and debits for the purposes of Part 5 (loan relationships). It is unnecessary to take account for this purpose of credits and debits within clause 573, as profits and losses on derivative contracts to which that clause applies are brought into account as trading profits rather than as chargeable gains.

1859. The credits and debits in question are those referable to the shares acquired or delivered. That is, they are credits and debits arising in respect of the derivative contract before the exercise of the option or the running to delivery of the future, as appropriate, as a result of which the shares were acquired. And they are referable to the shares which are the subject of the contract. *Subsection (2)* also provides that any necessary apportionment of credits and debits may be made on a just and reasonable basis.

1860. *Subsection (4)* indicates that the credits and debits in question are those arising in respect of any accounting period of the company during which it is a party to the derivative contract up to and including that in which the shares are disposed of. It is a question of fact whether in any of those accounting periods there are relevant credits or debits.

Clause 670: Treatment of net gains and losses on exercise of option

1861. This clause modifies the amounts allowable under section 38 of TCGA in respect of a disposal of (a) shares acquired as a result of the exercise of rights under an option, if those rights were held under a derivative contract which is an embedded derivative in a creditor relationship within clause 645 or (b) the asset representing the creditor relationship in such a case. It is based on paragraph 45H(1), (2), (3), (4), (5), (5A) and (6) and 12(11C) of Schedule 26 to FA 2002.

1862. "Creditor relationship" is defined in clause 704.

1863. As in clause 667, it is theoretically possible for the clause to apply to each instalment of a staged exercise of the option as well as the terminal exercise of the option. Paragraph (c) of *subsection (1)* is therefore in terms of the exercise or disposal of "any of" those rights.

1864. Credits and debits arising in a case to which clause 645 applies are brought into account as chargeable gains or allowable losses under clause 641. The effect of this clause is to reverse that treatment when the asset representing the creditor relationship or the shares acquired under the option are disposed of. It avoids double charging of so much of the value in that asset or shares as represents the credits or debits already brought into charge as a chargeable gain or allowable loss.

1865. The adjustment under *subsection (5)* applies only if the circumstances in which the shares were acquired involved a disposal treated as not occurring because of section 127 of TCGA. That provision disregards as a disposal the replacement of a holding of shares by another such holding in the course of a reorganisation of share capital. That is, the disposal of the rights under the option, as a result of exercising those rights, was not treated as a disposal.

1866. Similarly to clause 667, if the adjustment to be made under *subsection (3)* or (5) is a reduction that exceeds the amounts otherwise allowable under section 38 of TCGA, the excess is added to the consideration for the disposal.

1867. *Subsection (7)* disapplies sections 37 and 39 of TCGA in relation to a disposal covered by this clause. Those sections remove from the chargeable gains calculation any consideration and expenditure that is taken into account in an income calculation.

Clause 671: Meaning of G, L and CV in section 670

1868. This clause provides the meaning of labels used in the calculations made under clause 670(3) and (5). It is based on paragraphs 12(1) and (11B) and 45H(6) and (7) of Schedule 26 to FA 2002.

1869. The chargeable gains ("G") and allowable losses ("L") relevant to those calculations are those referable to the shares acquired as a result of the exercise of the option. That is, they are credits and debits arising in respect of the derivative contract before the exercise of the option as a result of which the shares were acquired. And they are referable to the shares which are the subject of the contract.

1870. *Subsection (5)* indicates that the credits and debits in question are those arising in respect of any accounting period of the company during which it is a party to the derivative contract up to and including that in which the shares are disposed of.

Clause 672: Treatment of net gains and losses on disposal of certain embedded derivatives

1871. This clause modifies the amounts allowable under section 38 of TCGA on a disposal of the asset representing the creditor relationship mentioned in clause 648 in a case where that clause applies. It is based on paragraph 45HZA(1), (2), (3), (4) and (5) of Schedule 26 to FA 2002.

1872. For the circumstances in which clause 648 applies, and for the meaning of an "exactly tracking contract for differences", see the commentary on that clause.

1873. As with clause 670, this clause in effect reverses the treatment of credits and debits in respect of the embedded derivative under clause 641 so that double counting is avoided when the asset representing the creditor relationship is disposed of.

1874. And similarly again to that clause and others, if the adjustment to be made under *subsection (2)* is a reduction that exceeds the amounts otherwise allowable under section 38 of TCGA, the excess is added to the consideration for the disposal.

Clause 673: Meaning of G, L and CV in section 672

1875. This clause provides the meaning of labels used in the calculations made under clause 672(2). It is based on paragraphs 12(1) and (11B) and 45HZA(5) and (6) of Schedule 26 to FA 2002.

1876. The definitions of "G", "L" and "CV" are similar to those in clause 671 but modified for the purposes of clause 672. See the commentary on clause 671.

Chapter 9: European cross-border transfers of business

Overview

1877. This Chapter gives the rules that apply for derivative contracts in the case of cross-border transfers within the European Community of the whole or part of a business carried on in the United Kingdom.

Clause 674: Introduction to Chapter
1878. This clause sets out the two conditions required for the Chapter to apply together with the claim requirement. It is based on paragraphs 30D(1), (2), (3) and (4), 30G(1) and 30I(1) of Schedule 26 to FA 2002.

1879. The source legislation for *subsection (2)(c)* requires that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA. The subsection says "within the charge to corporation tax" as the result is the same.

1880. See also the paragraph headed "references to Companies Act 2006" in Part 10 of Schedule 2 which provides for the interpretation of references to section 658 of that Act before that section comes into force.

Clause 675: Transfer of derivative contract at notional carrying value
1881. This clause provides the rule that if either of the conditions in clause 674 applies, debits and credits in respect of derivative contracts which are transferred as part of the business transfer are brought into account by both transferor and transferee as if the contracts had been transferred at the carrying value in the accounts of the transferor. It is based on paragraph 30D(1), (2) and (6) of Schedule 26 to FA 2002.

1882. The definition of "notional carrying value" is the same as that used in clause 625(6).

Clause 676: Transferor using fair value accounting
1883. This clause provides the rule to apply in place of clause 675 if the transferor company uses fair value accounting. It is based on paragraph 30D(7) of Schedule 26 to FA 2002.

Clause 677: Tax avoidance etc
1884. 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 this Chapter should apply. It is based on paragraph 30F(1) and (2) of Schedule 26 to FA 2002.

Clause 678: Procedure on application for clearance
1885. This clause sets out the procedure to be followed for an application that clause 677 should not apply. It is based on paragraph 30F(3) of Schedule 26 to FA 2002.

1886. This clause follows the procedure set out in the equivalent provision in Part 5 (loan relationships) (see clause 427).

Clause 679: Decision on application for clearance
1887. This clause sets out how the outcome of an application that clause 677 should not apply is notified. It is based on paragraph 30F(3) of Schedule 26 to FA 2002.

1888. This clause follows the procedure set out in the equivalent provision in Part 5 (loan relationships) (see clause 428).

Clause 680: Disapplication of Chapter where transparent entities involved
1889. This clause disapplies the Chapter under certain circumstances if transparent entities are involved in the transfer of business. It is based on paragraphs 30G(1) and (2) and 30I(1) of Schedule 26 to FA 2002.

Clause 681: Interpretation
1890. This clause defines "company" and explains what company residence in a member State means for the purposes of the Chapter. It is based on paragraph 30I of Schedule 26 to FA 2002.

Chapter 10: European cross-border mergers
Overview
1891. This Chapter gives the rules that apply for derivative contracts in the case of European cross-border mergers if the merging companies are resident in different member States of the European Community.

Clause 682: Introduction to Chapter
1892. This clause sets out the conditions (which include the different categories of merger) under which the Chapter applies. It is based on paragraphs 30B(1) and (2) and 30H(1) of Schedule 26 to FA 2002.

1893. The source legislation for *subsection (5)* requires that the transferee is resident in the United Kingdom or within the corporation tax charge in section 11 of ICTA. The subsection says "within the charge to corporation tax" as the result is the same.

1894. See also the paragraph headed "references to Companies Act 2006" in Part 10 of Schedule 2 which provides for the interpretation of references to section 658 of that Act before that section comes into force.

Clause 683: Meaning of "the transferee" and "transferor"
1895. This clause gives the meaning of the two terms for the different categories of merger set out in clause 682(2). It is based on paragraph 30B(9) of Schedule 26 to FA 2002.

Clause 684: Transfer of derivative contract at notional carrying value
1896. This clause provides that debits and credits in respect of derivative contracts transferred under a merger are brought into account as if the transfer had been for a consideration of an amount equal to the carrying value of the contract in the transferor company's or companies' accounts. It is based on paragraph 30B(3) of Schedule 26 to FA 2002.

Clause 685: Transferor using fair value accounting
1897. This clause provides the rule to apply in place of clause 684 if the transferor company uses fair value accounting. It is based on paragraph 30B(4) of Schedule 26 to FA 2002.

Clause 686: Tax avoidance etc
1898. This clause disapplies the Chapter if the merger is not effected for genuine commercial purposes unless the Commissioners for HMRC are satisfied, following an application, that this Chapter should apply. It is based on paragraph 30B(6), (7) and (8) of Schedule 26 to FA 2002.

1899. *Subsections (2)* and *(3)* provide a clearance procedure equivalent to that in the previous Chapter.

Clause 687: Disapplication of Chapter where transparent entities involved
1900. This clause disapplies the Chapter under certain circumstances if transparent entities are involved in the merger. It is based on paragraphs 30H(1) and (2) and 30I(1) of Schedule 26 to FA 2002.

Clause 688: Interpretation
1901. This clause defines some terms used in the Chapter. It is based on paragraphs 30B(9) and 30I of Schedule 26 to FA 2002.

Chapter 11: Tax avoidance
Clause 689: Overview of Chapter
1902. This clause describes the content of the Chapter. It is new.

Clause 690: Derivative contracts for unallowable purposes
1903. This clause prevents certain credits and debits being brought into account for corporation tax purposes, whether under this Part or otherwise, if the derivative contract in question has an "unallowable purpose". It is based on paragraph 23(1), (2), (3), (8), (9) and (10) of Schedule 26 to FA 2002.

1904. *Subsection (3)* prevents a company bringing into account all debits in respect of the derivative contract that are referable to the unallowable purpose. But *subsection (2)* only does so for credits that are "exchange credits" (defined in *subsection (6)*).

1905. *Subsection (4)* signposts the relief in clause 692, which provides that some of the debits mentioned in subsection (3) may be brought into account in the shape of "excess accumulated net losses".

1906. *Subsection (5)* makes clear that an amount that is not brought into account because of this clause (or clause 692) is nevertheless regarded as brought into account for the purposes of the priority rule in clause 699. That rule provides that this Part exhausts the corporation tax treatment of an amount to which it applies, unless

otherwise stated. The amounts in question are therefore not to be brought into account for corporation tax purposes in any other way.

Clause 691: Meaning of "unallowable purpose"

1907. This clause defines "unallowable purpose" and "has an unallowable purpose" for the purposes of clauses 690 and 692. It is based on paragraph 24 of Schedule 26 to FA 2002.

1908. A purpose is unallowable if it is one of the purposes for which the company is a party to the contract (or enters into related transactions in relation to it) but it is not a business or other commercial purpose of the company.

1909. *Subsection (2)* excludes any activities in respect of which the company is not within the charge to corporation tax from the business and commercial purposes of the company that are relevant to this definition. For example, if a non-UK resident company is a party to the contract for the purposes of a permanent establishment it has in the United Kingdom, the purposes of the activities of the company that are not part of the activities of the permanent establishment are disregarded.

1910. *Subsections (3)* to *(6)* exclude a tax avoidance purpose from the business and commercial purposes of the company for the purposes of this definition. The effect of this is that a tax avoidance purpose is an unallowable purpose unless it is a minor part of the company's motivation for being a party to, or entering into related transactions in relation to, the derivative contract.

Clause 692: Allowance of accumulated net losses

1911. This clause gives relief for some of the debits prevented from being brought into account by clause 690. It is based on paragraph 23(1), (4), (5), (6) and (7) of Schedule 26 to FA 2002.

1912. The amount that is relieved under this clause by being brought into account as a debit, by virtue of *subsection (4)*, is the amount of the "excess accumulated net losses" found in accordance with the method statement in *subsection (5)*.

1913. In effect, debits excluded for an accounting period because of clause 690(3) are nevertheless relieved in that or a later period to the extent that there are non-excluded credits against which they can be set.

1914. The calculation of the amount to be relieved is on a cumulative basis and that amount is reduced by any debit already given under this clause.

Clause 693: Bringing into account adjustments under Schedule 28AA to ICTA

1915. This clause brings into account under this Part credits and debits in respect of amounts treated under Schedule 28AA to ICTA (provision not at arm's length) as profits, losses or expenses. It is based on paragraph 31A of Schedule 26 to FA 2002.

1916. It brings credits and debits into account to the extent that actual amounts of such profits, losses or expenses would be brought into account.

1917. Schedule 28AA to ICTA identifies adjustments ("imputed amounts") to be made to return the profit or loss from a transaction between parties not at arm's length to what that profit or loss would be had the parties been at arm's length. This clause ensures that such amounts are taken into account under this Part although they arise under Schedule 28AA rather than under this Part.

1918. *Subsections (3)* and *(5)* indicate that the credits and debits brought into account by this clause are subject to the same rules as apply under this Part to credits and debits in respect of actual amounts. So, for example, debits brought into account in respect of expenses are those falling within the categories listed in clause 595(4).

Clause 694: Exchange gains and losses

1919. This clause gives effect in this Part to adjustments or other treatment of exchange gains and losses prescribed by Schedule 28AA to ICTA, further to those in clause 693. It is based on paragraph 8(1) and (4) of Schedule 28AA to ICTA and paragraph 27 of Schedule 26 to FA 2002.

1920. Under paragraph 1 of Schedule 28AA to ICTA, a company may be treated as not a party to a derivative contract. The actual exchange gains and losses on that contract are then disregarded. *Subsection (3)* provides that such exchange gains and losses are also left out of account in determining the credits and debits to be brought into account under this Part.

1921. Schedule 28AA to ICTA may also impute amounts of exchange gains and losses (the "adjusted amount") calculated on the basis that the parties to the derivative contract are acting at arm's length although in fact they do not do so. *Subsection (5)* requires the "adjusted amount" to be brought into account under this Part.

Clause 695: Transfers of value to connected companies

1922. This clause treats as a credit the amount paid by a company for the grant of an option by a company connected with it if the option is allowed to expire to the benefit of the connected company. It is based on paragraph 26 of Schedule 26 to FA 2002.

1923. Value is transferred on the expiry of the option because the connected company retains the amount paid for the option and does not suffer the commercial loss that would have occurred had the option been exercised. The required assumption in *subsection (6)*, that the option would have been exercised had the parties not been connected, points to the fact that it would have been advantageous to the option holder to exercise it (and therefore disadvantageous to the company granting the option).

1924. The clause applies only if the connected company is not within the charge to corporation tax in respect of the derivative contract under or because of this Part. For example, it applies if the connected company is not a UK resident company (and the

derivative contract is not held for the purposes of a permanent establishment it has in the United Kingdom).

1925. *Subsection (7)* indicates that, for the purposes of this clause, the definition of "option" in clause 580 is shorn of its usual limiting conditions (that a cash-settled option is not an option).

Clause 696: Derivative contracts with non-UK residents

1926. This clause excludes a debit if a company within the charge to corporation tax makes payments of notional interest in excess of payments of notional interest to it by a company which is non-UK resident. It is based on paragraph 31(1), (2), (3), (4) and (9) of Schedule 26 to FA 2002.

1927. This clause typically applies to a contract for differences which is an interest rate swap. It has some similarities with clause 695 in that the flow of benefit in the direction of a company outside the charge to corporation tax is countered in taxing the other company.

1928. *Subsection (4)* defines "notional interest payment". The rate applied in calculating such a payment is not necessarily an interest rate as such but paragraph (c) of the definition requires that it matches the interest rate specified in the contract.

Clause 697: Exceptions to section 696

1929. This clause sets out three circumstances in which clause 696 does not apply. It is based on paragraph 31(5), (6), (7), (8) and (9) of Schedule 26 to FA 2002 and section 153(2) of FA 2003.

1930. The third exception is if there is a double taxation agreement between the United Kingdom and the territory in which the non-UK resident is resident which covers payments of interest (whether by relief or otherwise). Unlike the first two exceptions, where the financial institution or non-UK resident must hold the derivative contract as principal, this exception can apply if the non-UK resident holds the derivative contract as agent or nominee of another person. But in that case, the relevant territory is that in which the principal is resident.

1931. "Permanent establishment" is defined in section 148 of FA 2003.

Clause 698: Disposals for consideration not fully recognised by accounting practice

1932. This clause brings into account that part of the consideration for a disposal of rights or liabilities under a derivative contract that is not fully recognised under applicable generally accepted accounting practice, if the company in question made the disposal with avoidance motives. It is based on paragraph 27A of Schedule 26 to FA 2002.

1933. *Subsection (5)* gives priority to paragraph 1(2) of Schedule 28AA to ICTA, if that provision would apply a tax charge on the disposal in question. That paragraph may operate in effect through clause 693.

Chapter 12: Priority rules

Clause 699: Priority of this Part for corporation tax purposes

1934. This clause provides that this Part has priority, as regards amounts brought into account in accordance with it in respect of any matter, over any corporation tax provision that would otherwise apply. It is based on paragraph 1(2) of Schedule 26 to FA 2002.

1935. This rule covers not only the case where an amount is dealt with under clauses 573 or 574 but also a case to which Chapter 7 applies.

1936. *Subsection (3)* lists particular cases where the rule is disregarded.

1937. Clause 700 deals with the case where Part 5 (loan relationships) has priority over this Part. If that Part applies to any amounts, those amounts are not in fact brought into account in accordance with this Part and so this clause cannot apply.

Clause 700: Relationship of this Part to Part 5: loan relationships

1938. This clause gives priority to Part 5 if the amount that would otherwise be brought into account under this Part, or (if different) the profit or loss accruing to the company on the derivative contract, is brought into account under that Part. This clause is based on section 101 of FA 1996.

1939. This rule covers, for example, the case where a loan relationship arises from the conduct of a derivative contract (say, if one party defaults on a payment in the course of an interest rate swap and so owes money to the other). A payment due in respect of the loan relationship is dealt with under Part 5 and not under this Part.

1940. *Subsection (3)* sets out the significant exception to the general rule, that is, in a case where clause 585 (loan relationships with embedded derivatives) applies. This Part applies instead of Part 5 to profits and losses in respect of an embedded derivative that is a derivative contract.

Chapter 13: General and supplementary provisions

Clause 701: Power to amend some provisions

1941. This clause contains powers for the amendment of this Part (and related paragraphs in Part 10 of Schedule 2). It is based on paragraph 13 of Schedule 26 to FA 2002 and paragraph 52 of Schedule 4 to FA 2005.

1942. The permitted amendments are broadly concerned with redefining what is or is not a derivative contract (whether by reference to the underlying subject matter of a relevant contract or otherwise). They are also concerned with adjusting the regime for special cases.

1943. *Subsections (1)* and *(2)* define what provisions in this Part and Schedule 2 may be amended by an order under this clause. The lists in these subsections reflect the fact that the rules in the amendable provisions of the source legislation (Parts 2 and 9 of Schedule 26 to FA 2002) are now ordered differently in this Part.

1944. *Subsection (5)* contains the commencement provisions for an order made under this clause. The normal rule is that an order applies to accounting periods ending on or after the date on which the order comes into force. That rule includes a degree of retrospection in that the order may apply by reference to events that occurred in that accounting period before the order came into force. Retrospective application is partly increased by paragraph (b) of this subsection, which allows the order to apply to periods of account beginning in the year in which they are made (which would cover, for example, an accounting period of less than 12 months which has ended before the order is made).

Clause 702: "Carrying value"
1945. This clause defines the meaning of "carrying value" for the purposes of this Part. It is based on paragraphs 28(6) and 50A(3A) and (3B) of Schedule 26 to FA 2002.

1946. *Subsections (2)* and *(3)* ensure that the effect of various provisions dealing with special cases carries through for the purposes of calculating the carrying value under this clause.

1947. *Subsection (4)* provides a definition of "impairment loss" (a term taken from international accounting standards) which is only implied by the source legislation by virtue of its reference to "amounts recognised for accounting purposes". The definition is modelled on that provided for loan relationships by clause 476. See *Change 67* in Annex 1.

Clause 703: "Chargeable asset"
1948. This clause defines the meaning of "chargeable asset" for the purposes of this Part. It is based on paragraphs 4A(4), 4B(5), 37(6) and 43A(3) of Schedule 26 to FA 2002.

1949. The definition extends under *subsection (2)* to amounts that are treated under section 143 of TCGA as assets whose disposal falls within TCGA. Those assets are obligations under a futures contract, that is, the obligation to supply or to take delivery of a commodity or other item under the contract at an agreed price. If there has been such market movement in the price of the commodity that the obligation is heading to produce a profit, a disposal of the obligation (before the contract has run to delivery) would be a disposal of an asset for the purposes of TCGA.

Clause 704: "Creditor relationship" and "debtor relationship"
1950. This clause defines "creditor relationship" and "debtor relationship" for the purposes of this Part. It is based on paragraphs 30A(7) and 54(1) of Schedule 26 to FA 2002.

1951. These terms occur in this Part in connection with a loan relationship or a relevant contract within clause 585(2). The clause therefore defines the terms by reference to clause 302 in Part 5. In short, a creditor relationship refers to a debt *owned* and a debtor relationship to a debt *owed* by the company.

Clause 705: Expressions relating to exchange gains and losses
1952. This clause provides for the interpretation of references in this Part to "exchange gains" or "exchange losses" in relation to a company. It is based on paragraph 54(2), (2A) and (3) of Schedule 26 to FA 2002.

1953. *Subsection (2)* provides that, in the event that the comparison of values described in *subsection (1)* gives neither a gain nor a loss, an exchange gain of nil arises. This rule applies in a case where it is necessary for there be an amount of an exchange gain or exchange loss for a provision to apply (say, clause 694(6)).

1954. *Subsection (3)* provides powers for the Treasury to make regulations as to the calculation of exchange gains and losses and any other profits, gains or losses if the company uses fair value accounting. See The Loan Relationships and Derivative Contracts (Exchange Gains and Losses using Fair Value Accounting) Regulations 2005 (SI 2005/3422). As in the case of the powers in clause 701, regulations made under these powers may apply to any period of account beginning in the year in which they are made.

1955. *Subsection (5)* sets out what a reference to an exchange gain or loss from a company's derivative contracts means (for the purposes of, say, clause 606(1)).

Clause 706: "Excluded body"
1956. This clause defines "excluded body" for the purposes of this Part. It is based on paragraphs 45C(3), 45D(2), 45G(1A), 45J(2) and 45K(2) of Schedule 26 to FA 2002.

1957. The bodies which are excluded bodies are all types of collective investment scheme.

1958. "Authorised unit trust" is defined in section 832(1) of ICTA by reference to section 468(6) of that Act, which in turn refers to a scheme in respect of which an order under section 243 of FISMA is in force in the relevant accounting period.

1959. "Investment trust" has the meaning given by section 842 of ICTA and "venture capital trust" the meaning given by section 834(1) of ICTA (by reference to Part 6 of ITA).

1960. "Open-ended investment company" is defined in clause 710 by reference to section 468A(2) of ICTA which in turn refers to a company incorporated in the United Kingdom to which section 236 of FISMA applies.

Clause 707: "Hedging relationship"

1961. This clause sets out two cases in which a company is regarded as having a "hedging relationship" for the purposes of this Part. It is based on paragraph 12(14) of Schedule 26 to FA 2002.

1962. The concept of "hedging" has to do with contracts undertaken to protect the company's assets (or to guard against increase in its liabilities) in a case where there is some form of market volatility associated with the item. The cases described in this clause derive from those set out in accounting standards. Paragraph 86 of Financial Reporting Standard 26, the equivalent for UK generally accepted accounting practice of International Accounting Standard 39, describes a hedging relationship as follows:

> Hedging relationships are of three types:
>
> fair value hedge: a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or commitment that is attributable to a particular risk and could affect profit or loss.
>
> cash flow hedge: a hedge of the exposure to variability in cash flows that is (i) attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss.
>
> hedge of a net investment in a foreign operation as defined in FRS 23.

1963. Paragraph 9 of Financial Reporting Standard 26 also provides definitions of "hedging instrument" and "hedged item".

Clause 708: "Plain vanilla contract"

1964. This clause defines "plain vanilla contract". It is based on paragraph 2(2B) of Schedule 26 to FA 2002.

1965. The term means any relevant contract except those to which a company is treated as a party under clause 584, 585 or 586.

Clause 709: "Securities house"

1966. This clause defines "securities house" for the purposes of this Chapter. It is based on paragraphs 45J(10), 45JA(5) and 45K(4) of Schedule 26 to FA 2002.

Clause 710: Other definitions

1967. This clause defines a number of terms for the purposes of this Part. It is based on paragraphs 12(1), (2), (9), (11), (12), (13) and (17) and 54(1) and (4) of Schedule 26 to FA 2002.

1968. Where appropriate, terms used in this Part in connection with the business of a life assurance company take the meaning given in Chapter 1 of Part 12 of ICTA (see in particular section 431(2) of ICTA).

1969. The clause does not rewrite those definitions in paragraph 54(1) of Schedule 26 to FA 2002 of terms that are no longer in use in that Schedule (for example, "UK company") or have been replaced by other terms (for example, "nested derivative"). Nor does it rewrite the definition of "investment trust" as that is already provided by section 842 of ICTA.

Part 8: Intangible fixed assets

Overview

1970. This Part gives a comprehensive scheme for the taxation of profits and losses arising to a company from its intangible fixed assets. It is based on Schedule 29 to FA 2002.

1971. This Part sets out a uniform and largely self-contained set of rules on the tax treatment of intangible fixed assets used for business purposes by companies. For assets within its rules, it overrides all other tax legislation. Broadly, it applies only to assets acquired from third parties, or created, after 31 March 2002. Other intangible fixed assets continue, subject to some particular exceptions, to be dealt with under general rules. The tax treatment of intangible fixed assets within this Part generally follows the accountancy treatment. In this respect, it resembles the loan relationship and derivative contract provisions which also largely erase the distinction between capital and revenue expenditure.

Chapter 1: Introduction

Clause 711: Overview of Part

1972. This clause provides a "route map" of the Part. It is new.

Clause 712: "Intangible asset"

1973. This clause explains what is meant by "intangible asset". It is based on paragraph 2 of Schedule 29 to FA 2002.

Clause 713: "Intangible fixed asset"

1974. This clause explains what is meant by "intangible fixed asset". It is based on paragraph 3 of Schedule 29 to FA 2002.

1975. *Subsection (2)* is an important general extension to the rules. That is, if an asset is an "intangible fixed asset" under the rules in this Part, so is an option or other right to acquire or dispose of that asset. There is a counterpart, obverse rule in clause 805.

Clause 714: "Royalty"

1976. This clause is definitional. It is based on paragraph 139 of Schedule 29 to FA 2002.

Clause 715: Application of this Part to goodwill
1977. This clause brings goodwill within the intangible fixed assets regime. It is based on paragraph 4 of Schedule 29 to FA 2002.

1978. The inclusion of goodwill extends the relevance of these rules to a far wider range of companies than would otherwise be the case.

Clause 716: "Recognised" amounts and "GAAP-compliant accounts"
1979. This clause identifies the accountancy amounts from which the related tax amounts are derived. It is based on paragraph 134 of Schedule 29 to FA 2002.

1980. *Subsection (4)* rewrites part of paragraph 5(1) of Schedule 29 to FA 2002. The subsection uses the label "GAAP-compliant accounts" as being a more neutral term than the label "correct accounts" used in the source legislation.

Clause 717: Companies without GAAP-compliant accounts
1981. This clause deals with the case where a company does not draw up accounts in accordance with generally accepted accounting practice or, exceptionally, does not draw up accounts at all. It is based on paragraph 5 of Schedule 29 to FA 2002.

1982. In both cases the rules apply as though GAAP-compliant accounts had been drawn up.

1983. *Subsection (3)* applies where accounts are GAAP-compliant in themselves but follow on from a period for which the accounts were not. It allows the later accounts to be adjusted to reflect the adjustments required in the earlier accounts.

Clause 718: GAAP-compliant accounts: reference to consolidated group accounts
1984. This clause allows reference to be made to consolidated group accounts in determining whether a company's accounts are GAAP-compliant. It is based on paragraph 6 of Schedule 29 to FA 2002.

Clause 719: Accounting value
1985. This clause is definitional. It is based on paragraph 135 of Schedule 29 to FA 2002.

Chapter 2: Credits in respect of intangible fixed assets
Clause 720: Introduction
1986. This clause introduces the rules dealing with the main category of accounting gains to be brought into account as credits for tax purposes. It is based on paragraph 13 of Schedule 29 to FA 2002.

1987. The rules in this Chapter do not apply on a realisation of an intangible fixed asset. *Subsection (3)* gives a signpost to the rules that do.

Clause 721: Receipts recognised as they accrue
1988. This clause covers all kinds of receipts (including most ordinary royalties) from the exploitation of intangible fixed assets, apart from those deriving from the realisation of such assets. It is based on paragraph 14 of Schedule 29 to FA 2002.

Clause 722: Receipts in respect of royalties so far as not dealt with under section 721
1989. This clause applies to credits in respect of some exceptional royalties to bring them within the charge when this would not otherwise happen. It is based on paragraph 14A of Schedule 29 to FA 2002.

Clause 723: Revaluation
1990. This clause applies when an intangible fixed asset is revalued upwards. It is based on paragraph 15 of Schedule 29 to FA 2002.

Clause 724: Negative goodwill
1991. This clause applies to certain releases of negative goodwill. It is based on paragraph 16 of Schedule 29 to FA 2002.

Clause 725: Reversal of previous accounting loss
1992. This clause applies to an accounting gain that reverses a previous loss for which relief was given. It is based on paragraph 17 of Schedule 29 to FA 2002.

1993. *Subsection (3)* ensures that if the tax debit in the previous period was not the same figure as the accounting loss, the credit on the reversal of the loss is the accounting gain adjusted in the ratio which the debit bears to the loss.

1994. There is a parallel, converse rule in clause 732.

Chapter 3: Debits in respect of intangible fixed assets
Clause 726: Introduction
1995. This clause introduces the rules dealing with the main category of accounting losses which may be brought into account as a debit for tax purposes. It is based on paragraph 7 of Schedule 29 to FA 2002.

1996. The rules in this Chapter do not apply to the realisation of an intangible fixed asset. S*ubsection (3)* provides a signpost to the Chapter that does.

Clause 727: References to expenditure on an asset
1997. This clause explains what is meant by "expenditure on an asset". It is based on paragraph 133 of Schedule 29 to FA 2002.

1998. *Subsection (2)* puts beyond doubt the exclusion of capital expenditure on tangible assets that might otherwise appear to come within *subsection (1)* such as expenditure on cars used by company staff promoting the company's brand name.

Clause 728: Expenditure written off as it is incurred

1999. This clause gives a deduction for expenditure never capitalised but written off in the period of account in which it is incurred. It is based on paragraph 8 of Schedule 29 to FA 2002.

2000. An example of expenditure within this clause might be expenditure on maintaining an asset or expenditure on acquiring an asset which, in the event, proves abortive.

Clause 729: Writing down on accounting basis

2001. This clause gives a deduction for amounts written off an intangible fixed asset that has been capitalised in the company's accounts. It is based mainly on paragraph 9 of Schedule 29 to FA 2002.

Clause 730: Writing down at fixed rate: election for fixed-rate basis

2002. This clause gives the option of a writing down deduction at a fixed rate, regardless of the accounting treatment of the intangible fixed asset. It is based on paragraph 10 of Schedule 29 to FA 2002.

2003. The main purpose of this option is to make relief available for the cost of acquiring the most durable of intangible assets which either are not amortised at all in the accounts or are amortised over a very long period. An example of such an asset could be a very strong brand name.

Clause 731: Writing down at fixed rate: calculation

2004. This clause gives the calculation rule that applies when the fixed rate writing down option is taken under the previous clause. It is based on paragraph 11 of Schedule 29 to FA 2002.

Clause 732: Reversal of previous accounting gain

2005. This clause gives relief if a previous, taxed, accounting gain is reversed. It is based on paragraph 12 of Schedule 29 to FA 2002.

2006. The debit will usually be the same as the accounting loss. If, however, the credit brought into account for the earlier period was different from the accounting gain, the formula in *subsection (3)* ensures that the debit to be recognised is the accounting loss adjusted in the ratio which the earlier credit bears to the earlier accounting gain.

2007. There is a parallel, converse rule in clause 725.

Chapter 4: Realisation of intangible fixed assets

Clause 733: Overview of Chapter

2008. This clause introduces the provisions that provide for credits or debits for tax purposes when an intangible fixed asset is realised. It is based on paragraph 18 of Schedule 29 to FA 2002.

2009. *Subsection (3)* rewrites paragraph 25 of Schedule 29 to FA 2002 as an early signpost to the possibility of roll-over relief in realisation cases.

Clause 734: Meaning of "realisation"
2010. This clause defines "realisation". It is based on paragraph 19 of Schedule 29 to FA 2002.

2011. Consistent with the underlying principle of this Part, "realisation" is defined by reference to generally accepted accounting practice. Only events which are "realisations" in these terms are within this Chapter. And only events within this Chapter can come within the roll-over rules in Chapter 7 of this Part.

2012. *Subsection (3)* is relevant to assets that have been wholly written off or to assets which have been generated internally (such as goodwill) which cannot be capitalised under generally accepted accounting practice.

Clause 735: Asset written down for tax purposes
2013. This clause gives the rules quantifying the credit or debit for an intangible fixed asset which has previously been written down for tax purposes. It is based on paragraph 20 of Schedule 29 to FA 2002.

Clause 736: Asset shown in balance sheet and not written down for tax purposes
2014. This clause gives the rules quantifying the credit or debit for an intangible fixed asset shown in the company's balance sheet and not previously written down for tax purposes. It is based on paragraph 21 of Schedule 29 to FA 2002.

2015. Examples of intangible fixed assets to which this clause applies include those sold soon after acquisition.

Clause 737: Apportionment in case of part realisation
2016. This clause deals with cases where either of the two previous clauses apply to a part realisation of an intangible fixed asset. It is based on paragraph 22 of Schedule 29 to FA 2002.

2017. The clause determines the appropriate proportion of the tax written-down value or cost of the asset to be set off.

2018. *Subsection (2)* gives a formula that covers both the simple case, where the tax written-down value has not diverged from the book value in the accounts, and the more complicated case where the tax and book values have diverged.

Clause 738: Asset not shown in balance sheet
2019. This clause deals with cases where the intangible fixed asset that is realised is never shown in the balance sheet. It is based on paragraph 23 of Schedule 29 to FA 2002.

2020. Internally-generated goodwill is probably the most common example of an intangible fixed asset to which this clause applies.

Clause 739: Meaning of "proceeds of realisation"
2021. This clause defines "proceeds of realisation". It is based on paragraph 24 of Schedule 29 to FA 2002.

Clause 740: Abortive expenditure on realisation
2022. This clause provides for a debit for tax purposes in respect of abortive realisation expenditure. It is based on paragraph 26 of Schedule 29 to FA 2002.

2023. "Abortive" expenditure is expenditure incurred for the purposes of a transaction which would have amounted to a realisation of the intangible fixed asset if it had proceeded to completion. Such expenditure would not be allowable under any other rules.

Clause 741: Meaning of "chargeable intangible asset" and "chargeable realisation gain"
2024. This clause defines two related key terms used in this Part. It is based on paragraph 137 of Schedule 29 to FA 2002.

Chapter 5: Calculation of tax written-down value
Overview
2025. Identifying the "tax written-down value" of an intangible fixed asset is an essential part of calculating the credit or debit for tax purposes.

2026. This Chapter provides rules to determine the "tax written-down value".

Clause 742: Asset written down on accounting basis
2027. This clause provides the tax written-down value when the intangible fixed asset has been written down on the accounting basis under clause 729. It is based on paragraph 27 of Schedule 29 to FA 2002.

Clause 743: Asset written down at fixed rate
2028. This clause provides the tax written-down value when the intangible fixed asset has been written down on the fixed-rate basis under clause 730. It is based on paragraph 28 of Schedule 29 to FA 2002.

Clause 744: Effect of part realisation of asset
2029. This clause provides the tax written-down value when there has been a part realisation of the intangible fixed asset. It is based on paragraph 29 of Schedule 29 to FA 2002.

Chapter 6: How credits and debits are given effect
Clause 745: Introduction
2030. This clause introduces this Chapter which deals with how effect is given to credits and debits brought into account under this Part. It is based on paragraph 30 of Schedule 29 to FA 2002.

2031. In this Part, accounting gains and accounting losses are translated, respectively, into credits and debits for tax purposes. Although all the credits and debits are brought into account as revenue items, different rules govern how they enter the calculation depending on the nature of the business activity for which the intangible fixed asset in respect of which they arise is held.

Clause 746: "Non-trading credits" and "non-trading debits"
2032. This clause explains two key terms. It is new.

Clause 747: Assets held for purposes of trade
2033. This clause incorporates the credits and debits directly into the trade profit calculation if the intangible fixed asset is held for the purposes of a trade. It is based on paragraph 31 of Schedule 29 to FA 2002.

Clause 748: Assets held for purposes of property business
2034. This clause incorporates the credits and debits directly into the property business profit calculation if the intangible fixed asset is held for the purposes of a property business. It is based on paragraph 32 of Schedule 29 to FA 2002.

2035. Paragraph 32(4) of Schedule 29 to FA 2002 has not been rewritten because it is not necessary. It is intended to make clear that losses of a furnished holiday lettings business consisting of Schedule 29 debits are still to be treated as trade losses but it is difficult to see what alternative, without paragraph 32(4), could ensue. Paragraph 32(4) applies the provisions of section 503 of ICTA which treats all a company's lettings of furnished holiday accommodation (as defined in section 504 of ICTA) as a separate and single trade for (and only for) the purposes of loss relief although the income remains chargeable as income from property. But paragraph 32(3) of Schedule 29 to FA 2002 already ensures that the furnished holiday lettings profits and other property profits are kept separate. That being the case, the fact that the debits and credits are (under paragraph 32(1) of Schedule 29 to FA 2002) brought into account as part of the separate furnished holiday lettings business identified by paragraph 32(3) would seem to be enough. Once that has taken place, the general corporation tax loss rules (of which section 503 of ICTA is really part) then apply in the ordinary way to the result.

Clause 749: Assets held for purposes of mines, transport undertakings, etc
2036. This clause incorporates the credits and debits directly into the profit calculation of a relevant business if the intangible fixed asset is held for the purposes of that business. It is based on paragraph 33 of Schedule 29 to FA 2002.

Clause 750: Assets held for purposes falling within more than one section
2037. This clause provides an apportionment rule. It is based on paragraph 30 of Schedule 29 to FA 2002.

Clause 751: Non-trading gains and losses
2038. This clause sets out rules to give effect to non-trading credits and debits. It is based on paragraph 34 of Schedule 29 to FA 2002.

Clause 752: Charge to tax on non-trading gains on intangible fixed assets
2039. This clause applies the charge to corporation tax on income when there is a non-trading gain under clause 751. It is based on section 18 of ICTA.

2040. It is necessary because the general charge label of the source referred to in paragraph 34(4) of Schedule 29 to FA 2002 ("Case VI of Schedule D") ceases to exist in this Bill.

Clause 753: Treatment of non-trading losses
2041. This clause provides for loss relief when there is a non-trading loss under clause 751. It is based on paragraph 35 of Schedule 29 to FA 2002.

2042. Relief under this clause is subject to a claim in accordance with *subsection (2)* Under the source legislation a discretionary power of extension of the time limit for the claim is exercised by the Commissioners for HMRC. In practice it would be exercised by an officer of HMRC and the Bill reflects that. See *Change 1* in Annex 1.

Chapter 7: Roll-over relief in case of realisation and reinvestment
Clause 754: The relief: the "old asset" and "other assets"
2043. This clause introduces a form of roll-over relief enabling some or all of a credit arising under Chapter 4 of this Part on the realisation of an intangible fixed asset (including goodwill) to be deferred. It is based on paragraph 37 of Schedule 29 to FA 2002.

2044. *Subsection (4)* is new. The rules in this Chapter deal only with mainstream cases where, broadly, assets already within the intangible fixed assets regime are replaced in arm's length transactions by a single company by assets that, on acquisition, are also within the regime. This is the simplest case. Subsection (4) gives a signpost to additional, more complex, rules that deal with those cases involving group company and related party transactions as well as transitional interaction with the capital gains rules.

Clause 755: Conditions relating to the old asset and its realisation
2045. This clause states the conditions for roll-over relief that must be met in respect of the intangible fixed asset that is replaced. It is based on paragraph 38 of Schedule 29 to FA 2002.

2046. *Subsection (4)* applies to such assets as internally-generated goodwill.

Clause 756: Conditions relating to expenditure on other assets
2047. This clause states the conditions that must be met in respect of the intangible fixed asset that replaces the old asset. It is based on paragraph 39 of Schedule 29 to FA 2002.

2048. *Subsection (1)* sets a reinvestment period which is subject to discretionary extension. Under the source legislation this power is exercised by the Commissioners for HMRC. In practice it would be exercised by an officer of HMRC and the Bill reflects that. See *Change 1* in Annex 1.

Clause 757: Claim for relief
2049. This clause sets out the required contents of a claim for relief. It is based on paragraph 40 of Schedule 29 to FA 2002.

Clause 758: How the relief is given: general
2050. This clause states how the relief is given. It is based on paragraph 41 of Schedule 29 to FA 2002.

Clause 759: Determination of appropriate proportion of cost and adjusted cost
2051. This clause adjusts the cost of the intangible fixed asset that is replaced in cases of part realisation. It is based on paragraph 42 of Schedule 29 to FA 2002.

Clause 760: References to cost of asset where asset affected by change of accounting policy
2052. This clause modifies the cost of the intangible fixed asset that is replaced, for the purposes of the reinvestment relief rules, in cases where there has been a change of accounting policy resulting in adjustments under Chapter 15 of this Part. It is based on paragraph 42A of Schedule 29 to FA 2002.

Clause 761: Declaration of provisional entitlement to relief
2053. This clause allows a company reinvestment relief on a provisional basis if it intends to incur expenditure on other assets within the prescribed time limit. It is based on paragraph 43 of Schedule 29 to FA 2002.

Clause 762: Realisation and reacquisition
2054. This clause treats an intangible fixed asset that is realised and subsequently reacquired as a different asset for the purposes of the reinvestment relief rules. It is based on paragraph 44 of Schedule 29 to FA 2002.

2055. This enables relief to be given where, for example, a company has a change of business plans.

Clause 763: Disregard of deemed realisations and reacquisitions
2056. This clause gives a general rule that deemed realisations and reacquisitions are ignored for the purposes of the reinvestment relief rules. It is based on paragraph 45 of Schedule 29 to FA 2002.

Chapter 8: Groups of companies: introduction

Clause 764: Meaning of "company", "group" and "subsidiary"

2057. This clause gives rules of interpretation. It is based on paragraph 46 of Schedule 29 to FA 2002.

Clause 765: General rule: a company and its 75% subsidiaries form a group

2058. This clause gives the basic group membership rule for the purposes of the intangible fixed assets regime. It is based on paragraph 47 of Schedule 29 to FA 2002.

Clause 766: Only effective 51% subsidiaries of principal company to be members of group

2059. This clause imposes an additional group requirement for the purposes of the intangible fixed asset rules. It is based on paragraph 48 of Schedule 29 to FA 2002.

2060. *Subsection (2)* is new and gives a signpost to the definition of "effective 51% subsidiary".

Clause 767: Principal company cannot be 75% subsidiary of another company

2061. This clause gives a general rule that prevents a 75% subsidiary company from being the principal company of a group. It is based on paragraph 49 of Schedule 29 to FA 2002.

2062. *Subsection (3)* defines the only exception to the general rule.

Clause 768: Company cannot be member of more than one group

2063. This clause gives a general rule that prevents a company from belonging to more than one group for the purposes of the reinvestment relief rules. It is based on paragraph 50 of Schedule 29 to FA 2002.

2064. If a company *is* a member of more than one group, this clause sets out tests that are applied sequentially to determine to which group that company belongs for the purposes of the reinvestment relief rules.

Clause 769: Continuity of identity of group

2065. This clause gives a general rule that preserves the identity of a group as long as the same company remains the principal company of the group. It is based on paragraph 51 of Schedule 29 to FA 2002.

Clause 770: Continuity where group includes an SE

2066. This clause preserves group identity in certain cases involving the formation of an SE. It is based on paragraph 51A of Schedule 29 to FA 2002.

2067. This provision and the other rules specifically concerning SEs remove any uncertainty about their tax position. The clause preserves continuity of group identity in the circumstances set out in *subsection (1)*.

Clause 771: Meaning of "effective 51% subsidiary"
2068. This clause defines a key term. It is based on paragraph 52 of Schedule 29 to FA 2002.

Clause 772: Equity holders and profits or assets available for distribution
2069. This clause imports definitions, adapted as necessary, from ICTA. It is based on paragraph 53 of Schedule 29 to FA 2002.

Clause 773: Supplementary provisions
2070. This clause gives minor supplementary "group" rules. It is based on paragraph 54 of Schedule 29 to FA 2002.

2071. *Subsection (2)* applies certain provisions of TCGA. Those TCGA provisions cover certain statutory bodies created to run an industry (or part of an industry) under public ownership. They include, in particular, those set up under the Transport Acts of 1962 and 1968. The effect of subsection (2) is that they can be treated as companies for the purposes of testing whether their subsidiaries form a group with them.

Chapter 9: Application of this Part to groups of companies
Clause 774: Overview of Chapter
2072. This Chapter sets out the special rules that apply to companies that are "grouped" under the rules in Chapter 8 of this Part and this clause introduces them. It is new.

Clause 775: Transfers within a group
2073. This clause allows the transfer of intangible fixed assets on a tax-neutral basis between group members. It is based on paragraph 55 of Schedule 29 to FA 2002.

2074. Without this rule, intra-group transfers, being transactions between related parties, would be regarded as taking place at market value (under clause 845) and would trigger the normal realisation rules.

Clause 776: Meaning of "tax-neutral" transfer
2075. This clause defines a key term. It is based on paragraph 140 of Schedule 29 to FA 2002.

2076. Here and elsewhere in this Part the provisions refer to transfers that *are* tax-neutral rather than, as in the source legislation, transfers that are *treated* as tax-neutral. Since "tax-neutral" is a defined term, the abstractness of the source is not necessary.

Clause 777: Relief on realisation and reinvestment: application to group member
2077. This clause allows, subject to certain conditions, group members to be treated as the same company for reinvestment relief purposes. It is based on paragraph 56 of Schedule 29 to FA 2002.

2078. *Subsection (3)(e)* aligns the reference in this clause to a "dual resident investing company" with other such references in the source legislation (reproduced in this Part) by introducing a signpost to the provision defining that term.

Clause 778: Relief on reinvestment: acquisition of group company: introduction
2079. This clause, along with clause 779, extends reinvestment relief to reinvestment in shares in a company which owns assets within the intangible fixed assets regime. It is based on paragraph 57 of Schedule 29 to FA 2002.

Clause 779: Rules that apply to cases within section 778
2080. This clause is supplementary to the previous clause and provides reinvestment relief for reinvestment in shares in a company which owns assets within the intangible fixed assets regime. It is based on paragraph 57 of Schedule 29 to FA 2002.

Clause 780: Deemed realisation and reacquisition at market value
2081. This clause provides for a deemed realisation and reacquisition of an asset in certain cases where a company leaves a group following an earlier transfer to it of intangible fixed assets on a tax-neutral basis. It is based on paragraph 58 of Schedule 29 to FA 2002.

2082. It is the first of several clauses dealing with degrouping transactions which amount to disposals of the underlying intangible fixed asset by means of a disposal of the shares in the company to which it belongs. They are needed to ensure that such an indirect disposal of intangible fixed assets does not provide a tax advantage over a direct disposal.

2083. The broad effect of these provisions is to recognise a gain or loss deferred on an earlier tax-neutral disposal if the asset in question leaves the group otherwise than by a direct disposal of the asset. The rules achieve this by creating a deemed realisation and reacquisition of the asset by the company at market value immediately after the time it acquired the asset from another group company.

2084. S*ubsection (5)(d)* gives a signpost to an exception to this rule where degrouping is part of a commercially motivated merger the purpose of which is not tax avoidance. Consistent with the approach elsewhere, "bona fide" in the source legislation is rewritten as "genuine".

Clause 781: Character of credits and debits brought into account as a result of section 780
2085. This clause supplements the previous clause to determine how credits and debits are brought into account. It is based on paragraph 58 of Schedule 29 to FA 2002.

Clause 782: Certain transferees of businesses etc not treated as leaving group
2086. This clause disapplies clause 780 in the case of certain European cross-border transfers of business. It is based on paragraph 58 of Schedule 29 to FA 2002.

Clause 783: Associated companies leaving group at the same time
2087. This clause modifies the effect of clause 780 so that, when more than one company degroups at the same time, a degrouping charge arises only in circumstances that amount to a subsequent effective disposal of the intangible fixed asset. It is based on paragraph 59 of Schedule 29 to FA 2002.

2088. *Subsection (4)* is new and gives a signpost to an exception to this rule where degrouping is part of a commercially motivated merger the purpose of which is not tax avoidance. That exception may be relevant because clause 780 is subject to that exception and clause 783 merely modifies the effect of clause 780.

Clause 784: Groups with a relevant connection
2089. This clause defines the link between groups that must exist if the previous clause is to apply. It is based on paragraph 59 of Schedule 29 to FA 2002.

Clause 785: Principal company becoming member of another group
2090. This clause modifies the effect of clause 780 in cases where degrouping occurs only because the principal company becomes a member of another group: a degrouping charge then arises only in circumstances which amount to a subsequent effective disposal of the intangible fixed asset within six years. It is based on paragraph 60 of Schedule 29 to FA 2002.

Clause 786: Character of credits and debits brought into account as a result of section 785
2091. This clause supplements the previous clause to determine how credits and debits are brought into account. It is based on paragraph 60 of Schedule 29 to FA 2002.

Clause 787: Company ceasing to be member of group because of exempt distribution
2092. This clause disapplies the degrouping rules in clauses 780 and 785 for certain demergers unless there is a "chargeable payment" to members within five years of the related "exempt distribution". It is based on paragraph 61 of Schedule 29 to FA 2002.

2093. *Subsection (5)* gives a signpost to the meaning of terms that are part of the general demergers tax rules.

Clause 788: Provisions supplementing sections 780 to 787
2094. This clause gives interpretative rules for the degrouping provisions. It is based on paragraphs 63 and 64 of Schedule 29 to FA 2002.

Clause 789: Merger carried out for genuine commercial reasons
2095. This clause disapplies the degrouping rules in clauses 780 to 787 in the case of company mergers where exploitation of the group rules is not the object. It is based on paragraph 62 of Schedule 29 to FA 2002.

2096. The definition of "merger" in paragraph 62 of Schedule 29 to FA 2002 is restructured to make it clearer. This involves relocating some of the detail of the definition in a separate clause (clause 790).

Clause 790: Provisions supplementing section 789
2097. This clause gives interpretative provisions to identify a "merger" for the purposes of the preceding clause. It is based on paragraph 62 of Schedule 29 to FA 2002.

Clause 791: Application of roll-over relief in relation to degrouping charge
2098. This clause allows reinvestment relief in cases where a company is treated as realising an intangible fixed asset under the degrouping rules. It is based on paragraph 65 of Schedule 29 to FA 2002.

2099. This is one of the two exceptions to the general rule in clause 763 that deemed realisations do not count for the purposes of the reinvestment rules. The other is dealt with in clause 794.

Clause 792: Reallocation of charge within group
2100. This clause provides, subject to certain conditions, for the transfer of a degrouping charge from the company leaving the group to another company in the group it is leaving. It is based on paragraph 66 of Schedule 29 to FA 2002.

2101. This transfer of charge may allow, for example, the charge to be sheltered by reliefs available elsewhere in the main group.

Clause 793: Further requirements about elections under section 792
2102. This clause sets out the conditions for, and the form of, the election required for the reallocation provided for in the previous clause. It is based on paragraph 66 of Schedule 29 to FA 2002.

Clause 794: Application of roll-over relief in relation to reallocated charge
2103. This clause allows reinvestment relief for the company to which a degrouping charge is transferred under clause 792. It is based on paragraph 67 of Schedule 29 to FA 2002.

2104. This is the second of the two exceptions to the general rule in clause 763 that deemed realisations do not count for the purposes of the reinvestment rules. The other is dealt with in clause 791.

Clause 795: Recovery of charge from another group company or controlling director
2105. This clause gives alternative rights of recovery if any corporation tax arising from a degrouping charge is not paid within six months of it falling due. It is based on paragraph 68 of Schedule 29 to FA 2002.

Clause 796: Interpretation of section 795
2106. This clause gives interpretative rules for the previous clause. It is based on paragraph 68 of Schedule 29 to FA 2002.

Clause 797: Recovery under section 795: procedure etc
2107. This clause sets out the procedural aspects of the recovery provision in clause 795. It is based on paragraph 69 of Schedule 29 to FA 2002.

Clause 798: Recovery under section 795: time limit
2108. This clause sets a three year time limit for the service of a recovery notice under clause 795. It is based on paragraph 70 of Schedule 29 to FA 2002.

2109. *Subsections (3)* to *(6)* determine the start date of the three year period depending on the origins of the original charge.

Clause 799: Disregard of payments between group members for reliefs
2110. This clause ensures that a payment by one group company to another for the transfer of relief is left out of account provided it does not exceed the "amount of the relief". It is based on paragraph 71 of Schedule 29 to FA 2002.

Chapter 10: Excluded assets
Clause 800: Introduction
2111. Not all assets that might fall within the definition of "intangible fixed asset" are intended to come within the rules in this Part. This clause introduces the rules on assets that are excluded. It is new.

Clause 801: Right to dispose of or acquire excluded asset also excluded
2112. This clause gives an important general extension to the exclusion rules in this Chapter: if an asset is excluded by those rules, so is an option or other right to acquire or dispose of that asset. It is based on paragraph 72 of Schedule 29 to FA 2002.

2113. There is a counterpart, obverse rule in clause 713(2).

Clause 802: Effect of partial exclusion
2114. This clause addresses the case where an asset falls partly within and partly outside the intangible fixed asset rules. It is based on paragraph 72 of Schedule 29 to FA 2002.

Clause 803: Non-commercial purposes etc
2115. This clause is an exclusion rule of general application which can exclude any asset by reference to the purpose for which it is held. It is based on paragraph 77 of Schedule 29 to FA 2002.

2116. This clause is necessary because the intangible fixed assets regime is largely autonomous and does not contain general calculation rules that apply elsewhere for corporation tax such as the prohibition of a deduction for expenses not incurred

wholly and exclusively for the purposes of a trade. Without this rule there would be no test of purpose or commerciality for non-trading gains and losses.

Clause 804: Assets for which capital allowances previously made
2117. This clause excludes entirely assets in respect of which capital allowances have previously been made. It is based on paragraph 73A of Schedule 29 to FA 2002.

Clause 805: Rights over tangible assets
2118. This clause excludes rights over tangible assets. It is based on paragraph 73 of Schedule 29 to FA 2002.

Clause 806: Financial assets
2119. This clause excludes financial assets. It is based on paragraph 75 of Schedule 29 to FA 2002.

2120. *Subsection (3)* lists the main financial assets but is not intended to be exhaustive.

Clause 807: Rights in companies, trusts etc
2121. This clause excludes shares and other rights in companies, rights under a trust and the interest of a partner in a partnership. It is based on paragraph 76 of Schedule 29 to FA 2002.

2122. *Subsections (2)* and *(3)* provide for exceptions that follow the accounting treatment. They are exceptions to an exclusion, so the assets they refer to come within the intangible fixed assets regime.

Clause 808: Assets representing production expenditure on films
2123. This clause excludes certain expenditure on films. It is based on paragraph 80A of Schedule 29 to FA 2002.

Clause 809: Oil licences
2124. This clause excludes oil licenses. It is based on paragraph 74 of Schedule 29 to FA 2002.

2125. Oil licences are potentially only transitory intangible assets in that they may subsequently be charged to a tangible asset account representing successful exploration costs. They are outside the accountancy definition of goodwill and intangible assets and are subject to their own industry reporting standard.

Clause 810: Mutual trade or business
2126. This clause excludes, except as respects royalties, intangible fixed assets to the extent they are held for the purposes of a mutual trade or business. It is based on paragraph 79 of Schedule 29 to FA 2002.

2127. *Subsection (2)* is new. It gives a signpost to an exception relevant to certain insurance companies.

Clause 811: Sound recordings
2128. This clause excludes, except as regards royalties, intangible fixed assets to the extent they represent certain expenditure on sound recordings. It is based on paragraph 80B of Schedule 29 to FA 2002.

Clause 812: Master versions of films
2129. This clause excludes certain recent film expenditure from the intangible fixed assets regime. It is based on paragraph 80A of Schedule 29 to FA 2002.

Clause 813: Computer software treated as part of cost of related hardware
2130. This clause excludes, except as regards royalties, intangible fixed assets to the extent they represent expenditure on certain computer software. It is based on paragraph 81 of Schedule 29 to FA 2002.

2131. Software acquired with the related hardware is not treated as an intangible asset under accountancy rules, so it is excluded from the intangible fixed assets regime.

Clause 814: Research and development
2132. This clause limits the application of the rules in this Part to the extent specified where intangible fixed assets represent expenditure on research and development. It is based on paragraph 82 of Schedule 29 to FA 2002.

Clause 815: Election to exclude capital expenditure on software
2133. This clause, if the company so elects, limits the application of the rules in this Part to the extent specified where intangible fixed assets represent capital expenditure on computer software. It is based on paragraph 83 of Schedule 29 to FA 2002.

2134. This clause sets out the substantive rule and its tax effects. This rule reflects the existence of capital allowances rules that would normally offer a company more beneficial relief. The election switches off the intangible fixed assets rules in this Part that would otherwise override those capital allowances rules.

2135. *Subsection (8)* is new. It gives a signpost to the extension of the right to make an election under this clause to some insurance companies.

Clause 816: Further provision about elections under section 815
2136. This clause gives procedural rules in respect of the election under the preceding clause. It is based on paragraph 83 of Schedule 29 to FA 2002.

Chapter 11: Transfer of business or trade

Clause 817: Overview of Chapter

2137. This clause introduces the rules that allow transfers of intangible fixed assets to be made on a tax-neutral or other tax advantageous basis when they are made as part of certain transfers of businesses. It is new.

2138. The purpose of these rules is to ensure continuity or consistency of treatment where those assets change hands in the course of genuine commercial business reorganisations.

2139. *Subsection (2)* gives a signpost to provisions dealing with the "genuine commercial transaction requirement". This requirement limits the application of the reliefs under this Chapter to cases where the transfer is not motivated by tax avoidance.

Clause 818: Company reconstruction involving transfer of business

2140. Where there are certain transfers of a business (or part of a business) as part of a company reconstruction, this clause allows the tax-neutral transfer of intangible fixed assets that are within the intangible fixed asset rules. It is based on paragraph 84 of Schedule 29 to FA 2002.

2141. A "tax-neutral transfer" is defined in clause 776.

Clause 819: **European cross-border transfers of business: introduction**

2142. This clause introduces the rule in clause 820 providing for the tax-neutral transfer of assets in the case of certain European cross-border transfers of business and states the main conditions for it to apply. It is based on paragraph 85 of Schedule 29 to FA 2002.

Clause 820: **Transfer of assets on European cross-border transfer of business**

2143. This clause provides for the tax-neutral transfer of assets in the case of certain European cross-border transfers of business. It is based on paragraph 85 of Schedule 29 to FA 2002.

Clause 821: **European cross-border mergers: introduction**

2144. This clause introduces the rule in clause 822 providing for the tax-neutral transfer of assets in the case of certain European cross-border mergers and states the main conditions for it to apply. It is based on paragraph 85A of Schedule 29 to FA 2002.

Clause 822: **Transfer of assets on European cross-border merger**

2145. This clause provides for the tax-neutral transfer of assets in the case of certain European cross-border mergers. It is based on paragraph 85A of Schedule 29 to FA 2002.

Clause 823: **Interpretation of sections 821 and 822**
2146. This clause gives rules of interpretation relevant to the two preceding clauses. It is based on paragraph 85A of Schedule 29 to FA 2002.

Clause 824: Transfer of business of building society to company
2147. This clause allows the tax-neutral transfer of intangible fixed assets within the intangible fixed assets rules when the business of a building society is transferred to a company. It is based on paragraph 90 of Schedule 29 to FA 2002.

Clause 825: Application of sections 780 and 785 where transfer within section 824 occurs
2148. This clause relaxes certain degrouping rules in Chapter 9 of this Part on the transfer of a building society's business to a company. It is based on paragraph 90 of Schedule 29 to FA 2002.

Clause 826: Amalgamation of, or transfer of engagements by, certain societies
2149. This clause allows the tax-neutral transfer between certain societies of intangible fixed assets within the intangible fixed assets rules when the transfer is part of an amalgamation of the societies or when the whole or a part of the business of one society is transferred to the other ("a transfer of engagements"). It is based on paragraph 91 of Schedule 29 to FA 2002.

Clause 827: Claims to postpone charge on transfer
2150. This clause sets out the circumstances under which a charge under this Part can be postponed when a trade is transferred to a non-UK resident company. It is based on paragraph 86 of Schedule 29 to FA 2002.

Clause 828: Relief on transfer
2151. This clause sets out the effect of the clause 827 postponement of charge. It is based on paragraph 86 of Schedule 29 to FA 2002.

Clause 829: Charge on subsequent realisations
2152. This clause provides for a whole or partial reinstatement of the charge postponed under 827. It is based on paragraph 86 of Schedule 29 to FA 2002.

Clause 830: Exclusion from section 829 of group transfers
2153. This clause allows transfers, subsequent to the transfer of the trade under 827, of assets between group members without triggering the reinstatement rules in clause 829. It is based on paragraph 86 of Schedule 29 to FA 2002.

Clause 831: The genuine commercial transaction requirement and clearance
2154. This clause states the genuine commercial transaction conditions and provides for an advance clearance procedure in respect of it. It is based on paragraph 84 of Schedule 29 to FA 2002.

2155. Many of the relieving provisions in Part 11 of Schedule 29 to FA 2002 are conditional on the transactions involved not having an avoidance purpose. And to provide certainty to those contemplating a transaction they provide for an advance clearance application. In the source legislation these matters are repeated in each relieving provision to which they apply. Rather than rewrite the same condition and clearance as part of each of the clauses to which they apply, they are rewritten only once, in this clause, and applied, where appropriate, by reference, in the clauses to which they are relevant, to the "genuine commercial transaction requirement".

2156. *Subsection (3)* defines the "appropriate applicant" referred to in *subsection (2)*. The source legislation defines in each relevant paragraph who should make the clearance application. Rewriting the clearance rule only once (as described in the previous paragraph) necessitates identification of the appropriate applicant depending on the transaction in respect of which the application is to be made.

Clause 832: Procedure on application for clearance
2157. This clause deals with procedural matters in respect of the clearance application under the previous clause. It is based on paragraph 88 of Schedule 29 to FA 2002.

Clause 833: Decision on application for clearance
2158. This clause deals with the outcome of a clearance application under clause 831. It is based on paragraph 88 of Schedule 29 to FA 2002.

Chapter 12: Related parties
Clause 834: Overview of Chapter
2159. This clause introduces the Chapter that gives rules to determine whether parties to a transaction are "related parties" and therefore subject to special rules (set out in Chapter 13 of this Part). It is new.

2160. The approach in this Bill to "related parties" differs in two ways from that in the source legislation.

2161. First, the provisions that define who are "related parties" *precede* the rules that then apply to them.

2162. Second, those two groups of rules are separated into different Chapters.

Clause 835: "Related party"
2163. This clause defines "related party". It is based on paragraph 95 of Schedule 29 to FA 2002.

2164. The definition depends on terms that are defined in the eight clauses that immediately follow this clause.

Clause 836: "Control"
2165. This clause defines "control" for the related party rules. It is based on paragraph 96 of Schedule 29 to FA 2002.

Clause 837: "Major interest"
2166. This clause defines "major interest" for the related party rules. It is based on paragraph 96 of Schedule 29 to FA 2002.

Clause 838: General rule
2167. This clause gives a general rule about the attribution of rights and powers for the related party rules. It is based on paragraph 97 of Schedule 29 to FA 2002.

Clause 839: Rights and powers held jointly
2168. This clause gives a further rule about the attribution of rights and powers, held jointly, for the related party rules. It is based on paragraph 98 of Schedule 29 to FA 2002.

Clause 840: Partnerships
2169. This clause gives a further rule about the attribution of rights and powers for the related party rules. It is based on paragraph 99 of Schedule 29 to FA 2002.

Clause 841: "Participator" and "associate"
2170. This clause defines certain terms used in the related party rules. It is based on paragraph 100 of Schedule 29 to FA 2002.

Clause 842: Introduction
2171. This clause introduces the rules that determine whether a person is connected with another for the purposes of the related party rules. It is based on paragraph 101 of Schedule 29 to FA 2002.

Clause 843: Who are connected persons
2172. This clause states which persons are connected for the purposes of the related party rules. It is based on paragraph 101 of Schedule 29 to FA 2002.

Chapter 13: Transactions between related parties
Clause 844: Overview of Chapter
2173. This clause gives a "route map" of the Chapter. It is new.

2174. The Chapter sets out the special rules that apply to transactions between persons who are "related parties" within the meaning of the rules in Chapter 12 of this Part.

Clause 845: Transfer between company and related party treated as at market value
2175. This clause gives the main related party, market value rule. It is based on paragraph 92 of Schedule 29 to FA 2002.

2176. Paragraph 92 of Schedule 29 to FA 2002 also sets out the exceptions to the basic rule. When the intangible fixed assets rules were first introduced there were only two exceptions. But, subsequently, further exceptions were added and the paragraph grew in both length and complexity with little commonality in the substance of the exceptions. It is therefore rewritten in five clauses in this Bill, the first stating the basic market value rule and the four immediately following stating the exceptions.

Clause 846: Transfers not at arm's length
2177. This clause disapplies the market value rule in clause 845 when a transfer falls within the provisions mentioned because it is not at arm's length. It is based on paragraph 92 of Schedule 29 to FA 2002.

Clause 847: Transfers involving other taxes
2178. This clause partially disapplies the market value rule in clause 845 in prescribed circumstances. It is based on paragraph 92 of Schedule 29 to FA 2002.

2179. Where the clause has effect, it is only in respect of the party to the transaction that is *not* within the intangible fixed asset rules.

Clause 848: Tax-neutral transfers
2180. This clause disapplies the market value rule in clause 845 when the transfer is "tax-neutral" within the meaning of this Part. It is based on paragraph 92 of Schedule 29 to FA 2002.

Clause 849: Transfers involving gifts of business assets
2181. This clause disapplies the market value rule in clause 845 when the transfer is a gift of a business asset qualifying for relief under the capital gains rules. It is based on paragraph 92 of Schedule 29 to FA 2002.

Clause 850: Part realisation involving related party acquisition: exclusion of roll-over relief
2182. This clause prohibits roll-over relief under Chapter 7 of this Part if an intangible fixed asset is partly realised and an interest in it is acquired by a related party. It is based on paragraph 93 of Schedule 29 to FA 2002.

Clause 851: Delayed payment of royalty by company to related party
2183. This clause gives a timing rule for the deduction of a royalty paid to a related party. It is based on paragraph 94 of Schedule 29 to FA 2002.

2184. The effect of *subsection (2)* is to bring approximate symmetry to the timing of the charge on the recipient of the royalty and relief for the payer.

Chapter 14: Miscellaneous provisions
Overview
2185. This Chapter groups together a number of miscellaneous rules, many of relatively limited or specialised application.

Clause 852: Treatment of grants and other contributions to expenditure
2186. This clause brings grants and other contributions in respect of intangible fixed assets into account. It is based on paragraph 102 of Schedule 29 to FA 2002.

2187. S*ubsection (2)* refers to a gain recognised in the profit and loss account. This includes amounts recognised separately as incomings or netted off against expenditure.

Clause 853: Grants to be left out of account for tax purposes
2188. This clause excludes from the previous clause certain grants made out of UK public funds. It is based on paragraph 103 of Schedule 29 to FA 2002.

Clause 854: Finance leasing etc
2189. This clause provides for finance leased intangible fixed assets to be brought within this Part, in respect of the lessor. It is based on paragraph 104 of Schedule 29 to FA 2002.

2190. The rules in this Part apply automatically without adaptation to a finance leased intangible fixed asset of the lessee in the same way as they would if the asset were simply purchased with the aid of a loan. But special provisions are required to bring finance leased assets within the scope of this Part for the lessor**.** That is because finance leases are, for the lessor, financial assets and financial assets are excluded by clause 806(1).

Clause 855: Further provision about regulations under section 854
2191. This clause states the regulations that may be made in respect of finance leased intangible fixed assets under clause 854. It is based on paragraph 104 of Schedule 29 to FA 2002.

2192. Regulations have been made and are in SI 2002/1967.

Clause 856: Assets acquired or realised together
2193. This clause requires individual values to be allocated to assets acquired or realised together with others as part of the same bargain. It is based on paragraph 105 of Schedule 29 to FA 2002.

Clause 857: Deemed market value acquisition: adjustment where nil accounting value
2194. This clause provides for accounting entries based on market value for the purposes of the calculation rules. It is based on paragraph 106 of Schedule 29 to FA 2002.

2195. This clause is relevant when an intangible fixed asset is transferred at a nil accounting value but is treated under the rules in this Part as acquired at market value. The most common example is internally-generated goodwill.

Clause 858: Fungible assets
2196. This clause gives a "single asset" rule for assets that are "fungible". It is based on paragraph 107 of Schedule 29 to FA 2002.

2197. *Subsection (2)* defines "fungible assets". An example (from the dairy farming industry) is milk quota.

Clause 859: Asset ceasing to be chargeable intangible asset: deemed realisation at market value
2198. This clause gives a market value deemed realisation and reacquisition rule in three particular cases. It is based on paragraph 108 of Schedule 29 to FA 2002.

2199. *Subsection (2)* lists the cases to which the clause applies. In each, without changing ownership, the asset ceases to be a "chargeable intangible asset". That is, any gain on realisation would cease to fall within the intangible fixed assets rules (see clause 741).

2200. There is an obverse rule in clause 863 which applies when an asset *becomes* a chargeable intangible asset.

Clause 860: Asset ceasing to be chargeable intangible asset: postponement of gain
2201. This clause gives relief in certain cases where clause 859(2)(a) applies. It is based on paragraph 109 of Schedule 29 to FA 2002.

Clause 861: Treatment of postponed gain on subsequent realisation
2202. This clause recovers the relief given under clause 860 if there is a subsequent realisation of the intangible fixed asset within six years of the company ceasing to be UK resident. It is based on paragraph 109 of Schedule 29 to FA 2002.

Clause 862: Treatment of postponed gain in other cases
2203. This clause recovers the relief given under clause 860 in three other particular cases. It is based on paragraph 109 of Schedule 29 to FA 2002.

Clause 863: Asset becoming chargeable intangible asset
2204. This clause gives an accounting value deemed acquisition rule in three particular cases. It is based on paragraph 110 of Schedule 29 to FA 2002.

2205. *Subsection (1)* lists the cases to which the clause applies. In each, without changing ownership, the asset becomes a "chargeable intangible asset". That is, any gain on realisation would fall within the intangible fixed assets rules (see clause 741).

2206. This is the obverse of the rule in clause 859 which applies when an asset *ceases* to be a chargeable intangible asset.

Clause 864: Tax avoidance arrangements to be ignored
2207. This clause neutralises the effect on the calculations where there are transactions intended to exploit the intangible fixed asset rules. It is based on paragraph 111 of Schedule 29 to FA 2002.

2208. If "tax avoidance arrangements" are entered into they are ignored in calculating entitlement to credits and debits in respect of intangible fixed assets.

Clause 865: Debits for expenditure not generally deductible for tax purposes
2209. This clause applies some general rules, outside this Part, which restrict deductions. It is based on paragraph 112 of Schedule 29 to FA 2002.

Clause 866: Delayed payment of employees' remuneration
2210. This clause prevents a deduction for employees' remuneration paid late. It is based on paragraph 113 of Schedule 29 to FA 2002.

2211. It is possible, in certain circumstances, for employees' remuneration to come within the intangible fixed asset rules. An example might be the remuneration of staff employed in promoting a company's product brands. If the remuneration is not paid within nine months from the end of the accounting period for which it is charged in the accounts, paragraph 113 of Schedule 29 to FA 2002 defers the tax deduction for that remuneration until it is paid.

2212. Paragraph 113 of Schedule 29 to FA 2002 is modelled on section 43 of FA 1989 which applies the same restriction outside this Part to other income types. For income tax, section 43 was rewritten in sections 36 and 37 of ITTOIA as two sections. For clarity and consistency that model is followed for corporation tax. This clause rewrites that part of paragraph 113 of Schedule 29 to FA 2002 that states the main restriction and, in so doing, is consistent with the approach to rewriting section 43 of FA 1989.

Clause 867: Provisions supplementing section 866
2213. This clause gives interpretative and other supporting rules for the previous clause. It is based on paragraph 113 of Schedule 29 to FA 2002.

2214. *Subsection (5)* rewrites paragraph 113(5) of Schedule 29 to FA 2002 and contains a Change. *Subsection (4)* deals with the case in which the company submits its tax return before the end of the nine months period mentioned in clause 866(2) and all or any of the remuneration is unpaid. The company must assume the remuneration will remain unpaid. If, subsequently, the remuneration is paid within the time limit the calculation can be adjusted and the return amended. The Bill drops the requirement under paragraph 113(5) of a claim for that adjustment. This mirrors the rewrite of section 43(5) of FA 1989 as a general calculation rule in clause 1289(3). See *Change 68* in Annex 1.

Clause 868: Delayed payment of pension contributions
2215. This clause delays a deduction for employees' pension contributions paid late. It is based on paragraph 114 of Schedule 29 to FA 2002.

Clause 869: Bad debts etc
2216. This clause gives special rules applying to debts. It is based on paragraph 115 of Schedule 29 to FA 2002.

2217. The rules in paragraph 115 of Schedule 29 to FA 2002 correspond to general rules that apply outside this Part; that is, the rules in sections 88D and 94 of ICTA rewritten in Part 3 (trading income).

Clause 870: Assumptions for calculating chargeable profits
2218. This clause gives special rules when this Part applies to a "controlled foreign company". It is based on paragraph 116 of Schedule 29 to FA 2002.

Chapter 15: Adjustments on change of accounting policy
Overview
2219. This Chapter rewrites the rules in Part 13A of Schedule 29 to FA 2002. Part 13A gives rules dealing with a company's change of accounting policy where it affects assets within the intangible fixed assets regime.

2220. Part 13A of Schedule 29 to FA 2002 applies, in particular, when a company changes between UK generally accepted accounting practice and International Accounting Standards. It ensures that any change in accounting value of the assets resulting from the change of accounting policy will be brought into account for tax purposes.

Clause 871: Introduction to Chapter
2221. This clause explains when the rules in this Chapter apply. It is based on paragraph 116A of Schedule 29 to FA 2002.

Clause 872: Adjustments in respect of change
2222. This clause provides for an adjustment when the value of an intangible fixed asset changes as a result of a change of accounting policy. It is based on paragraph 116B of Schedule 29 to FA 2002.

2223. This clause provides for the change in value to translate into a corresponding credit or debit.

Clause 873: Effect of application of section 872 in later period and subsequently
2224. This clause sets out the effects of an adjustment under the previous clause. It is based on paragraph 116B of Schedule 29 to FA 2002.

Clause 874: Original asset not subject to fixed-rate writing down
2225. This clause provides for an adjustment when a change of accounting policy results in one intangible fixed asset being treated as two or more assets and gives the calculation rules. It is based on paragraph 116C of Schedule 29 to FA 2002.

Clause 875: Effect of application of section 874 in later period and subsequently
2226. This clause sets out the effects of an adjustment under the previous clause. It is based on paragraph 116C of Schedule 29 to FA 2002.

Clause 876: Original asset subject to fixed-rate writing down
2227. This clause ensures the calculation rules work properly when a change of accounting policy results in an intangible fixed asset that was subject to a fixed-rate writing down election under clause 730 being treated as two or more assets. It is based on paragraph 116D of Schedule 29 to FA 2002.

2228. It gives rules:

- to apportion the former tax written-down value of the original intangible fixed asset to each disaggregated asset on the basis of the ratio of their new accounting values; and

- to determine how written-down value and cost recognised for tax purposes will be identified subsequently.

2229. The election under clause 730 in respect of the original intangible fixed asset applies to that asset for the period prior to the change and to each of the disaggregated assets subsequently.

Clause 877: Election for fixed-rate writing down in relation to resulting asset
2230. This clause allows a fixed rate writing down election under clause 730 to be made in respect of disaggregated assets and gives calculation rules to deal with the effects. It is based on paragraph 116E of Schedule 29 to FA 2002.

Clause 878: Exclusion of credits or debits brought into account under other provisions
2231. This clause prevents double counting and gives priority to other rules in this Part where double counting might otherwise arise. It is based on paragraph 116G of Schedule 29 to FA 2002.

Clause 879: Subsequent events affecting asset subject to adjustment under this Chapter
2232. This clause gives rules on subsequent accounting adjustments in respect of intangible fixed assets which have already been subject to the provisions of this Chapter on a change of accounting policy. It is based on paragraph 116H of Schedule 29 to FA 2002.

Chapter 16: Pre-FA 2002 assets etc

Overview

2233. The clauses in this Chapter are based on the provisions in Part 14 of Schedule 29 to FA 2002 "Commencement and transitional provisions" and some of the key terms used in the source legislation have been revised.

2234. There are two tests which together determine whether an asset can come within this Part of the Bill. The first is that the asset must be goodwill or an intangible fixed asset for accountancy purposes and not fall within certain statutory exceptions.

2235. The second brings within the scope of this Part only those intangible fixed assets which:

- came into existence on or after 1 April 2002; or
- were acquired directly or indirectly from independent parties on or after that date.

2236. Assets in existence before 1 April 2002 remain outside this Part and subject to general corporation tax rules for as long as they remain within the same economic family as they did before that date. This basic rule is subject to a number of exceptions.

2237. The source legislation identifies intangible fixed assets that do not fall within the regime as "existing assets" and the law which governs their tax treatment as the "existing law". This Part replaces these terms with new, more appropriate terms.

Clause 880: Overview of Chapter

2238. This clause gives a "route map" of the Chapter and introduces a revised approach to some key terms. It is new.

Clause 881: Meaning of "pre-FA 2002 assets"

2239. This clause defines a key term. It is new.

2240. This and clause 880 together replace paragraph 117 of Schedule 29 to FA 2002 as a general introduction to the intangible fixed assets regime. The focus of paragraph 117 of Schedule 29 is the "commencement date", that is the date at which the intangible fixed assets regime came into force: 1 April 2002. And it refers to the law which applied up to that date as "the existing law". This Part revises the approach to both these concepts.

2241. This Part drops "the commencement date" as a defined term, throughout the rules and refers instead directly to 1 April 2002 on each occasion that such reference is necessary.

2242. This Part also drops the expression "the existing law" and refers to "the pre-FA 2002 law". Similarly dropped is the related expression "existing assets" (defined in paragraph 118(3) of Schedule 29 to FA 2002) in favour of "pre-FA 2002 assets" (defined in this clause).

Clause 882: Application of this Part to assets created or acquired on or after 1 April 2002

2243. This clause gives the general timing rule to identify which assets come within this Part. It is based on paragraph 118 of Schedule 29 to FA 2002.

Clause 883: Assets treated as created or acquired when expenditure incurred

2244. This clause defines when an asset is created or acquired for the purposes of clause 882: when the expenditure is incurred. It is based on paragraph 120 of Schedule 29 to FA 2002.

Clause 884: Internally-generated goodwill: time of creation

2245. This clause gives a special rule defining when internally-generated goodwill is created for the purposes of clause 882. It is based on paragraph 121 of Schedule 29 to FA 2002.

Clause 885: Certain other internally-generated assets: time of creation

2246. This clause gives a special rule defining when internally-generated assets (other than goodwill) not qualifying for capital allowances, are created for the purposes of clause 882. It is based on paragraph 122 of Schedule 29 to FA 2002.

Clause 886: Assets representing production expenditure on films: time of creation

2247. This clause gives a special rule defining when an asset representing production expenditure on films is treated as created for the purposes of clause 882. It is based on section 51(2) of FA 2006.

Clause 887: General rule

2248. This clause gives a general rule to define when expenditure on acquisition of an asset is incurred for the purposes of clause 883 and, ultimately, clause 882. It is based on paragraph 123 of Schedule 29 to FA 2002.

2249. The general rule in *subsection (1)* is subject to two qualifications to which *subsection (2)* gives a signpost and which limit any conflict with pre-FA 2002 timing rules for capital gains and capital allowances.

Clause 888: Cases where chargeable gains rule applies

2250. This clause qualifies the rule in clause 887 in respect of certain expenditure that would not have qualified for any form of tax relief under the pre-FA 2002 law. It is based on paragraph 124 of Schedule 29 to FA 2002.

2251. Goodwill is an example of an asset potentially within this rule.

2252. If the expenditure does not fall within *subsection (1)(c)* (that is, it would have been treated as incurred on or after 1 April 2002 for capital gains purposes) this clause is not in point and the general rule in clause 887 applies to the expenditure.

Clause 889: Cases where capital allowances general rule applies

2253. This clause qualifies the rule in clause 887 in respect of certain expenditure that would, before FA 2002, have qualified for relief under the capital allowances provisions. It is based on paragraph 125 of Schedule 29 to FA 2002.

2254. A patent is an example of an asset potentially within this rule.

2255. This clause replicates the general rule for capital allowances in section 5 of CAA.

Clause 890: Fungible assets: application of section 858

2256. This clause provides for separate pools of fungible assets in order that expenditure on them after 1 April 2002 can come within this Part. It is based on paragraph 126 of Schedule 29 to FA 2002.

2257. This and the next clause complement clause 858 which treats fungible assets held by the same person in the same capacity as indistinguishable parts of a single asset. An example of a fungible asset is a milk quota which grows or diminishes as additional assets of the same kind are acquired or realised. So successive acquisitions are treated as increasing the size of the single asset, whereas a disposal of some, but not all, of the units comprising the single asset is treated as a part realisation.

2258. The general principle of the intangible fixed assets rules is that only expenditure on or after 1 April 2002 should come within the regime. But without further rules this would not be achieved for fungible assets. If fungible assets of a particular kind are held by a company before 1 April 2002 any additional assets of that kind acquired subsequently would fail the time test in clause 882 because the acquisitions would be regarded as merely enlarging an existing single asset.

2259. The separate pool approach of this clause enables the time test in clause 882 to be satisfied by fungible assets acquired on or after 1 April 2002 which are additions to assets of the same kind.

Clause 891: Realisation and acquisition of fungible assets

2260. This clause gives identification rules for transactions involving fungible assets treated as comprising separate pools under the previous clause. It is based on paragraph 126 of Schedule 29 to FA 2002.

2261. Identification rules are necessary to determine which of the two pools a transaction in fungible assets diminishes or expands. And they are also necessary because the nature of fungible assets is such that it could often be relatively easy to dispose of an asset of this kind held before 1 April 2002 and replace it immediately

afterwards with a newly acquired, identical asset. The intangible fixed assets rules are not intended to apply to assets "recycled" in this way.

Clause 892: Certain assets acquired on transfer of business

2262. This clause preserves symmetry of tax treatment between the intangible fixed assets rules and the capital gains rules on certain transfers of intangible fixed assets that are outside the intangible fixed assets regime. It is based on paragraph 127 of Schedule 29 to FA 2002.

2263. The capital gains provisions listed in *subsection (2)* allow a no gain/no loss treatment on the transferor of an intangible asset to a transferee who is not a related party. Without a special rule, in the circumstances described in *subsection (1)*, the asset transferred would be within this Part in the hands of the transferee and carry an acquisition cost based on the "fair value" of the asset in the accounts of the transferee. This could result in relief under this Part being available on a sum that was not liable to tax in the hands of the transferor.

2264. To avoid this mismatch between the treatment of the transferor and the transferee, this clause ensures that the asset transferred in these circumstances is excluded from this Part in the hands of the transferee as well as the transferor. The asset remains within the capital gains rules in the hands of the transferee, with an acquisition cost equal to the transferor's disposal value.

Clause 893: Assets whose value derives from pre-FA 2002 assets

2265. This clause excludes certain assets from the intangible fixed assets rules to the extent that they derive their value from excluded assets. It is based on paragraph 127A of Schedule 29 to FA 2002..

2266. *Subsection (1)(e)* introduces a new term ("the preserved status conditions") to refer to the conditions set out in clause 894.

Clause 894: The preserved status conditions etc

2267. This clause defines a key term in the previous clause. It is based on paragraph 127A of Schedule 29 to FA 2002.

Clause 895: Assets acquired in connection with disposals of pre-FA 2002 assets

2268. This clause excludes certain assets from the intangible fixed assets rules if acquired from a related party in connection with the disposal of other excluded assets. It is based on paragraph 127B of Schedule 29 to FA 2002.

Clause 896: Application to royalties

2269. This clause brings royalties within the intangible fixed assets regime. It is based on paragraph 119 of Schedule 29 to FA 2002.

2270. This clause rewrites only those parts of paragraph 119 of Schedule 29 to FA 2002 which have enduring effect and are not transitional.

2271. Paragraph 119(2) to (4) of Schedule 29 to FA 2002 ensures the correct tax treatment of royalties during the transitional period spanning 1 April 2002. They are spent and are not rewritten.

Clause 897: Application to pre-FA 2002 assets consisting of telecommunication rights

2272. This clause brings certain telecommunication rights within the intangible fixed assets regime. It is based on paragraph 128 of Schedule 29 to FA 2002.

2273. *Subsection (2)* ensures that the intangible fixed assets rules work properly for telecommunication rights dealt with under a previous special tax regime.

2274. Paragraph 128(4) of Schedule 29 to FA 2002 is spent and is not rewritten.

Clause 898: Relief where assets disposed of on or after 1 April 2002

2275. This clause extends roll-over relief under Chapter 7 of this Part to the disposal of certain intangible fixed assets otherwise remaining within the capital gains rules. It is based on paragraph 130 of Schedule 29 to FA 2002.

2276. The effect of this clause is that the "amount available for relief" (in clause 758(1)) reduces the company's consideration received for the existing asset for the purposes of the capital gains rules and the tax cost of the new asset.

Clause 899: Relief where degrouping charge on asset arises on or after 1 April 2002

2277. This clause extends roll-over relief under Chapter 7 of this Part to the deemed disposal of certain intangible fixed assets otherwise remaining within the capital gains rules. It is based on paragraph 131 of Schedule 29 to FA 2002.

2278. It applies when a capital gains degrouping charge under section 179 of TCGA arises on the deemed disposal of intangible fixed assets which would have come within the intangible fixed assets rules had they not been pre-FA 2002 assets and when the event triggering the degrouping charge is on or after 1 April 2002.

2279. The effect of this clause is that the "amount available for relief" (in clause 758(1)) reduces the company's consideration deemed received for the pre-FA 2002 asset for the purposes of the capital gains rules and the tax cost of the new asset.

Clause 900: Meaning of "chargeable asset within TCGA" in sections 898 and 899

2280. This clause defines the key term used in the two preceding clauses. It is based on paragraph 130 of Schedule 29 to FA 2002.

2281. *Subsection (3)* substitutes a cross-reference to section 10B of TCGA for the cross-reference to section 10(3) of TCGA in the source legislation. Section 10(3) was repealed in FA 2003 and replaced by section 10B. The substitution in this clause

reflects the implied substitution by section 17(2)(a) of the Interpretation Act 1978 and so preserves the effect of the source legislation.

Chapter 17: Insurance companies

Overview

2282. The clauses in this Chapter rewrite a small number of provisions in Schedule 29 of FA 2002 that apply only to insurance companies.

Clause 901: Effect of application of the I minus E basis: non-trading amounts

2283. This clause ensures that credits and debits referable to life assurance business are taxed in a way consistent with the I minus E basis. It is based on paragraph 36 of Schedule 29 to FA 2002.

Clause 902: Excluded assets

2284. This clause gives particular excluded asset rules that apply to an insurance company with life assurance business. It is based on paragraph 78 of Schedule 29 to FA 2002.

Clause 903: Elections to exclude capital expenditure on computer software

2285. This clause extends the right to elect under clause 815 for exclusion of capital expenditure on computer software to insurance companies with life assurance business. It is based on paragraph 83 of Schedule 29 to FA 2002.

Clause 904: Transfers of life assurance business: transfers of assets treated as tax-neutral

2286. This clause allows the tax-neutral transfer of intangible fixed assets within the rules in this Part where those assets are included in certain transfers of life assurance business between insurance companies. It is based on paragraph 89 of Schedule 29 to FA 2002.

Clause 905: Pre-FA 2002 assets: Lloyd's syndicate capacity

2287. This clause integrates intangible fixed assets within the income regime syndicate capacity rules in FA 1994 into the intangible fixed assets rules in this Part. It is based on paragraph 129 of Schedule 29 to FA 2002.

Chapter 18: Priority rules

Clause 906: Priority of this Part for corporation tax purposes

2288. This clause states the priority of the provisions in this Part over other tax rules. It is based on paragraph 1(3) of Schedule 29 to FA 2002.

CORPORATION TAX BILL

EXPLANATORY NOTES

[VOLUME II]

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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