These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007.
These notes are published in three volumes.

INCOME TAX ACT 2007

EXPLANATORY NOTES – VOLUME 3 (SCHEDULES AND ANNEXES)

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Schedule 1: Minor and consequential amendments

Overview

3149. This Schedule makes consequential amendments.

3150. The commentary on this Schedule makes specific points about certain of the amendments made.

Part 1: Income and Corporation Taxes Act 1988

Section 9

3151. The amendments ensure that section 9 will not operate on the provisions in this Act to convert them into provisions of the Corporation Tax Acts. They mirror parallel amendments made by ITTOIA.

Section 118

3152. Section 118 of ICTA has been substantially amended to incorporate definitions formerly included in section 117 of ICTA. Section 117 sets out the rules for the restriction of certain loss relief for individuals who carry on a trade as a limited partner while section 118 sets out similar rules for companies. Section 117 has been rewritten (see sections 104 to 106 of this Act) and repealed, so various definitions from that section need to be incorporated directly into section 118.

Section 256

3153. The amendments to this section, and other provisions of Chapter 1 of Part 7 of ICTA, have the effect that entitlement to personal reliefs for individuals who, under the source legislation, were able to claim the reliefs only by virtue of meeting the condition in section 278(2)(a) of ICTA is provided for by these provisions, as amended, rather than by the provisions of Part 3 of this Act. See the overview commentary on Part 3.

3154. Subsection (3) is repealed because that rule is now in Part 2 of this Act.

Section 256A

3155. This new section corresponds to section 58 of this Act. The same oversight corrected there is corrected here also. See *Change 8* in Annex 1.

Section 256B

3156. This new section corresponds to section 43 of this Act.

Sections 257BA, 257BB, 257C and 265

3157. One effect of these amendments is that transfers of blind person's allowances or married couple's allowances claimed under these provisions can be made only to other individuals whose entitlement to those allowances arises under these provisions, rather than under the provisions in Part 3 of this Act. See *Change 7* in Annex 1.

Section 266

3158. Section 266(6) and (6A) of ICTA are repealed, as they are obsolete. The Association of Friendly Societies have confirmed that no such policies have been written for many years

and that all such existing policies have been converted to "paid-up". They agree that the provision is no longer needed.

Section 278

3159. This section will now govern entitlement to personal reliefs for a non-UK resident individual who is a Commonwealth citizen or an EEA national and does not meet the requirements of section 56(2) of this Act. It also applies to all individuals who are entitled to mainstream life insurance relief under section 266 of ICTA.

Section 312(2A)

3160. Section 1034(3) of this Act provides that the enterprise investment scheme (EIS) sections in Part 5 of this Act do not have effect in relation to shares issued before 6 April 2007. Since it is helpful to apply *Change 56* in Annex 1 to such shares when this Act comes into effect, there is a consequential amendment to section 312(2A) of ICTA. This applies the new interpretation of an administration reflected in section 252(2) of this Act to shares issued before 6 April 2007. The amendment will have effect where the administration commences on or after 6 April 2007 in accordance with the commencement provision in section 1034(1).

Section 349(3A) and (4)

3161. References to qualifying deposit right in sections 349(3A) and (4) of ICTA have not been rewritten as they are obsolete. See *Change 133* in Annex 1.

Section 353

3162. The only interest relief remaining in ICTA is for interest payments on a loan to buy a life annuity by virtue of section 365 of ICTA. The relief is given under section 353 and the amendment makes clear that relief is given as a tax reduction.

Section 368

3163. Section 368 is not being retained. It is very unlikely that interest would qualify for relief by virtue both of section 365 of ICTA and of some other provision. See *Change 155* in Annex 1.

Sections 459 to 461B

3164. Before the introduction of corporation tax in 1965, friendly societies were within the scope of the charge to income tax and were provided with an exemption from income tax. Since 1965 they have been within the scope of the charge to corporation tax and are not within the charge to income tax and so an exemption from income tax is not needed.

3165. Sections 459 to 466 provide exemptions for friendly societies. These provisions have their origin in FA 1966 (one year after the introduction of corporation tax) which provided for the taxation of profits of registered friendly societies above the exemption limit as if the society were a mutual insurance company (see section 463).

3166. Section 459 exempts unregistered societies from income and corporation tax if their income does not exceed £160. The low exemption for unregistered societies was maintained.

3167. Section 460(1) provides a similar exemption from income tax and corporation tax for registered friendly societies.

3168. Section 461 is concerned with exemption from profits, other than those arising from life or endowment business principally for societies registered before 1 June 1973. Accordingly, redundant references to income tax have been removed.

3169. Section 461B is concerned with exemption from profits, other than those arising from life or endowment business for qualifying societies and contains similar redundant references to income tax in subsections (1) and (5). Accordingly these have been removed.

Section 467

3170. Section 467(1) provides tax exemptions for trade unions and employers' associations. It contains a reference to income tax which is redundant and which has therefore been removed.

3171. Before the introduction of corporation tax in 1965, trade unions and employers associations were within the scope of the charge to income tax and were provided with an exemption from income tax. Since 1965 they have been within the scope of the charge to corporation tax.

Section 469

3172. This section's application to the trustees of an unauthorised unit trust is rewritten in this Act. Some provisions have been retained and new provisions inserted to set out the treatment of payments to unit holders liable to corporation tax.

Section 477A

3173. References to a qualifying deposit right in section 477A(1A) and (10) of ICTA have not been rewritten as they are obsolete. See *Change 133* in Annex 1.

Section 481(5A)

3174. Section 481(5A) of ICTA (deposit rights) has not been rewritten as it is obsolete. See *Change 133* in Annex 1.

Section 515

3175. The International Maritime Satellite Organisation (INMARSAT) have confirmed that the exemptions provided have become otiose. The opportunity has been taken to repeal the income tax and corporation tax exemptions at the same time.

Section 519A

3176. The references to income tax have been removed from section 519A of ICTA. These are not needed because, were it not for the exemption, all health service bodies would be subject to corporation tax, rather than income tax.

Section 556

3177. Following the House of Lords decision in Agassi v Robinson [2006 UKHL 23][1], section 556 of ICTA has been amended to make clear that when a payment or transfer of the

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[1] [2006] STC 1056

type referred to in section 555 of ICTA is made, no liability to corporation tax will arise regardless of whether there is a duty to deduct income tax under section 555 of ICTA. See *Change 156* in Annex 1.

Section 571

3178. New subsection (1A) ensures that the amount charged forms part of "total income" in Step 1 of section 23 of this Act.

Section 573

3179. This section provides relief for an investment company which incurs an allowable loss for the purposes of corporation tax on chargeable gains on the disposal of shares in a qualifying trading company. If the conditions of the section are met, the amount of the allowable loss may be set off against income for the purposes of corporation tax. This section is supplemented by sections 575 and 576 of ICTA.

3180. Section 573(4) provides in part that, if relief for an allowable loss is obtained by a company under the section by set off against income for corporation tax purposes, no deduction is to be made for the loss for the purposes of corporation tax on chargeable gains.

3181. This amendment omits that provision. The equivalent provision in section 574(1) of ICTA has not been included in Chapter 6 of Part 4. Instead section 125A(1) of TCGA, introduced by this Schedule, contains both provisions.

Section 575

3182. This amendment inserts a new *subsection (4)* defining "new consideration". This definition was formerly in section 576(5) of ICTA which is repealed.

Section 576

3183. This section supplements sections 573 to 575 of ICTA. The provisions of section 576(1) to (1B) and (4) to (5) are included in Chapter 6 of Part 4 so far as they supplement sections 574 and 575 of ICTA, but in the case of section 575 only so far as that section applies for the purposes of section 574.

3184. Section 576(1) and (1C) continue in force with necessary amendments so far as they supplement section 573 of ICTA.

3185. This amendment inserts a new *subsection (1D)* defining "holding". This definition was formerly in subsection (5) which is repealed.

3186. Section 576(2) and (3) have effect for the purposes of corporation tax on chargeable gains where relief is obtained against income for corporation tax purposes under section 573 of ICTA and for the purposes of capital gains tax where share loss relief is obtained under section 574 of that Act. Those subsections have been omitted and their provisions are contained for both purposes in section 125A(2) and (3) of TCGA introduced by this Schedule.

3187. Section 576(4) defines a "qualifying trading company" in terms of its being an "eligible trading company" and having been such for a specified continuous period. Section 576(4A) defines an "eligible trading company" by applying the requirements of section 293 and other provisions of Chapter 7 of Part 3 of ICTA (enterprise investment scheme) with

modifications. Section 134 of this Act avoids the double layer of definition in section 576(4) and omits the concept of an "eligible trading company".

3188. The same approach has been taken in making consequential amendments to section 576(4) to (4B) for corporation tax purposes. Those subsections have been omitted and replaced by new sections 576A to 576K of ICTA, which, together with sections 573, 575, 576 and 576L, form new Chapter 5A of Part 13 of ICTA.

3189. Section 576(5) has been omitted and the terms defined in it which are relevant for corporation tax purposes are to be found in sections 575(4), 576(1D), and 576L of ICTA.

Section 576A

3190. This new section of ICTA mirrors section 134 of this Act. It replaces section 576(4) of ICTA.

Section 576B

3191. This new section of ICTA mirrors section 137 of this Act, which corresponds to section 181 with modifications.

3192. *Subsection (2)* corresponds to section 181(3) and *subsection (6)* corresponds to section 181(7). For the reason for the introduction of subsections (3) and (7) of section 181 see *Change 42* in Annex 1 and the commentary on section 181.

3193. *Subsection (5)* corresponds to section 181(6), including the change made in section 181(6)(d) by *Change 41* in Annex 1.

3194. The definition of "non-qualifying activities" in *subsection (7)* includes the change affecting the definition of that term for the purposes of section 181(8) made by *Change 43* in Annex 1.

Section 576C

3195. This new section of ICTA mirrors section 138 of this Act.

Section 576D

3196. This new section of ICTA mirrors section 139 of this Act, which corresponds to section 185 with modifications. *Change 44* in Annex 1 made to section 185(1)(a) is replicated in *subsection (1)(a)*.

Section 576E to 576I

3197. These new sections of ICTA mirror sections 140, 141, 142, 143 and 144 of this Act respectively.

Section 576J

3198. This new section of ICTA mirrors section 145 of this Act. See *Change 25* in Annex 1 and the commentary on section 145(1).

3199. It does not, however, include in *subsection (3)* any cross-reference to section 575(2) of ICTA as it is beyond the scope of this Act to make an amendment to section 575(2) of ICTA for corporation tax purposes corresponding to the amendment to the provisions of that

subsection made for income tax purposes in section 136(2) of this Act. See *Change 24* in Annex 1.

Section 576K

3200. This new section of ICTA mirrors section 146 of this Act.

Section 576L

3201. This new section of ICTA contains definitions formerly in section 576(5) of ICTA. *Subsections (2)* to *(4)* contain provisions to reflect that, in the new sections 576B to 576K of ICTA, the definition of "shares" in most cases either applies in a modified form or does not apply at all.

Sections 587B, 587BA and 587C

3202. The amendments to sections 587B and 587C of ICTA mean that they deal only with relief given to companies subject to corporation tax.

3203. The amendment to the definition of "charity" in section 587B(9) removes redundant references to the British Museum and the Natural History Museum. See *Change 79* in Annex 1 and the commentary on section 430.

3204. A new section 587BA replaces, for corporation tax, section 587C(2) and (3) of ICTA. The new section clarifies that, in cases where land is held by owners as joint tenants or as tenants in common, the fact that one or more owners may not be eligible for relief under section 587B of ICTA does not deny relief to other eligible owners. See *Change 80* in Annex 1.

Sections 710 to 727A

Section 728

3205. The repeal of sections 710 to 727A of ICTA (together with the repeal of words in section 728(2) of ICTA) also omits the transitional corporation tax application of the provisions in those sections by section 710(1A) of ICTA. That transitional application of corporation tax is redundant. The provisions of Chapter 2 of Part 4 of FA 1996 (loan relationships) apply for corporation tax to such transfers as are dealt with for income tax by sections 710 to 727A of ICTA.

Section 737E

3206. The omission of the references to section 727A of ICTA removes what would otherwise have been the only income tax application of section 737E of ICTA. The income tax application of that section has been rewritten in Part 12 of this Act. See in particular sections 654 to 658.

Section 742

3207. Section 742(9)(c) of ICTA, which defines "benefit" for the purposes of sections 739 to 741, is redundant. It is repealed without replacement.

Section 746

3208. Section 746 of ICTA (persons resident in the Republic of Ireland) is obsolete. It is repealed without replacement.

Section 780

3209. New *subsection (3C)* ensures that the amount charged forms part of "total income" in Step 1 of section 23 of this Act.

Section 781

3210. New *subsection (1A)* ensures that the amount charged forms part of "total income" in Step 1 of section 23 of this Act.

Section 789

3211. The amendments clarify how references to surtax in old double taxation arrangements are to be treated in relation to dividend income. See *Change 157* in Annex 1.

Section 798C

3212. This section is being amended to make it clear that relief is given in computing income from the relevant source (in the same way as relief under section 811 of ICTA) rather than as a deduction from total income.

Section 804

3213. This section is amended so that the clawback of excess double taxation relief operates in terms of tax rather than by reference to an amount of income. See *Change 158* in Annex 1.

Section 807

3214. In addition to substituting equivalent references to terms and provisions in Part 12 of this Act for the references to terms and provisions in sections 710 to 727A of ICTA, this amendment also omits redundant corporation tax references for the reasons given in the commentary on the amendments made by this Schedule to sections 710 to 728 of ICTA.

Section 823

3215. This section is being repealed without being rewritten, as it is unnecessary.

3216. This provision was enacted in 1927 on the introduction of surtax and was intended to meet the situation where deductions were allowed at different times and impacted on other reliefs (especially earned income relief). With today's mechanisms for tax compliance and Self Assessment procedures, this provision is unnecessary.

Section 832

3217. Section 832(5) is repealed as it has been overtaken by the Adoption and Children Act 2002 (if it was not redundant before). See *Change 151* in Annex 1 and the commentary on section 989.

Sections 835 and 836

3218. Some provisions of these sections are not being rewritten.

3219. Section 835(2) and section 836 are obsolete in the context of Self Assessment.

3220. Section 835(6)(b) concerned charges on income, and has been replaced by rules providing that the relevant payments are deductions from income (if appropriate) in the year in which they are paid. See *Change 138* in Annex 1.

3221. Section 835(7)(b) and (8) are unnecessary now that the structure of the tax calculation has been made more explicit.

Section 840A

3222. The inclusion of the European Investment Bank follows the approach in section 991 of this Act. See *Change 135* in Annex 1 and the commentary on section 991.

Schedule 16

Paragraph 8

3223. Paragraph 8 of Schedule 16 to ICTA has not been rewritten as it is obsolete following the abolition of Advance Corporation Tax (ACT) in April 1999.

3224. Prior to April 1999, paragraph 8 of Schedule 16 applied only to payments which "should have been included in a return under Schedule 13" (ie ACT payments). Following the abolition of ACT, section 91 of FA 1999 (which amended paragraph 8 of Schedule 16), did not simply repeal paragraph 8 of Schedule 16 but instead amended it to apply whenever a payment was included when it "should not have been so included". This goes beyond the original intention of paragraph 8 and is unnecessary.

Paragraph 10(2)

3225. Assessments made under Chapter 15 of Part 15 of this Act will always be due on the date mentioned in section 951 of this Act (ie either 14 days after the return period or 14 days after the date of payment, in accordance with sections 949 and 950). So the reference in paragraph 10(2) of Schedule 16 to ICTA to payments being "due within 14 days after the issue of the notice of assessment" has not been rewritten.

3226. The background is as follows.

3227. Paragraph 10(2) had its origin in paragraph 10(2) of Schedule 20 to FA 1972. Both paragraphs were identically written as follows:

> Income tax assessed on a company under this Schedule shall be due within 14 days after the issue of the notice of assessment (unless due earlier under paragraph 4(1) or 9 above).

3228. The opening words of paragraph 4(1) of Schedule 20 to FA 1972 stated that paragraph 4(1) was subject to paragraph 4(4) of that Schedule.

3229. Paragraph 4(4) stated that where a payment was erroneously included on a return under Schedule 14 to FA 1972 (advance corporation tax (ACT)) and should have been included on a return under Schedule 20 (later Schedule 16 to ICTA), the Inland Revenue would raise an assessment. Under paragraph 10(2), the due date for such a payment was 14 days after the issue of the notice of assessment, this being an assessment other than one raised under either paragraph 4(1) or 9.

3230. Since the abolition of ACT by FA 1998 and the repeal of paragraph 4(3) of Schedule 16 to ICTA (paragraph 4(4) of Schedule 20 to FA 1972) by FA 1999 it is no longer possible to raise such an assessment. So all assessments raised under the source legislation will be due at the time the return is due under either paragraph 4(1) or 9.

Part 2: Other enactments

Taxes Management Act 1970

Section 17

3231. The amendments made to section 17 of TMA effectively enact regulation 12(1) of the building society regulations (SI 1990/2231) so that references to building societies are explicitly included in section 17. See *Change 126* in Annex 1.

3232. The enactment of regulation 12(1) ensures that the legislation which deals with deduction of income tax in respect of building societies is split between primary and secondary legislation in the same way as for deposit-takers.

Section 37A

3233. The amendments made to section 37A of TMA extend it to civil partners. See *Change 159* in Annex 1.

Section 55(1)(c)

3234. Assessments made under Chapter 15 of Part 15 of this Act will always be due on the date mentioned in section 951 (ie either 14 days after the return period or 14 days after the date of payment, in accordance with sections 949 and 950). So the reference in section 55(1)(c) of TMA to assessments other than those due under paragraphs 4(1) or 9 of Schedule 16 to ICTA is unnecessary since there can be no such assessments. See the commentary on paragraph 10(2) of Schedule 16 to ICTA above.

Section 87

3235. Section 87 has been replaced with a new section as part of the consequential amendments made in conjunction with Chapter 15 of Part 15 of this Act.

Section 98

3236. Under section 1034(3), Part 5 of this Act which deals with the enterprise investment scheme (EIS) does not have effect in relation to shares issued before 6 April 2007. Instead the EIS provisions in ICTA continue to have effect for these shares.

3237. The consequential amendments to the Table in section 98 include the addition of references to the applicable provisions in Part 5 of this Act. At the end of the Table a sentence is inserted explaining that these references are to provisions that apply only in relation to shares issued after 5 April 2007.

Section 99B

3238. New section 99B imposes a penalty of up to £3,000 where a person fraudulently or negligently gives an incorrect non-UK resident declaration under any of sections 858 to 861 of this Act. It is based on section 98(2) of TMA and the reference to section 482(2) of ICTA in the second column of the Table in section 98 of TMA.

3239. The reference to section 482(2) is omitted from the second column of the Table in section 98 of TMA and is not being replaced with a reference to sections 858 to 861 (which rewrite sections 481(5)(k), 482(2) and (2A) of ICTA and regulation 4(1)(a) to (c) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231)).

3240. The reason for not replacing the reference to section 482(2) is that it will not be possible to raise a penalty under section 98(1) of TMA in respect of sections 858 to 861. This is because *Change 130* in Annex 1 means that all non-UK resident declarations will have to be in a prescribed or authorised format in order for a gross payment to be made. If the declaration is not in the prescribed or authorised format the payment will be made under deduction of tax.

3241. But this new section ensures that fraudulent or negligent non-UK resident declarations will continue to be subject to a penalty, as is currently the case under section 98(2) of TMA.

Finance Act 1988

Section 130

3242. Section 130(7)(a) of FA 1988 has been amended to refer to section 684 of ITEPA 2003 and a specific provision has been included in section 130(9A) of FA 1988 to cover PAYE regulations made under ICTA. (When section 203 of ICTA was repealed by section 722 of, and paragraph 30 of Schedule 6 to, ITEPA, section 130(7)(a) of FA 1988 should have been amended.)

3243. Section 130(7)(b) of FA 1988 has been amended to refer to section 946 of this Act. And now that section 130(7)(b) covers tax which a company is liable to pay in respect of payments to which Chapter 15 of Part 15 of this Act applies, section 130(7)(c)(i) and (ii) will be repealed.

3244. Section 130(7)(c)(i) and (ii) referred to sections 476(1) and 479 of ICTA. But these references should have been replaced with references to sections 477A and 480A of ICTA (rewritten in Chapter 15 of Part 15 of this Act) when sections 476 and 479 were repealed. The amendments made by this Act update the legislation accordingly.

Finance Act 1989

Section 151

3245. As a result of the amendment made by this Schedule to section 467 of ITTOIA, any gain arising to trustees under Chapter 9 of Part 4 of ITTOIA is treated as income of the trustees. It follows that it is not necessary to provide separately for such gains in section 151(2)(b) of FA 1989. Accordingly section 151(2)(a) is amended and section 151(2)(b) is omitted.

Finance Act 1991

Section 53

3246. Section 53 has not been rewritten as it is redundant. It was originally enacted to validate an ultra vires transitional provision in the Income Tax (Building Societies) Regulations 1986 (SI 1986/482). This provision purported to require deduction in respect of sums paid or credited before 6 April 1986, the date of commencement of the regulations. SI 1986/482 was revoked with effect from 1991-92 following the repeal of section 476 ICTA by FA 1990. So section 53 is no longer necessary.

Taxation of Chargeable Gains Act 1992

Sections 4 and 6

3247. The amendments to references to "total income" operate by reference to "Step 3 income", defined by reference to section 23 of this Act, to reflect the standardised meaning of the phrase "total income". See the commentary on that section.

Section 11

3248. This new section replaces the former section 11 of TCGA.

3249. New *subsection (1)* replaces section 11(1) of TCGA and corresponds to section 833 of this Act relating to the residence status of visiting forces and others for income tax purposes.

3250. Section 833 is based on section 323(2) of ICTA which refers to "a period during which a member of a visiting force to whom section 303(1) of ITEPA 2003…applies". Section 11(1) of TCGA makes the same reference. Section 833 avoids the reference to section 303(1) of ITEPA and includes a full description of the persons to whom it applies.

3251. The new section 11(1) of TCGA, accordingly, links directly to section 833 of this Act and applies to the persons to whom section 833 applies.

3252. New *subsections (2)* and *(3)* replace section 11(3) and (4) of TCGA and correspond to the income tax exemption in section 841 of this Act. As explained in the commentary on section 841, the income tax exemption for Agents-General in section 320(1) of ICTA is repealed as it duplicates an exemption given elsewhere. For the same reason, the capital gains tax exemption in section 11(2) of TCGA is omitted.

Section 105A

3253. Under section 1034(3), Part 5 of this Act which deals with the enterprise investment scheme (EIS) does not have effect in relation to shares issued before 6 April 2007. Instead the EIS provisions in ICTA continue to have effect for these shares.

3254. The consequential amendments which relate to the EIS scheme in TCGA provide that there are alternative references to the applicable provisions in ICTA and to the applicable provisions in Part 5 of this Act.

3255. Where it may not be clear which of the provisions apply, the amendment includes an explanation that references to Part 5 of this Act or any provision of that Part are to a Part or provision that applies only in relation to shares issued after 5 April 2007. In the case of the amendments to section 105A, this explanation is included in a new *subsection (9).*

Section 119

3256. This section excludes from the computation of a capital gain or loss on the disposal of securities the amounts taken into account under the accrued income scheme. It deploys provisions from sections 710 to 727A of ICTA for this purpose.

3257. The extensive amendments are necessary to ensure that section 119 of TCGA continues to apply by reference to terms and provisions in Part 12 of this Act exactly as it does by reference to terms and provisions in sections 710 to 727A of ICTA.

3258. See also *Change 101* in Annex 1.

Section 125A

3259. This new section of TCGA is based on the provisions of sections 573(4), 574(1) and 576(2) and (3) of ICTA which have effect for the purposes only of capital gains tax or corporation tax on chargeable gains.

3260. *Subsections (1)* and *(3)* make clear that relief can only be obtained once for the loss, either by way of share loss relief or as a deduction in computing chargeable gains.

Sections 150A and 150B

3261. See the commentary on section 105A of TCGA about the consequential amendments which relate to the EIS scheme in TCGA. The amendment to section 150A inserts a new *subsection (13)* which explains the references to Part 5 of this Act. This is applied to section 150B by the amendment to section 150B(6).

Sections 151BA to 151BC

3262. These three new sections of TCGA are based on those provisions of Schedule 16 to FA 2002 (community investment tax relief - CITR) which have effect for the purposes of capital gains tax or corporation tax on chargeable gains.

Section 151BA

3263. This new section of TCGA sets out the special rules for identifying securities and shares disposed of where a holding includes securities or shares to which CITR is attributable. It is based on paragraph 47 of Schedule 16 to FA 2002.

3264. *Subsections (1)* to *(5)*, *(8)* and *(9)* replace sub-paragraphs (1) to (4), (7) and (8) of that paragraph so far as they have effect for the purposes of capital gains tax or corporation tax on chargeable gains. Those sub-paragraphs continue to apply for the purposes of relief against corporation tax for companies. Section 377 of this Act, based on those sub-paragraphs, applies for the purposes of relief against income tax for individuals.

3265. *Subsections (6)* and *(7)* replace sub-paragraphs (5) and (6) of paragraph 47 of Schedule 16 to FA 2002, which have effect only for the purposes of capital gains tax or corporation tax on chargeable gains.

Section 151BB

3266. This new section of TCGA disapplies the no disposal treatment in sections 116(10) and 127 to 130 of that Act in the case of rights issues and other reorganisations in respect of shares to which CITR is attributable. It is based on paragraph 40 of Schedule 16 to FA 2002.

Section 151BC

3267. This new section of TCGA disapplies the no disposal treatment in sections 135 and 136 of that Act in relation to a reconstruction or amalgamation affecting a holding of shares or debentures to which CITR is attributable. It is based on paragraphs 41 and 48(2) of Schedule 16 to FA 2002.

3268. *Subsections (1)* to *(4)* correspond to and replace each of the sub-paragraphs of paragraph 41 of Schedule 16 to FA 2002 which has effect only for the purposes of capital gains tax or corporation tax on chargeable gains.

3269. *Subsection (5)* is based on paragraph 48(2) of Schedule 16 to FA 2002 and replaces it so far as it has effect for the purposes of capital gains tax or corporation tax on chargeable gains. That sub-paragraph continues to apply for the purposes of relief against corporation tax for companies. Section 379(2) of this Act, based on that sub-paragraph, applies for the purposes of relief against income tax for individuals.

Section 231

3270. The amendments to section 231(1) and (3) of TCGA add a reference to Part 5 of this Act (EIS). Although relief under section 229 of TCGA is not available for disposals after 5 April 2001 (section 54 of FA 2000), section 231 of TCGA could still have some application where there is an unconditional contract to acquire a replacement asset under section 227(5) of TCGA.

Sections 256 to 256B

3271. The amendment to section 256 and new sections 256A and 256B are based on section 505(4) and (7) of ICTA and result from the need to separate the capital gains tax aspects of those provisions from the income tax aspects rewritten in this Act in sections 541 and 542. In the same way as in section 542 of this Act, new section 256B of TCGA refers to officers of Revenue and Customs, rather than the Board. See *Change 5* and the commentary on section 542.

Section 257

3272. The amendment to section 257 of TCGA is based on section 587B(3) of ICTA. This material is located within section 257 of TCGA because section 587B(3) of ICTA deals only with the capital gains base cost to the charity receiving the gift; it does not apply to the relief available to the person making the gift. The amendment applies only if relief is available to a company under section 587B or to an individual under Chapter 3 of Part 8 of this Act. See also the commentary on section 434.

3273. New *subsection (2B)(c)* deals with the case where a qualifying interest in land is disposed of by persons with a joint tenancy or with tenancies in common. See the commentary on section 442.

Sections 261B and 261C

3274. These sections replace section 72 of FA 1991 with a rewritten version of the rules for claiming to treat losses of a trade etc as allowable losses for the purposes of capital gains tax.

3275. The unused part of the loss (which extends to the whole of it if none of it has been used) may be used for capital gains tax purposes even if no claim for trade loss relief has been made. This could arise in circumstances where the person has no income in respect of which to make a claim. This reflects HMRC practice. See *Change 160* in Annex 1 and the commentary on section 71.

Sections 261D to 261E

3276. These sections replace section 90(4) and (5) of FA 1995 with a rewritten version of the rules for claiming to treat post-cessation expenditure of a trade etc as allowable losses for the purposes of capital gains tax.

3277. The unused part of the expenditure (which extends to the whole of it if none of it has been used) may be used for capital gains tax purposes even if no claim for trade loss relief has been made. This could arise in circumstances where the person has no income in respect of which to make a claim. This reflects HMRC practice. See *Change 160* in Annex 1 and the commentary on section 101 of this Act.

Section 263ZA

3278. This section concerns a claim made to treat a deduction which cannot be allowed under section 555 of ITEPA because of an insufficiency of income as an allowable loss for capital gains tax purposes. The amendments clarify the meaning of "total income" in section 263ZA(1) and (2) and explain how the excess deduction is calculated when there are other deductions which may be due under Step 2 of the calculation in section 23 of this Act.

Section 271

3279. New *subsections (7A)*, *(7B)* and *(7C)* rewrite the exemption in section 516 of ICTA to the extent that it relates to capital gains tax.

Section 285A

3280. This new section rewrites section 510A of ICTA to the extent that it relates to capital gains tax.

Schedule 5B

Paragraph 13C

3281. The substituted *sub-paragraph (4)* has the effect of combining part of the provision in this paragraph with material from section 300A(10) of ICTA. This is also noted in the commentary on section 223 of this Act.

Paragraph 19

3282. See the commentary on section 105A of TCGA about the consequential amendments which relate to the enterprise investment scheme (EIS) in TCGA. The amendment to paragraph 19(3) of Schedule 5B to TCGA inserts a new *paragraph (d)* which explains the references to Part 5 of this Act in Schedule 5B.

Schedule 5C

Paragraph 3

3283. Part 2 of Schedule 19 to FA 2004 provides that postponement of chargeable gains cannot be made under Schedule 5C to TCGA (venture capital trusts: deferred charge on re-investment) by reference to shares issued after 5 April 2004. There is therefore no need to make a consequential amendment to the reference in paragraph 3(1)(g) of Schedule 5C to relief having been given under Part 1 of Schedule 15B to ICTA.

3284. But, as withdrawal of approval of a venture capital trust may take place after 5 April 2007, the reference in paragraph 3(1)(f) to "section 842AA(8) of the Taxes Act" is replaced with a reference to the corresponding provision in this Act.

Finance Act 1994

Schedule 20

Paragraph 11

3285. This provision has been amended so that the clawback of excess double taxation relief operates in terms of tax rather than by reference to an amount of income. See *Change 158* in Annex 1.

Finance Act 1998

Section 161

3286. This amendment substitutes equivalent references to terms and provisions in Part 12 of this Act for the references to terms and provisions in sections 710 to 727A of ICTA. See also *Change 101* in Annex 1.

Finance Act 2000

Section 44

3287. This section requires the apportionment of trustees' expenses in a case where any income of a trust would be treated as the income of a settlor but for the fact that it is given to or arises to a charity. The amended section 44 of FA 2000 applies to the calculation of a beneficiary's income for corporation tax purposes. New section 646A of ITTOIA makes corresponding provision for income tax.

Schedule 15

3288. Under section 1034(3), Part 5 of this Act which deals with the enterprise investment scheme (EIS) does not have effect in relation to shares issued before 6 April 2007. Instead the EIS provisions in ICTA continue to have effect for these shares.

3289. The consequential amendments to the corporate venturing scheme provide that there are alternative references to the applicable provisions in ICTA and to the applicable provisions in Part 5 of this Act.

3290. In case it is not clear which of the provisions apply, the amendment inserts a new *sub-paragraph (9)* in paragraph 102 of Schedule 15 explaining that references to Part 5 of this Act or any provision of that Part are to a Part or provision that applies only in relation to shares issued after 5 April 2007.

Capital Allowances Act 2001

Section 570B

3291. This section is inserted as a consequence of section 1014.

Sections 575 and 575A

3292. These sections set out the definition of "connected" in full in place of the cross-reference to section 839 of ICTA. See the commentary on section 993.

Finance Act 2002

Schedule 16

3293. Part 7 of this Act, based on Schedule 16 to FA 2002, provides for individuals to obtain income tax reductions for investments in community development finance institutions (CDFIs). That Schedule continues in force so far as it provides for companies to obtain relief against corporation tax for such investments. The relief is referred to as CITR.

Paragraphs 4 to 7

3294. This amendment substitutes for paragraphs 4 to 7 a new *paragraph 4* applying Chapter 2 (accredited community development finance institutions) of Part 7 of this Act for the purposes of Schedule 16 to FA 2002. This amendment ensures that accreditation in accordance with that Chapter applies for the purposes of both CITR for individuals under Part 7 of this Act and CITR for companies under Schedule 16 to FA 2002.

Paragraph 12

3295. This amendment substitutes for paragraph 12(2) new *sub-paragraphs (2)*, *(2A)* and *(2B)*. These new sub-paragraphs ensure that the limit on the value of investments made in the CDFI in any accreditation period in respect of which it may issue tax relief certificates applies to the aggregate value of investments made by companies under Schedule 16 to FA 2002 and of investments made by individuals under Part 7 of this Act.

Paragraphs 40 and 41

3296. This amendment omits paragraphs 40 and 41 which have effect only for the purposes of capital gains tax or corporation tax on chargeable gains. Sections 151BB and 151BC(1) to (4) of TCGA, introduced by this Schedule, are based on those paragraphs. See the commentary on those new sections of TCGA.

Paragraph 47

3297. There are two amendments to paragraph 47.

3298. The first omits the references to capital gains tax and corporation tax on chargeable gains in paragraph 47(3) and (4). Section 151BA(2) and (3) of TCGA, introduced by this Schedule, are based on those sub-paragraphs so far as they have effect for those purposes (see the commentary on that new section of TCGA). Those sub-paragraphs continue to apply for the purposes of CITR for companies. Section 377(2) and (3), based on those sub-paragraphs, apply for the purposes of CITR for individuals.

3299. The second omits paragraph 47(5) and (6). Those sub-paragraphs have effect only for the purposes of capital gains tax or corporation tax on chargeable gains. Section 151BA(6) and (7) of TCGA, introduced by this Schedule, are based on those sub-paragraphs. See the commentary on that new section of TCGA.

Paragraph 48

3300. This amendment omits the reference to capital gains tax and corporation tax on chargeable gains in paragraph 48(2). Section 151BC(5) of TCGA, introduced by this Schedule, is based on that sub-paragraph so far as it has effect for those purposes (see the commentary on that new section of TCGA). That sub-paragraph continues to apply for the

purposes of CITR for companies. Section 379(2), based on that sub-paragraph, applies for the purposes of CITR for individuals.

Proceeds of Crime Act 2002

Schedule 10

Paragraph 4

3301. This amendment substitutes equivalent references to terms and provisions in Part 12 of this Act for the references to terms and provisions in sections 710 to 727A of ICTA. In particular, the indirect disapplication of those provisions by references to sections 713 and 716 of ICTA has been replaced by a direct disapplication of the whole of Part 12 to the transfer in question. This has the same net effect.

Income Tax (Earnings and Pensions) Act 2003

Section 48

3302. Section 48(2)(b) of ITEPA excludes payments subject to deduction under section 555 of ICTA (payments to non-UK resident entertainers and sportsmen) from the scope of Chapter 8 of Part 2 of ITEPA. This section has been extended to exclude transfers as well as payments. See *Change 161* in Annex 1.

Section 404A

3303. This new section in ITEPA specifies that an amount counting as employment income under section 403 of that Act is treated as the highest part of total income. It is based on section 833(3) of ICTA. See also the commentary on section 1012 of this Act.

Section 476

3304. New *subsection (5A)* ensures that the amount charged forms part of “total income” in Step 1 of section 23 of this Act.

Schedule 5

Paragraph 11(10)

3305. From 2007-08 it is the definition of a company in administration or receivership in Part 5 of this Act rather than the definition in section 312(2A) of ICTA which applies in relation to enterprise management incentives (EMI). This includes the reference to the Northern Ireland legislation as amended by the Insolvency (Northern Ireland) Order 2005. See *Change 56* in Annex 1.

3306. Unlike other consequential amendments that stem from the rewrite of the enterprise investment scheme (EIS), the impact of this amendment is not affected by when the EIS shares in question are issued.

Finance Act 2004

Section 102

3307. Section 102 of FA 2004 provides that where a payee has suffered deduction on a payment that was in fact exempt under section 758 of ITTOIA, a claim for relief can be made

to the Board. This provision has not been rewritten. As a result such claims will be made to an officer of Revenue and Customs. See *Change 5* in Annex 1.

Section 189

3308. Section 189(2) of FA 2004 defines "relevant UK earnings" for the purpose of determining the maximum amount of relief for certain pension contributions. The source definition includes income within section 833(5B) of ICTA (certain patent income). As section 833 is being repealed, this amendment expressly includes patent income in section 189(2) through a new subsection (2A). Furthermore, as a simplification measure, the revised provision does not reproduce the restrictions to section 833(5B) in section 833(5C) and (5E) of ICTA. See *Change 125* in Annex 1.

3309. The amendment also directly incorporates income from a UK furnished holiday lettings business in the definition of UK relevant earnings. That part of the amendment is based on section 504A(2)(c) of ICTA.

Income Tax (Trading and Other Income) Act 2005

Section 13

3310. Following the House of Lords decision in Agassi v Robinson [2006 UKHL 23][2], section 13 of ITTOIA has been amended to make clear that when a payment or transfer of the type referred to in section 555 of ICTA is made, a liability to income tax will arise regardless of whether there is a duty to deduct income tax under section 555 of ICTA. See *Change 156* in Annex 1.

Section 51

3311. Section 51 of ITTOIA is repealed under the new approach to charges on income and patent royalties. See *Change 81* in Annex 1.

Section 108

3312. This amendment removes redundant references to the British Museum and the Natural History Museum. See *Change 79* in Annex 1 and the commentary on section 430 of this Act.

Section 272

3313. This section is consequentially amended as a result of the repeal of section 51 of ITTOIA. See *Change 81* in Annex 1.

Section 457

3314. Subsection (3) is repealed as it is no longer necessary. It deemed the profit on the disposal of deeply discounted securities to be income of the trustees for the purposes of applying the trust rate. It is already income of the trustees for other purposes by virtue of sections 429 and 437 of ITTOIA. And the liability of the trustees at the trust rate is now provided for directly by sections 481 and 482 of this Act (see Type 6).

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[2] [2006] STC 1056

3315. The substituted *subsection (5)* makes more explicit the requirement that the scheme's accounts show the amount as income available for payment to unit holders or for investment. It also continues to ensure that the effect of section 3 of ICTA is preserved in the case of unauthorised unit trusts (UUTs). If the income referred to in subsection (1) is treated as income in the trust's accounts, it is then treated as being paid out to unit holders (see section 469(3) of ICTA and section 547(2) of ITTOIA). So the trustees of the UUT are charged at the basic rate of income tax rather than the trust rate. See the commentary on section 504 of this Act.

Section 465A

3316. This new section specifies that an amount taxed under Chapter 9 of Part 4 of ITTOIA is treated as the highest part of total income. It is based on section 833(3) of ICTA. See also the commentary on section 1012 of this Act.

Section 467

3317. New *subsection (1A)* ensures that the amount charged forms part of "total income" of trustees in Step 1 of section 23 of this Act. This was expressly stated to be the case prior to ITTOIA (see section 547(9) of ICTA as it applied until 5 April 2005) and the position is now made explicit in line with the similar rule for individuals (section 465(5) of ITTOIA) and personal representatives (section 466(1) of ITTOIA).

3318. The amendment to subsection (7) omits the rule that the amount is charged at the trust rate (except for charitable trusts). It is unnecessary because gains within section 467 of ITTOIA are included in the list in section 482 of this Act (see Type 7).

Section 535

3319. This amendment addresses the provisions relating to chargeable event gains within Chapter 9 of Part 4 of ITTOIA. Relief under Chapters 2 (gift aid) and 3 (gifts of shares etc to charities) of Part 8 of this Act is not taken into account in computing top slicing relief. In the source legislation these provisions were in section 25(6) of FA 1990 (gift aid) and section 587B(2) of ICTA (gifts of assets etc). They are now located with the top slicing provisions themselves.

Section 539

3320. This section has been rewritten to clarify that relief for a deficiency is given as a tax reduction. A formal claims requirement has also been introduced. See *Change 3* in Annex 1.

Section 619A

3321. This new section in ITTOIA replaces section 660C(3) of ICTA. It ensures that income under section 619(1)(a) and (b) of ITTOIA is treated as the highest part of the settlor's income for the purposes of Chapter 2 of Part 2 of this Act.

Section 620

3322. This amendment removes redundant references to the British Museum and the Natural History Museum. See *Change 79* in Annex 1 and the commentary on section 430.

Section 624

3323. New *subsection (1A)* makes it explicit that trustees' expenses are not taken into account in measuring the income of a settlor under section 624 of ITTOIA. This follows from the fact that it is the income arising that is deemed to be the settlor's and the income arising is the gross amount out of which the trustees may pay expenses.

Section 628

3324. This amendment removes redundant references to the British Museum and the Natural History Museum. See *Change 79* in Annex 1 and the commentary on section 430 of this Act.

Section 646A

3325. This new section in ITTOIA is based on section 44 of FA 2000. It requires the apportionment of trustees' expenses in a case where any income of a settlement would be treated as the income of a settlor but for the fact that it is given to or arises to a charity. Expenses are allocated rateably between charitable income and other income. The rule applies both in cases where expenses affect the amount of income liable at the special trust rates, and in cases where expenses affect the amount of income of a beneficiary liable to income tax. Section 44 of FA 2000 is being amended to provide for the position of a beneficiary within the charge to corporation tax. For the treatment of expenses generally see *Change 91* in Annex 1.

Section 680A

3326. This new section is based on section 698A of ICTA. It ensures that payments by personal representatives to beneficiaries out of income retain the character of the underlying income. The opportunity has been taken to clarify a point of doubt in the source legislation. See *Change 162* in Annex 1.

3327. It may be noted that section 698A(1) and (2) of ICTA apply only where income is treated under "this Part" in a particular way. In fact, following ITTOIA, the income tax cases to which "this Part" previously applied are now in Chapter 6 of Part 5 of ITTOIA. But paragraph 5 of Schedule 2 to ITTOIA enables the reference to "this Part" to be read as embracing the ITTOIA provisions now in Chapter 6 of Part 5 of ITTOIA.

Section 682

3328. New *subsection (4A)* ensures that the amount charged forms part of "total income" in Step 1 of section 23 of this Act. If exceptionally the relief being recovered under section 682(4)(b) was a relief given as a tax reduction, then the recovery is a charge to an amount of income tax instead (see section 32 of this Act).

Schedule 2

Paragraph 109

3329. Amendment to this transitional provision is necessary because section 539 of ITTOIA has been rewritten. See the commentary on Schedule 1 (section 539 of ITTOIA). Relief for a deficiency within this provision is given as a deduction from total income instead of as a tax reduction.

Finance Act 2005

Schedule 2

3330. As part of the alignment of the building society and deposit-taker regimes on deduction of tax, paragraphs 5 and 6 of Schedule 2 to FA 2005 have been replaced with a new paragraph, paragraph 11, of Schedule 2 to FA 2005.

3331. In respect of qualifying time deposits (see section 866 of this Act) there was some doubt about whether relevant arrangements (as defined in paragraph 1 of Schedule 2 to FA 2005) with deposit-takers would be paid gross. This was because, under the source legislation, paragraph 6 of Schedule 2 to FA 2005 treats relevant arrangements as if they are deposits rather than deposits made by way of loan. (For building societies, paragraph 5 of Schedule 2 to FA 2005 treats relevant arrangements as a deposit or loan.)

3332. But it was clearly the intention that all the deposit-taker rules applied to relevant arrangements. New paragraph 11(b) treats relevant arrangements as if they were deposits consisting of a loan in order to put the matter beyond doubt.

3333. As part of *Change 126* in Annex 1 (enactment of regulations) regulation 2(4) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (as amended by SI 2005/3474) has been enacted so that references to interest in Chapter 2 of Part 15 of this Act include returns on relevant arrangements (as defined in paragraph 1 of Schedule 2 to FA 2005).

Finance (No 2) Act 2005

Section 7

3334. The amendments to references to "total income" operate by reference to "Step 3 income", defined by reference to section 23 of this Act. See the commentary on that section.

Part 3: Amendments having effect in relation to shares issued after 5 April 2007 Income and Corporation Taxes Act 1988

Chapter 3 of Part 7

3335. Under section 1034(2), Part 5 of this Act does not have effect in relation to shares issued before 6 April 2007. Instead the ICTA provisions dealing with the enterprise investment scheme (EIS) on which Part 5 of this Act is based continue to have effect for these shares.

3336. So this paragraph provides that the omission of Chapter 3 of Part 7 of ICTA (except for section 305A) only has effect in relation to shares issued after 5 April 2007.

Schedule 2: Transitionals and savings

Overview

3337. This Schedule provides transitionals and savings.

3338. The commentary on this Schedule makes specific points on certain of the entries.

Part 1: General provisions

3339. These paragraphs ensure continuity of the law, despite the fact that this Act repeals and rewrites provisions.

3340. It is made clear that the proposition about the continuity of the law does not apply to changes in the law made by this Act.

3341. The paragraphs in this Part stand instead of section 17(2) of the Interpretation Act 1978 and provide a comprehensive set of transitional arrangements.

Part 2: Changes in the law

3342. This paragraph allows anyone affected by a change in the law made by this Act to elect that the change does not apply to events occurring before 6 April 2007. This allows the Act to be applied as soon as possible without imposing charges retrospectively.

3343. The Act applies for income tax purposes. But it also makes consequential amendments to corporation tax. So corporation tax is also provided for here.

Part 3: Rates at which income tax is charged

3344. These paragraphs prevent any difficulties arising from the changes made by this Act in the names of the lower rate and the rate applicable to trusts.

Part 4: Personal reliefs

3345. These paragraphs ensure that individuals who are entitled to blind person’s allowance or married couple’s allowance immediately before 6 April 2007 will be able to transfer the appropriate part of that relief to their spouse or civil partner for the tax years 2007-08 and 2008-09. See *Change 7* in Annex 1.

Part 5: Losses (except losses on disposal of shares)

Trade loss relief against general income

Early trade losses relief

3346. The first paragraph under these headings deal with losses in tax years 2007-08 onwards which, under the Part 4 of this Act, can reduce profits of tax years before 2007-08 (tax years before this Act has effect).

3347. The second paragraph under each heading relates to a person who makes a loss for tax year 2006-07 and is denied the corresponding relief under ICTA because the way in which the trade was being carried on was not commercial on 5 April 2007. That person is not to be denied relief for a loss made in 2007-08 purely because this Act looks to a different date, than would have been the case under ICTA, in deciding whether the trade is commercial. See *Change 9* in Annex 1.

Sideways relief: trade leasing allowances given to individuals

3348. This paragraph relates to an individual who makes a loss for tax year 2006-07 and is denied relief under ICTA for trade leasing allowances because the individual fails to meet the tests concerning the period for which the individual carries on the trade or devotes most of his or her time to it. That person is not to be denied relief for trade leasing allowances in 2007-08

purely because this Act looks to different periods for these tests than would have been the case under ICTA. See *Change 10* in Annex 1.

Reliefs for limited partners not to exceed contribution to the firm

Reliefs for members of LLPs not to exceed contribution to the LLP

Members of LLPs: carry-forward of losses

Reliefs for non-active partners not to exceed contribution to the firm

Non-active partners: carry-forward of losses

3349. Each of these paragraphs reflects the clarification that losses used as capital losses are treated in the same way as if they had reduced non-trade income. See *Change 13* in Annex 1 and the commentary on section 103 of this Act.

Restrictions on reliefs for non-active partners: pre-10 February 2004 events

3350. This paragraph adapts, where appropriate, the approach in section 110 of this Act to follow that of section 118ZE of ICTA (restriction on relief for non-active partners).

3351. Broadly, the "aggregate amount" in section 118ZE of ICTA ignored sideways relief given for losses of a tax year with a basis period ending before 10 February 2004 (with suitable adjustments for tax years whose basis period straddled that date). But such relief as was ignored was, so far as possible, deducted from contributions to capital made by the individual before 10 February 2004.

3352. That might still be relevant to an individual who would have been able to benefit from section 118ZJ of ICTA (carry forward of unrelieved losses of non-active partners) that potentially permitted sideways relief for brought forward losses. Additionally, it could be relevant to cases where a partnership that was trading on 10 February 2004 sets up a new trade after that date, because of the change from "contribution to the trade" in the source legislation to "contribution to the firm". See *Change 16* in Annex 1.

Application of existing regulations under sections 114 and 802

3353. The Partnership (Restrictions on Contributions to a Trade) Regulations 2005 (SI 2005/2017) are amended consequentially on the change from "contribution to the trade" in the source legislation to "contribution to the firm". See *Change 16* in Annex 1.

Loss relief against miscellaneous income: Case VI losses

3354. This paragraph allows Schedule D Case VI losses to continue to be carried forward for relief against certain income of future years. The income in question would have been Schedule D Case VI income but for ITTOIA 2005 removing, for income tax, that concept in relation to tax years starting after 5 April 2005.

Part 6: Losses on disposal of shares

3355. The transitional provisions in this Part relate principally to the provisions of Chapter 3 of Part 7 of ICTA which are applied, with modifications, by cross-reference for the purpose of the definition of eligible trading company in section 576(4A) of that Act. Section 576(4A) of ICTA was introduced with effect from 6 April 1998 in relation to shares issued on or after

that date. The majority of those provisions of Chapter 3 of Part 7 of ICTA, as modified, have been included in full in sections 137 to 146 of this Act for the purposes of share loss relief.

3356. Part 5 of this Act (Enterprise investment scheme), which is based on Chapter 3 of Part 7 of ICTA (other than section 305A of ICTA), has effect only in relation to shares issued on or after 6 April 2007. See the commentary on section 1034(3). One of the effects of section 1034(3) is that all *Changes* in Annex 1 relating to sections of Part 5 apply for the purposes of that Part only to shares issued on or after 6 April 2007.

3357. But Chapter 6 of Part 4 (losses on disposal of shares) applies to give share loss relief if the shares are disposed of on or after 6 April 2007, including cases where the shares were issued before that date.

3358. In determining whether the shares are shares in a qualifying trading company, the conditions applicable at the time of issue of the shares must be met. It is therefore necessary to include transitional provisions relating to sections 137 to 146, notwithstanding that no transitional provisions are required for the provisions of Part 5 to which they correspond.

3359. The transitional provisions in this Part, accordingly, reflect all the amendments made since 6 April 1998 to the provisions of Chapter 3 of Part 7 of ICTA which are the origins of sections 137 to 146 and of other sections of Part 5 of this Act which are applied for the purposes of sections 137 to 146, including the minor changes in the law made by this Act.

3360. In addition to those provisions, this Part contains transitional provisions relating to sections 134 and 151 necessary to provide for the conditions applicable if the shares were issued before 6 April 1998.

3361. The transitional provisions which relate to sections of this Act which are replicated for corporation tax purposes in the new sections 576A to 576L of ICTA also apply to those new sections.

Qualifying trading companies

3362. This transitional provision, together with that relating to section 151 (interpretation of Chapter), provides for the conditions which apply to determine whether shares issued before 6 April 1998 are shares in a qualifying trading company.

Disposals of new shares

3363. This transitional provision has the effect that *Change 24* in Annex 1 applies only to "new shares" (as defined in section 145(1)(b)) issued on or after 6 April 2007. See the commentary on sections 136 and 145. This Change applies only for the purposes of share loss relief.

The trading requirement

3364. This transitional provision has the effect that, for the purposes of share loss relief as well as EIS relief, *Changes 41* and *42* in Annex 1 apply only to shares issued on or after 6 April 2007. Those Changes apply to section 181 to which section 137 corresponds with modifications. See the commentary on section 1034(3) for the commencement of section 181 as it applies for the purposes of EIS relief.

The control and independence requirement

3365. This transitional provision has the effect that, for the purposes of share loss relief as well as EIS relief, *Change 44* in Annex 1 applies only to shares issued on or after 6 April 2007. That Change applies to section 185 to which section 139 corresponds with modifications. See the commentary on section 1034(3) for the commencement of section 185 as it applies for the purposes of EIS relief.

Relief after an exchange of shares for shares in another company

3366. This transitional provision has the effect that *Changes 24* and *25* in Annex 1 apply only to "new shares" (as defined in section 145(1)(b)) issued on or after 6 April 2007. See the commentary on section 145 and also on section 136 to which *Change 24* also applies. Those Changes apply only for the purposes of share loss relief.

Excluded activities: wholesale and retail distribution

3367. This transitional provision has the effect that, for the purposes of share loss relief as well as EIS relief, *Change 45* in Annex 1 applies only to shares issued on or after 6 April 2007. That Change applies to section 193(5)(b) which is applied by section 137(7). See the commentary on section 1034(3) for the commencement of section 193 as it applies for the purposes of EIS relief.

Excluded activities: leasing of ships

3368. This transitional provision has the effect that, for the purposes of share loss relief as well as EIS relief, *Change 43* in Annex 1 applies only to shares issued on or after 6 April 2007. That Change applies to section 194 which is applied by section 137(7). See the commentary on section 1034(3) for the commencement of section 194 as it applies for the purposes of EIS relief.

Excluded activities: provision of services or facilities for another business

3369. This transitional provision has the effect that, for the purposes of share loss relief as well as EIS relief, *Change 46* in Annex 1 applies only to shares issued on or after 6 April 2007. That Change applies to section 199 which is applied by section 137(7). See the commentary on section 1034(3) for the commencement of section 199 as it applies for the purposes of EIS relief.

Meaning of company being "in administration"

3370. This transitional provision has the effect that, for the purposes of share loss relief, *Change 56* in Annex 1, relating to a company being in administration under the law of Northern Ireland, does not apply if a petition for an administration order was presented before 6 April 2007. The provision relates to section 252 only as it is applied by section 138(5) for the purposes of share loss relief. See the commentary on section 1034(3) for the commencement of section 252 as it applies for the purposes of EIS relief and also the consequential amendment to section 312(2A) of ICTA in Schedule 1.

Part 7: Enterprise investment scheme

3371. Part 5 of this Act deals with the enterprise investment scheme (EIS). It has effect only in relation to shares issued on or after 6 April 2007. See the commentary on section 1034(3).

One of the effects of section 1034(3) is that the Changes in Annex 1 relating to sections in Part 5 apply only to shares issued on or after 6 April 2007. There is an exception in the case of *Change 56*. See the consequential amendment to section 312(2A) of ICTA, explained in the commentary on that section in Schedule 1.

3372. Also since the ICTA provisions will not be repealed for shares issued before 6 April 2007 there is no need for transitional provisions in the case of most Finance Act amendments made to EIS. But there is an exception in the case of the FA 2006 amendment to the gross assets requirement, as noted below.

The gross assets requirement

3373. Paragraph 1(3) and (4) of Schedule 14 to FA 2006 defer the effect of the amendments to section 293(6A) of ICTA for shares subscribed for before 22 March 2006 and for investment funds approved before 22 March 2006 in specified circumstances. The transitional provision ensures that this treatment continues if the shares are not issued until after 5 April 2007.

Part 8: Venture capital trusts

3374. See the commentary on section 1034(3) and on Part 7 of this Schedule for the approach taken to the enterprise investment scheme (EIS).

3375. Venture capital trusts (VCTs) share many of the features described for EIS but in contrast to EIS the scheme does not lend itself to a single commencement provision. An approach for VCT which was similar to that proposed for EIS would involve a number of different commencement provisions. This would complicate things within the scheme and, for example, in relation to consequential amendments.

3376. So there are extensive transitional provisions for VCTs in this Part, concerned with Finance Act amendments, where there could be a continuing effect on or after 6 April 2007, and with the minor changes in the law made by this Act.

Part 9: Other reliefs

Interest: loans for investing in co-operatives

3377. The condition that relief is only available for interest on a replacement loan if it replaces an original loan made after 10 March 1981 has been removed. See *Change 71* in Annex 1.

Gift aid: restrictions on associated benefits

3378. This provision ensures that the priority rule introduced into section 419(8) of this Act (see *Change 77* in Annex 1) does not operate retrospectively.

Qualifying maintenance payments: maintenance assessments

3379. This provision follows section 86 of the Child Support, Pensions and Social Security Act 2000 under which the amendments to section 347B of ICTA contained in paragraph 8 of Schedule 3 to that Act are commenced. The power to commence such amendments is now a power to appoint a day under this transitional provision.

Part 10: Special rules about settlements and trustees

Trustees' expenses to be set against trustees' trust rate income

3380. The rule about when trustees' expenses are taken into account will operate from 6 April 2007 on an "incurred" rather than on a "paid" basis. See *Change 87* in Annex 1. This provision deals with expenses that were incurred before 6 April 2007.

Discretionary payments: trustees' tax pool

3381. This provision ensures that the tax pool as at 5 April 2007 is carried forward to 2007-08 (including in cases where trustees have been non-UK resident: see *Change 89* in Annex 1).

Part 14: Tax avoidance

Transfers of assets abroad: non-transferors receiving benefit- exclusion of income arising before 10 March 1981

3382. A saving provision is included for section 740(7) of ICTA.

Individuals in partnership: recovery of excess relief

Individuals claiming relief for film related trading losses

3383. Paragraphs have been added to make it explicit that the change from "contribution to the trade" in the source legislation to "contribution to the firm" does not affect references to provisions in this Act in various sections being taken, where necessary, as references to corresponding provisions in ICTA See *Change 16* in Annex 1.

3384. The Partnership (Restrictions on Contributions to a Trade) Regulations 2006 (SI 2006/1639) are amended consequentially on the change from "contribution to the trade" in the source legislation to "contribution to the firm". See *Change 16* in Annex 1.

Part 15: Deduction of income tax at source

Deduction by deposit-takers: discretionary or accumulation settlements

3385. These paragraphs rewrite the transitional provision in section 481(5B) of ICTA, parts of section 86 of FA 1995 and the Deposit-Takers (Interest Payments) (Discretionary or Accumulation Trusts) Regulations 1995 (SI 1995/1370) about certain deposits made before 6 April 1995.

3386. Under section 481(5B) of ICTA deposits made before 6 April 1995 are not liable to deduction of tax where, prior to making the payment, the deposit-taker has not received notification that the income arises to trustees of a discretionary or accumulation trust.

3387. In accordance with *Change 5* in Annex 1, references to "the Board" in section 481(5B)(b) of ICTA have been replaced with "an officer of Revenue and Customs".

3388. Under section 482(11)(ab) and (12) of ICTA, the Commissioners for Her Majesty's Revenue and Customs have power to make regulations in relation to the notification under section 481(5B) of ICTA and the circumstances in which the deposit-taker can delay acting on such a notification. This provision has not been rewritten as it is obsolete.

3389. The regulations in SI 1995/1370 were made under section 482(11)(ab) of ICTA. These regulations provide that a deposit-taker will not have to deduct tax from a payment made within 30 days of receipt of a notification that the income arises to trustees of a discretionary or accumulation trust and have been incorporated into the transitional provision. See *Change 126* in Annex 1 (enactment of regulations). This Act also revokes SI 1995/1370. See Schedule 3 to this Act (Repeals and revocations).

3390. In accordance with *Change 5* in Annex 1, references to "the Board" in regulation 5 of SI 1995/1370 have been replaced with "an officer of Revenue and Customs".

Deduction from certain UK public revenue dividends

3391. These paragraphs rewrite the transitional provision in section 37(10) to (13) of F(No 2)A 1997, about gilts issued before 6 April 1998.

3392. Section 37(10) of F(No 2)A 1997 provides that where any person holds a gilt issued before 6 April 1998, which was subject to a Treasury direction under section 50(1) of ICTA (that the gilt interest is to be paid gross), any application under section 50(2) of ICTA (for net payment) made before 6 April 1998 continues to have effect despite the provisions in F(No 2)A 1997 which provided that all gilt interest was to be paid gross in future.

3393. Section 37(11) to (13) of F(No 2)A 1997 provides that where a gilt held prior to 6 April 1998 was subject to deduction of tax and no Treasury direction under section 50(2) of ICTA was made, the holder will be deemed to have made an application for interest payments to be made net of tax. The deemed application can be revoked by notice withdrawing the deemed application under section 896 (withdrawal of application).

Schedule 3: Repeals and revocations

Part 1: Repeals and revocations: general

3394. Part 1 contains general repeals and revocations of enactments, including some spent enactments.

Part 2: Repeals having effect in relation to shares issued after 5 April 2007

3395. Part 2 contains repeals specific to EIS provisions. See the commentary on section 1034.

Schedule 4: Index of defined expressions

3396. This Schedule provides an index of defined expressions used in this Act. Nearly all of the definitions appear in this Act, but a few are contained in other Acts.

HANSARD REFERENCES

3397. The following table sets out the dates and Hansard or other Parliamentary references for each stage of this Act's passage through Parliament.

These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007.
These notes are published in three volumes.

Stage	**Date**	**Hansard or other Parliamentary reference**
House of Commons		
Introduction	7 December 2006	Vol 454 Col 463
Second Reading Committee	17 January 2007	
Second Reading (formal)	22 January 2007	Vol 455 Col 1258
Joint Committee on Tax Law Rewrite Bills		
First Report of Session 2006-2007	8 February 2007	HL 36 2006-07 HC 268 2006-07
House of Commons		
Third Reading	20 February 2007	Vol 457 Cols 209 to 222
House of Lords		
Introduction	21 February 2007	Vol. 689 Col 1071
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ANNEX 1: MINOR CHANGES IN THE LAW MADE BY THE BILL

Change 1: Rates of tax: stock dividends and release of loans: section 13

This change ensures that, in line with practice, income chargeable under Chapter 5 or 6 of Part 4 of ITTOIA which would otherwise be taxed at the higher rate is taxed at the dividend upper rate instead.

Section 1B of ICTA, as amended by paragraph 4 of Schedule 1 to ITTOIA, applies the dividend upper rate to an individual's income within Chapters 3 and 4 of Part 4 of ITTOIA (UK and foreign dividend income) that would otherwise have been taxed at the higher rate. It does not apply the dividend upper rate to income within Chapters 5 and 6 of Part 4 of ITTOIA (stock dividends from UK resident companies and release of loan to participator in close company). But the established practice in both cases has been to treat such income as if it fell within section 1B of ICTA.

This established practice has been recognised in the rewrite of section 1B of ICTA. Section 13(2) applies the dividend upper rate instead of the higher rate to "dividend income". This term is defined in section 19 to include income under Chapters 5 and 6 of Part 4 of ITTOIA. Accordingly, income within those Chapters will be taxed at the same rates as apply to ordinary dividends.

The amendment to section 1B of ICTA made by ITTOIA did not include references to Chapter 5 or 6 of Part 4 of ITTOIA because it was considered more appropriate to introduce such a change in the course of the rewrite of section 1B itself rather than as an amendment in ITTOIA.

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

Change 2: Rates of tax: income of personal representative under section 466 of ITTOIA: section 18

This change corrects an anomaly in relation to the rate of tax which applies when personal representatives are liable on gains charged under Chapter 9 of Part 4 of ITTOIA (gains from contracts for life insurance etc).

Chapter 9 provides for a charge where gains arise on certain insurance policies and contracts. The provisions setting out who is liable for tax in respect of the gain include section 465 (individuals) and section 466 (personal representatives) of ITTOIA. For liability under section 465, section 1A(2)(d) of ICTA ensures that a gain counts as savings income and benefits from the charge at the lower rate.

Where the gain arises in circumstances where personal representatives hold the rights in the policy or contract there are two possible outcomes.

The first, if the condition in section 466(2) of ITTOIA is *not* met, is that section 664(2)(e) of ITTOIA provides that the gain falls into the aggregate income of the estate. (The condition is that the circumstances are such that an individual liable under section 465 on the gain would not be entitled to the tax credit provided by section 530 of ITTOIA.). Section 680(4) of ITTOIA (income treated as bearing income tax) then treats this as income "bearing income tax at the lower rate".

In this case, the personal representatives are not chargeable under Chapter 6 of Part 5 of ITTOIA (beneficiaries' income from estates in administration) and, by virtue of section 698A of ICTA (taxation of income of beneficiaries at lower rate or at rates applicable to distribution income), the deemed income of the beneficiary is chargeable at the lower rate rather than the basic rate.

The second possible outcome, if the condition in section 466(2) of ITTOIA *is* met, is that the personal representatives are chargeable under section 466. The gain still falls into the aggregate income of the estate, but under section 664(2)(a) of ITTOIA rather than section 664(2)(e).

In this case, section 680(4) of ITTOIA does not apply and the normal rules that determine the rate of tax apply instead: the income does not fall within section 1A of ICTA, so the personal representatives are chargeable at the basic rate rather than the lower rate.

It was not intended that the basic rate should apply in these circumstances. The anomaly arose as a result of the amendment to section 1A of ICTA made by paragraph 1 of Schedule 35 to FA 2003. And in practice personal representatives have been given the benefit of the lower rate.

This change removes the anomaly: gains treated under section 466 of ITTOIA as income of personal representatives are included in the definition of savings income (see section 18(4)).

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

Change 3: Tax calculation: relief for deficiencies: amendment to section 539 of ITTOIA: section 26 and Schedule 1 (section 539 of ITTOIA)

This change amends the way in which relief under section 539 of ITTOIA is given and introduces a formal claims requirement.

Section 539(1) of ITTOIA provides for relief for a deficiency to be given as a deduction from total income. But the mechanics of the relief as set out in section 539(3) to (5) show that it is intended to work as a computational adjustment to the amount of income tax payable. Accordingly, the relief is included with those that operate as tax reductions in section 26 of the Act, and section 539 of ITTOIA is itself amended to make the position clear.

Amended section 539 of ITTOIA adopts a step approach to the calculation of the reduction. Since the greatest reduction in tax is achieved by charging dividend income at the dividend ordinary rate instead of at the dividend upper rate (a reduction from 32.5% to 10%), *Step 1* allocates the deficiency as far as possible to dividend income chargeable at the upper rate. On the same basis *Step 2* deals with savings income charged at the higher rate (a reduction from 40% to 20%) and *Step 3* with other income (a reduction from 40% to 22%).

The treatment set out above does not apply to certain life annuity contracts made in the accounting period of an insurance company or friendly society beginning before 1 January 1992. In such a case the provisions of paragraph 109 of Schedule 2 to ITTOIA apply to treat the deficiency as an income deduction. That paragraph is itself consequentially amended by this Act to make the position clearer.

The opportunity has also been taken to introduce a claims requirement in line with other insurance related reliefs (see *Change 83*). In practice, box 12.9 of the Self Assessment return does require a claim to relief. The introduction of a formal claims requirement regularises this practice and provides a straightforward way of resolving disputes.

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

Change 4: Tax calculation: order in which tax reductions are allowed: sections 27 and 28

This change introduces the rule that where no priority is specified, tax reductions are allowed in the order that provides the greatest reduction in income tax liability for the year. In addition, the priority between two specific tax reductions is clarified.

In calculating liability to income tax, section 835(4) of ICTA provides that, subject to any express provisions, deductions from income are made in the order that produces the greatest reduction in tax. There is no corresponding provision regarding the order in which reductions that are given in terms of tax are allowed.

In many cases the order in which two or more tax reductions are made does not affect the liability, but in calculating the amount of some tax reductions it is necessary to establish which other reductions have already been taken into account. The new rule in sections 27(2) and 28(2) mirrors the rule on deductions in providing that, subject to any express provisions, tax reductions are made in the order that produces the lowest income tax liability for the year.

Some of the rules on particular tax reductions do provide an order of priority in relation to some other tax reductions. For example, from sections 256(3), 347B(5B) and 353(1H) of ICTA it can be seen that a reduction under section 353 is allowed before a reduction under section 347B and that reliefs under Chapter 1 of Part 7 of ICTA (personal reliefs) come after the other two.

There are in fact two distinct personal reliefs that operate as tax reductions and in practice it will always be beneficial for relief under section 273 of ICTA to be deducted before married couple's allowance because the latter is transferable. Accordingly, in setting out in section 27(5) those provisions that provide for a particular order, the reliefs under Chapter 1 of Part 7 have been separated with married couple's allowance to be given last.

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

Change 5: References to "officer of Revenue and Customs": sections 35, 36, 37, 38, 39, 45, 46, 47, 48, 49, 403, 459, 508, 538, 542, 551, 554, 557, 558, 561, 692, 695, 696, 697, 698, 703, 706, 707, 739, 743, 748, 751, 912, 915, 916, 931, 944 and 970, Schedule 1 (sections 256A and 256B of TCGA and section 102 of FA 2004) and Schedule 2 Part 15 (deduction by deposit-takers: discretionary or accumulation settlements)

This change replaces references to "the Board of Inland Revenue" (and one reference to "the Commissioners for Her Majesty's Revenue and Customs") in the source legislation with references to "an officer of Revenue and Customs".

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

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

Where the source legislation provides for a claim or election to be made to the Commissioners, this Act does not expressly state to whom such a claim or election is to be made. Where a return has been issued, section 42(2) of TMA requires the claim to be made in the return if possible and the return must be made to the officer who issued it. Similarly, where the claim is made outside a return, paragraph 2(1) of Schedule 1A to TMA requires the claim to be made to an officer.

Where a claim was formerly to the Commissioners, this change has a further consequence. Under section 46C of TMA (claims in a return) and paragraph 10 of Schedule 1A to TMA (claims outside a return), appeals concerning such claims are to the Special Commissioners. This contrasts with the rules in sections 31B to 31D of TMA under which, in most cases, a taxpayer may appeal to the General Commissioners or elect under section 31D to appeal to the Special Commissioners. The abolition of the requirement that a claim must be made to the Commissioners means that the rules in sections 31B to 31D will generally apply to appeals affected by this change. But in a few cases, especially where the issue is likely to be complex, appeals remain reserved to the Special Commissioners.

This Act also removes any unnecessary references to any claim or election being in a form specified by the Commissioners. In relation to a claim or election in a return section 113 of TMA provides that the return shall be in such form as the Commissioners prescribe. Paragraph 2(3) of Schedule 1A to TMA makes parallel provision in relation to claims and elections made outside returns.

Section 113 of, and Schedule 1A to, TMA do not apply to the form of certificates, notices etc. Where the source legislation provides that the Commissioners determine the form of such documents, this Act retains that approach, even though section 13 of CRCA means the work can be, and is, done by officers in practice. This is in order to indicate that such material is prescribed for HMRC as a whole.

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

In ITEPA and ITTOIA references to "an inspector" in the source legislation which were converted to "the Inland Revenue" (meaning any officer) were also identified as a change. But references to an inspector are treated by section 50(2) of CRCA as references to an

officer of Revenue and Customs. It follows that it is no longer appropriate to identify the conversion of such references as a change.

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

Change 6: Blind person's allowance: enactment of ESC A86: section 38

This change gives statutory effect to ESC A86.

For claimants in England and Wales, the blindness condition for entitlement to blind person's allowance under section 265 of ICTA is met where the claimant is on a register compiled by a local authority under section 29 of the National Assistance Act 1948.

ESC A86 states that:

> When a person becomes entitled to the blind person's allowance by being included on a register compiled under the National Assistance Act 1948 s 29, then he or she shall (subject to the normal time limits for claims) also be given the blind person's allowance for the previous year if, at the end of that previous year, he or she had already obtained the evidence of blindness (such as an ophthalmologist's certificate) upon which the registration was subsequently based.

To get the benefit of the concession, the individual must make a claim for the tax year preceding the year of registration. This requirement is preserved, so that a person who qualifies for relief under section 38(4) must make a claim for the tax year preceding the tax year in which he or she is first registered.

Section 38(4) gives effect to this concession.

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

Change 7: Personal reliefs: transfers between spouses or civil partners: sections 39, 47, 48, 49, 51, 52 and 53, Schedule 1 (sections 257BA, 257BB and 265 of ICTA) and Schedule 2 Part 4 (personal reliefs)

This change removes the ability of spouses or civil partners to transfer blind person's allowance or married couple's allowance between them, in certain circumstances in which one or both of them is non-UK resident.

For those who are entitled to blind person's allowance or married couple's allowance immediately before the Act comes into force, the change does not have effect until the start of the 2009-10 tax year.

Section 278 of ICTA provides that the various personal reliefs provided for by Chapter 1 of Part 7 of ICTA are not available to individuals who are non-UK resident unless they fall within one of the categories in section 278(2)(a) to (e).

The entitlement to relief of non-UK residents who fall within the categories in section 278(2)(b) to (e) is dealt with in the Act, by virtue of section 56(3). The entitlement of non-UK residents who fall only within section 278(2)(a) (which concerns Commonwealth citizens and EEA nationals) continues to be dealt with in Chapter 1 of Part 7 of ICTA.

In the case of blind person's allowance and married couple's allowance, there is provision in Chapter 1 of Part 7 of ICTA for the transfer of part of the allowance between spouses and civil partners in certain circumstances.

It will continue to be possible for these allowances to be transferred between spouses or civil partners, if both individuals qualify under section 56 or both qualify under section 278(2)(a). But it will no longer be possible for these allowances to be transferred from one spouse or civil partner to the other if one of them qualifies under section 56 and the other qualifies under section 278(2)(a).

This change is necessary to ensure that the provisions of the Act are fully compatible with the provisions of the Human Rights Act 1998. See the overview commentary on Part 3 of the Act and the explanation concerning the European Convention on Human Rights towards the end of the Explanatory Notes.

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

Change 8: Married couple's allowance: calculation of income threshold: section 58 and Schedule 1 (section 256A of ICTA)

This change corrects an omission in the amendments made by the Tax and Civil Partnership Regulations 2005 (SI 2005/3229).

Paragraph 52 of the Regulations inserted section 257AB of ICTA, which applies to marriages and civil partnerships entered into on or after 5 December 2005. Section 257A of ICTA continues to apply where the marriage took place before that date, unless an election is made for the new rules to apply.

The two provisions are intended to operate in the same way except that under the new provision it is the higher income spouse or civil partner rather than the husband who is entitled to claim. Both provisions apply only where at least one party to the marriage or civil partnership was born before 6 April 1935.

The amount of the married couple's allowance is reduced from its maximum level when the claimant's income exceeds a certain threshold. In this Act that threshold is called "adjusted net income" and is defined in section 58. A corresponding provision is inserted into ICTA by Schedule 1 to this Act to cater for claimants under that Act.

In calculating the claimant's income for this purpose, section 835(5) of ICTA provides that deductions under Chapter 1 of Part 7 of ICTA are not to be taken into for the purposes of section 257A(5). Section 835(5) should have been amended so that it applied also for the purposes of section 257AB(4), to keep the rules for the two provisions in step, but this was overlooked. This change corrects this, so that section 58 and section 256A of ICTA apply in the calculation of married couple's allowance for all marriages and civil partnerships whenever they were entered into.

It may be noted that corresponding changes were made to other legislation by adding references to section 257AB(4) to existing references to section 257A(5). Regulation 104 inserted such a reference in section 25(9A) FA 1990 and regulation 177 inserted such a reference in section 192(5) FA 2004. This reinforces the view that there was never any intention to have any difference in treatment as regards the measure of income between the two married couple's allowance provisions.

The change is taxpayer-adverse in that when calculating whether the taper applies to reduce entitlement to married couple's allowance under section 257AB, it is required that income is

determined before the deduction of personal allowance (and if appropriate blind person's allowance and certain life insurance related reliefs). But making this change will bring the law into line with what it was understood was being achieved when the Tax and Civil Partnership Regulations were made.

The change applies only to couples where the rules relating to marriages or civil partnerships entered into after 5 December 2005 apply, where one individual was born before 6 April 1935, and where the claimant's income is in the range of income to which the tapering rules in section 46(4) apply. The number of people potentially affected is considered likely to be small, as is the tax effect in any individual case.

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

Change 9: Trading losses: trades carried on "on a commercial basis": basis periods: sections 66 and 74 and Schedule 2 Part 5 (trade loss relief against general income and early trade losses relief)

This change amends the rule about when a trade must be carried on "on a commercial basis", if certain restrictions on loss relief are not to apply, so that it operates by reference to basis periods rather than years of assessment.

The source legislation is set out in terms of a requirement for the trade to be carried on "on a commercial basis throughout the year of assessment". And if there is a change in the basis on which it is carried on during the year, it is to be treated as being carried on throughout the year as it is carried on by the end of the year. But this does not fit well with the fact that profits and losses are determined by reference to basis periods.

The sections now state that the trade is commercial if it is carried on a commercial basis "throughout the basis period for the tax year" or, if there is a change during the basis period, "by the end of the basis period".

As a result of looking to basis periods, it is no longer necessary for these sections to cater for the possibility of the trade only being carried on for part of a tax year (since a trade cannot, by definition, be carried on for less than a complete basis period).

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

Change 10: Trading losses: trade leasing allowance given to individuals: alignment of individual's time commitment with period during which trade carried on: section 75 and Schedule 2 Part 5 (sideways relief: trade leasing allowances given to individuals)

This change eliminates an inconsistency that arose following the change from preceding year basis to current year basis of assessment introduced by FA 1994.

A mismatch exists between the requirement that, to benefit from a trade leasing allowance, an individual must carry on the trade giving rise to the trade leasing allowance throughout one defined period and that during a different defined period substantially all of the individual's time must be devoted to carrying on the trade.

For example, the accounts of the trade could show a loss for the year from 1 July 2003 to 30 June 2004. So the basis period would cover the same period. But the individual must carry on

the trade for a continuous period of at least six months in the tax year ending 5 April 2005 and substantially the whole of the individual's time throughout the year ending 5 April 2005 must be given to carrying on the trade.

The mismatch between these periods arose when individuals became taxable on a current year rather than preceding year basis. This change, introduced by FA 1994, also resulted in losses being determined for a tax year by reference to a basis period ending in that tax year, rather than the losses being those arising in the tax year itself.

Section 384(6) to (8) of ICTA deal with the restriction of set-off of leasing allowances against the general income of an individual. It addressed a concern that an individual could obtain an advantage by entering into a leasing activity in partnership simply to benefit from capital allowances, but not actually participate in the business, and then leave the partnership once the allowances had become available. The provision was designed to distinguish, in a broad way, between those activities, which were not commercially motivated, and those that were. It did this by looking at the taxpayer's degree of personal involvement in the leasing activities.

The provision was originally enacted as section 70 of FA 1980. The use of capital allowances on assets provided for leasing in the course of a trade was restricted such that the allowances could not be used to establish a loss available for set-off against general income unless, in accordance with section 70(1):

> (a) the trade is carried on by him for a continuous period of at least six months in, or beginning or ending in, the year of loss as defined in that section; and
>
> (b) he devotes substantially the whole of his time to carrying it on throughout that year or if it is set up or permanently discontinued (or both) in that year, for a continuous period of at least six months beginning or ending in that year.

The definition of "year of loss" was "any year of assessment" in respect of which a loss was sustained in any trade. Accordingly losses were looked at on a fiscal year basis, that is by looking at the loss actually sustained in the year from 6 April to the following 5 April. And the time commitment test was looked at for the same period.

But, when the preceding year basis of assessment was abolished by Chapter 4 of Part 4 of FA 1994, the "year of loss" provisions were amended by section 209(3) of that Act so that losses are computed for the same period as profits, in other words they are measured by reference to a basis period ending in a year of assessment. But the time commitment test was not updated. So an individual sufficiently involved in the business during a basis period, but not sufficiently involved during a year of assessment, will fail to meet the time commitment test. Equally, the reverse circumstances could occur.

Accordingly the drafting complexities and illogicality of looking at different periods for determining whether a loss relief should be available have been eliminated by aligning the periods. Both conditions should be satisfied by reference to the basis period rather than the tax year.

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

Change 11: Carry-forward of trading losses: business transferred to a company: deletion of rule specifying order in which loss is to be set off against sources of income: section 86

This change removes the rule in section 386(2) of ICTA.

Section 386 of ICTA, which is rewritten in section 86, is concerned with the case where an individual has accumulated losses from a trade which is incorporated, and where the individual later receives income from the company concerned. It makes provision for such losses to be set against such income.

Section 386(2) of ICTA specifies that losses should be set off against the income in a particular order, namely income that is taxed by assessment and then other income.

The rule dates from section 29 of FA 1927, at which time earned and unearned income were taxed at different rates. It does not fit with self-assessment and has no practical effect, since HMRC practice is to allow the taxpayer to make the set-off in the order that provides maximum benefit.

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

Change 12: Carry back of terminal losses: sections 89 and 90

This change makes it clear, in cases where a person makes a claim for terminal trade loss relief, that relief is to be used with other reliefs in a way that minimises the claimant's income tax liability.

The change also codifies current practice as regards the calculation of terminal loss relief under section 388(6) of ICTA.

Under section 388(1) of ICTA, a terminal loss is to be deducted from or set off against the profits charged to income tax for the year of assessment. It is not entirely clear what "charged" means in this context. For instance, whether it means income before or after the deduction of other reliefs. This change removes the concept of "charged" profits completely. So deductions for terminal trade loss relief will be made from profits in accordance with the rules set out in section 25, that is in the manner that minimises the claimant's income tax liability.

The change also makes it clear that:

1. the profit or loss of a "terminal loss period" (see section 90) is calculated by allocating profits or losses of periods of account to terminal loss periods;
2. any overlap profit available as a deduction from trading profits in the final tax year is to be deducted in calculating the loss (if any) of the part of the final 12 months of trading falling in the final tax year; and
3. in the case of partners, one looks to the partner's share of the profit or loss of the actual trade for the periods of account in question.

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

Change 13: Trading losses given against capital gains: effect of provisions restricting relief: sections 95, 104, 107, 109, 110, 113, 115 and 792 and Schedule 2 Part 5 (reliefs for limited and non-active partners and for members of LLPs not to exceed contribution to the firm or LLP and members of LLPs and non-active partners: carry forward of losses)

This change provides that for limited partners etc:

- restrictions on using a trading loss against other income apply equally to treating the trading loss as a capital loss; and
- a trading loss used as a capital loss is accordingly treated in relation to those restrictions in the same way as if it had been used against other income.

The amount that may be treated as a capital loss

Section 72 of FA 1991 permits a trading loss to be treated as a capital loss to the extent that there is insufficient income against which to set off the trading loss in a claim under section 380 of ICTA.

Section 72 restricts the amount of a trading loss capable of being treated as a capital loss, to the:

> amount …which is available for relief under [section 380].

This means that any restriction set on relief under section 380 is also set on relief under section 72.

For an individual who is a limited partner at some time during a tax year section 117(1) of ICTA sets a restriction on the amount of a trading loss that can be set off under section 380 against the individual's income for a tax year.

The restriction is that the loss can only be set against:

(a) income (if any) from the trade concerned, or

(b) other income up to an overall limit (L) calculated in accordance with section 117.

Therefore, in the case of the individual who is a limited partner, the loss is "available for relief" under section 380 for the purpose only of being set against income of the trade concerned or otherwise up to L.

Applying this restriction to relief for the loss under section 72 results in that relief being subject to the overall limit of L as well.

The amount of any income from the trade concerned is ignored for this purpose. Any part of the loss that is outside L cannot be relieved under section 72, even if it could have been set against income from the trade but for some reason was not, eg, because other reliefs were set against the income. This approach is necessary to give full effect to the restriction that any part of the loss that is outside L can be used under section 380 only for the purpose of being set against income from the trade concerned.

It would be anomalous for section 72 to transform into a generally available capital loss any part of a trading loss which can only be set against income from the trade concerned.

The same considerations apply to section 72 in the case of restrictions on the use of trading losses under section 380 involving either members of limited liability partnerships (section 117 of ICTA as applied by section 118ZB of ICTA) or non-active partners (section 118ZE of ICTA).

They also apply in the case of the restrictions set by sections 118ZL(1) (partnerships exploiting films) and 391 (losses from trade etc carried on abroad) of ICTA on the use of losses under section 380. These sections provide that certain trading losses can only be set against specified income. That is, the losses are "available for relief" under section 380 for the purpose only of being set against the specified income. Giving full effect to these restrictions results in no relief being available under section 72 for losses covered by them.

Sections 95(2), 104(3), 107(4), 110(3) and 115(3) now set out expressly the interaction between these restrictions on trade loss relief and the treating of trading losses as capital losses. Sections 109(1) and (3) and 113(1) and (4) and Schedule 2 Part 5 (members of LLPs and non-active partners: carry forward of losses) are consequential on the changes in sections 107 and 110.

The reliefs to take into account in deciding how much of a trading loss can be used against other income

For an individual who is a limited partner at some time during a tax year, section 117(1) of ICTA sets a limit on the amount of a trading loss that can be used under section 380 or 381 of ICTA against income (other than from the trade concerned). The limit for the tax year has regard to other relief given to the individual under section 380 of 381 for losses from the trade (see section 117(1) and the definition of "aggregate amount" in section 117(2)).

If relief for a trading loss cannot be fully given in a claim under section 380 of ICTA, part of the trading loss may be relieved by treating it as a capital loss under section 72 of FA 1991.

The definition of "aggregate amount" in section 117(2) of ICTA refers to relief given under section 380 of ICTA but it does not expressly mention relief given under section 72 of FA 1991 (which as noted in the previous paragraph is given for amounts that would have been relieved under a section 380 claim if sufficient income had been available).

Practice has been to treat the definition's reference to amounts of relief given under section 380 of ICTA as encompassing relief given under section 72 of FA 1991.

Section 74 of FA 2005 seems to assume that this practice is correct (see, in particular, subsection (5) of that section).

Further, section 78 of FA 2005 amended the definition of "aggregate amount" so that the amount of any "reclaimed relief" is deducted as part of the process of arriving at the aggregate amount. Losses that have been claimed under section 72 of FA 1991 may contribute to the amount of any "reclaimed relief".

Again, this seems to assume that the practice referred to above is correct. It would be anomalous to deduct an amount X, computed with reference to section 72 of FA 1991, from an amount Y, computed entirely independently of section 72 of FA 1991.

The same considerations apply in the case of limits on the use of trading losses involving members of limited liability partnerships (section 117 of ICTA as applied by section 118ZB of ICTA) or non-active partners (section 118ZE of ICTA).

The practice of treating the reference to section 380 of ICTA in the definition of "the aggregate amount" as extending to section 72 of FA 1991 has been made explicit in sections 104(5), 107(6), and 110(5) and in Schedule 2 Part 5 (reliefs for limited and non-active partners and for members of LLPs not to exceed contribution to the firm or LLP).

The conditions for recovery of excess relief

The conditions for excess relief to be recovered under section 74 of FA 2005 are set out in section 74(1). Section 74(1)(a) refers to relief being claimed in respect of a relevant loss under section 380 or 381 of ICTA. Section 74(1)(b) refers to any of that relief being claimed against income other than from the relevant trade.

In a tax year for which there is no income against which to offset a trading loss under section 380 of ICTA, relief may be given under section 72 of FA 1991 by treating the trading losses as capital losses (see *Change 160* which makes explicit provision for such cases). In such a case it is arguable the condition in section 74(1)(b) of FA 2005 would not be met.

Such a case is unlikely to arise often in practice, if at all. And section 74 of FA 2005 clearly contemplates recovering relief that has been claimed under section 72 of FA 1991 (see section 74(4) and (5) and section 75 of FA 2005).

Section 792(2) permits relief to be recovered even if the relief in respect of a relevant loss consists wholly of treating the trading loss as a capital loss.

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

Change 14: Post-cessation expenditure: meaning of qualifying event: definition of statutory insolvency arrangement: section 98

This change replaces the term "relevant arrangement or compromise (within the meaning of section 74 of ICTA)" in section 109A(4) of ICTA with the term "statutory insolvency arrangement", which is defined in section 259 of ITTOIA.

Before the enactment of ITTOIA, a trading deduction for bad and doubtful debts was denied, for the purposes of both income tax and corporation tax, by section 74(1)(j) of ICTA, except in the circumstances covered in paragraph (j)(i) to (iii). Section 74(1)(j)(ii) of ICTA then allowed a deduction for a debt or part of a debt released as part of a relevant arrangement or compromise. Section 74(2) of ICTA defined this term.

Section 35 of ITTOIA introduced an income tax provision for bad and doubtful debts that uses a new term "statutory insolvency arrangement", defined in section 259 of ITTOIA. But the provision in section 109A of ICTA dealing with relief for post-cessation expenditure was not amended to incorporate the new term. This change corrects the position.

The effect of the change is, broadly, to allow claims for unpaid debts released under arrangements or compromises of a kind corresponding to those covered within the meaning of the former definition, but taking effect under or by virtue of the law of a country or

territory outside the United Kingdom. This broadens the scope for taxpayers to make claims and is therefore taxpayer-favourable.

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

Change 15: Trading losses: restrictions: determination of contribution to the firm: sections 104, 107, 110 and 113

This change streamlines the process of calculating an individual's contribution to the firm by specifying that it is to be determined at the end of a basis period rather than the end of a tax year.

Section 117 of ICTA specifies that the restriction on the amount of sideways relief which may be given to an individual for a loss sustained in a trade must not exceed the amount of the contribution (to the trade) at the "appropriate time". This time is defined (broadly) as the end of the tax year in which the loss is sustained or for which the loss is allowed.

The loss itself is of course calculated for the basis period for the tax year. And it is simpler for the contribution to be calculated on the same basis. Especially as the end of the basis period will correspond with the end of a period of account, so making it easier for the individual to determine the part of the contribution represented by (undrawn) profits. The end of a tax year may not so correspond, making it more difficult to determine profits, and perhaps requiring the individual to wait until the accounts for any overlapping period of account have been prepared.

This change is in principle and in practice adverse to some taxpayers and favourable to others. It also affects when tax is paid and administrative requirements. But the numbers affected are expected to be few and the amounts involved small.

Change 16: Trading losses: restrictions: contribution to the firm in place of contribution to the trade: sections 104, 105, 106, 107, 108, 110, 111, 114, 792, 793, 794, 797, 800, 801, 802, 803, Schedule 2 Part 5 (restriction on reliefs for non-active partners: pre-10 February 2004 events and application of existing regulations under sections 114 and 802) and Schedule 2 Part 14 (individuals in partnership: recovery of excess relief and individuals claiming relief for film-related trading losses)

This change provides for certain restrictions (and related anti-avoidance provisions) on the use of trade losses, incurred by individuals in a partnership, to operate by reference to the individual's contribution to the firm (rather than contribution to the trade, as in source legislation). It also deals with a number of consequential matters and clarifies a number of points about what is included in an individual's contribution.

Contribution to the firm

For individuals who are members of limited liability partnerships (LLPs), the source legislation restricts sideways or capital gains relief for trading losses by reference to the individual's *contribution to the limited liability partnership* (see section 118ZC(2) and (3) of ICTA).

By contrast, for individuals who are limited partners or non-active partners (who are not also members of LLPs), the source legislation restricts sideways or capital gains relief for trading

losses by reference to the individual's *contribution to the trade* (see sections 117(3)(a) and 118ZG(2) and (3) of ICTA).

But partnership law is more likely to look at capital contributed to the partnership (referred to in the relevant sections of the Act as the firm), rather than to capital contributed to a trade that the partnership carries on. For instance, a person might become a limited partner in a partnership formed under the Limited Partnership Act 1907 (LPA). Under section 4(2) of the LPA the person, at the time of entering into the partnership, contributes a sum or sums as capital (or property valued at a stated amount). The LPA does not prevent further amounts being contributed at a later date. But the intention of the LPA is that the contribution is to the firm, not the trade. The firm uses the capital contributed to fund its various activities – be that one trade or more than one trade and any investments etc that the firm might hold. And the individual has limited liability for the debts and obligations of the firm, rather than just for the debts and obligations of any trade that the firm happens to carry on.

The Act reflects this by providing that sideways or capital gains relief restrictions on trade losses (and related anti-avoidance provisions) operate in relation to an individual's "contribution to the firm" rather than "contribution to the trade". This is, in principle, taxpayer-favourable as it may allow sideways relief or capital gains relief to be obtained by reference to a larger amount than would otherwise be the case. See sections 104(4), 105(2), (4) and (6), 106(4), 110(4), 111(2) and (4) to (6), 792(3), (4), (7) and (8), 793(2) and (4), 794(4), 797(2) and (5) and 801(2), (3) and (8) and Schedule 2 Part 14 (individuals in partnership: recovery of excess relief and individuals claiming relief for film-related trading losses).

Firm carries on more than one trade

Some consequential changes have been made to cater for the possibility that a firm might carry on more than one trade.

If a firm carries on only one trade, the restriction of sideways or capital gains relief for trade losses by reference to the contribution to the firm means that the individual can get such relief for losses up to the amount at risk, and no more. But if the firm carries on more than one trade, restricting sideways or capital gains relief for trade losses in each trade by reference to the contribution to the firm might result in the individual getting such relief for more than the amount at risk. Clearly the source legislation does not allow this in the case of limited partners and non-active partners (who are not also members of LLPs) as it restricts sideways or capital gains relief for trade losses by reference to the amount of capital contributed to each trade.

So in the case of limited partners and non-active partners (who are not also members of LLPs) the Act restricts the total sideways or capital gains relief available in respect of losses from all trades carried on by the firm to the amount that the individual has at risk.

As noted earlier, for LLPs a member's contribution is already in terms of the contribution to the LLP. But the source legislation does not explicitly deal with the possibility that an LLP might carry on more than one trade. Therefore to ensure that a consistent policy is applied throughout the sections (ie the relief available is restricted to the amount at risk), the restriction mentioned in the preceding paragraph has been explicitly applied in relation to members of LLPs as well. This is in principle taxpayer-adverse in the case of members of

LLPs. See sections 104(7), 105(10), 107(8), 110(7), 111(10), 792(6), 794(6), 800(9) and (10) and 803(4) and Schedule 2 Part 5 (restriction on relief for non-active partners: pre-10 February 2004 events).

Powers to make regulation in relation to contributions and regulations already made

In the case of firms (not LLPs) the powers, in section 118ZN of ICTA and section 122A of FA 2004, are to make provisions excluding amounts from an individual's contribution to the trade. Consequent on the move to "contribution to the firm", this Act provides powers that operate in relation to an individual's contribution to the firm.

The Act also treats regulations made under the powers in section 118ZN of ICTA and section 122A of FA 2004 as having been made, with suitable modifications, under corresponding powers in this Act. See sections 114(1), 802(2), Schedule 2 Part 5 (application of existing regulations under sections 114 and 802) and Schedule 2 Part 14 (individuals claiming for film-related trading losses).

Contribution to an LLP

The source legislation provides that the contribution to an LLP is the greater of the amount which the individual has contributed to it as capital (so far as it is not recoverable) and the amount of the individual's liability on a winding up (see section 118ZC(2) of ICTA).

But the total amount the individual has at risk in an LLP is, in principle, the sum of what has been contributed as capital to the LLP and the additional amount that the individual could be called on to meet in a winding up of the LLP.

The Act provides that an individual's contribution to a LLP takes account of the total amount at risk, namely any amounts contributed as capital to the LLP and any further amounts for which the individual is liable on a winding up. See section 108(7).

Profits or losses in accordance with generally accepted accounting practice

The Act provides explicitly, where source legislation does not, instances where a reference to profits or losses means amounts calculated in accordance with generally accepted accounting practice. See sections 105, 108(4) and 111(9).

Capitalised profits

The Act also explicitly provides that capitalised undrawn profits are included in an individual's contribution. See sections 105(3), 108(3), 111(3) and 801(4) and (5).

Contributions to a firm — trading profits not drawn

The Act also provides that an individual's share of trading profits, taken into account in determining the individual's contribution to the firm, is calculated by looking at periods where such profits were made, and ignoring trading losses in other periods. The source legislation does not contain an equivalent provision. The effect is broadly to determine an individual's share of undrawn trading profits as the amount that the individual would have received if such profits had been distributed fully on a period by period basis. See sections 105(8) and 111(8).

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

Change 17: Trading losses: restrictions: withdrawal of capital ignored where amounts charged to tax as profits of a trade: sections 105 and 108

This change brings the position of limited partners and active members of limited liability partnerships (LLPs) into line with that of non-active partners in relation to the treatment of amounts of capital withdrawn in the context of determining an individual's contribution to the firm.

It is possible that amounts of capital withdrawn may be regarded for tax purposes as profits charged to tax as profits of a trade. In these circumstances it is inequitable to restrict loss relief by reference to those amounts. Indeed section 118ZG(5) of ICTA (as inserted by section 124 of FA 2004) operates in relation to non-active partners to ensure that such amounts are not taken into account to restrict loss relief.

This change extends that rule to limited partners and members of LLPs generally.

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

Change 18: Employment losses: claims for set-off of losses made by an office holder against general income: section 128

This change extends the scope of the relief for employment losses to include office holders as well as employees.

Section 380 of ICTA provides for losses sustained by a person in any trade, profession, vocation or employment to be set off against that person's general income. It makes no mention of losses sustained by an office holder, but in practice HMRC accept a claim for the set-off of such a loss.

An employment loss might arise if an employee is remunerated (in whole or in part) by way of a share in the profit or loss of his employer, or if the employee is entitled to capital allowances that exceed earnings.

In the former case, HMRC accept that a loss can arise if an employee is obliged, under the terms of his employment, to make a payment to his employer that exceeds his income. For example, someone paid commission on sales might be obliged to guarantee his employer against bad debts and the guarantee payment could exceed the commission in any given year.

The reason for employment being included in section 380 of ICTA appears to have been that certain employments (which included certain offices), like trades, were originally taxed under Schedule D, so the loss provisions which applied to trades applied to those employments (and offices). Almost all employments were taxed under Schedule E following the transfer from Schedule D to Schedule E brought about by section 18 of FA 1922, but the inclusion of the word "employment" in the loss provision was never amended.

In fact, HMRC took the view as long ago as 1925 that the transfer of offices and employments to Schedule E should not deprive the taxpayer of any benefits enjoyed under Schedule D. Accordingly, and despite the wording of section 380(1) of ICTA, loss relief is in practice available to office holders as well as to employees.

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

Change 19: Employment losses: disapplication of restriction of set-off of capital allowances against general income: section 128

This change disapplies a potential restriction on the ability of an employee to set off part of a loss attributable to first-year allowances. The restriction was designed to apply to trades rather than employments and is extremely unlikely to apply to employments.

Section 384A of ICTA is an anti-avoidance section dealing with the restriction in certain circumstances of the ability of an individual to set off part of a loss attributable to first-year allowances against general income. It was designed to counter contrived arrangements under which higher rate taxpayers were able to reduce their tax liabilities by entering into partnerships with a corporate member.

The provision was originally enacted as section 41 of FA 1976. The particular scheme that the provision was designed to counter operated as follows. An individual or individuals liable to income tax at the higher rates would enter into a partnership, which would include a corporate member. The partnership would acquire machinery or plant, which was then leased out. The partnership would be entitled to first-year allowances, which would be shared between the individual members for offset against general income taxable at high rates. But income received from the leasing activity would be allocated to the corporate member and be taxed at the much lower corporate rate. Therefore an advantage was obtained because of the mismatch between the rates at which income was taxed and first-year allowances were relieved.

The provision was drafted to counter not only this scheme but also other possible arrangements. Section 41(1) of FA 1976 (which gave rise to section 384A(2) of ICTA, rewritten in section 77) fulfilled the function of dealing with the identified scheme, while section 41(2) of FA 1976 (which gave rise to section 384A(4) of ICTA, rewritten in section 78) was designed as a blanket provision to counter future schemes. It operated by denying loss relief if an individual entered into a scheme with the sole or main benefit of obtaining a reduction in tax by way of first-year allowances made in connection with the transfer of a trade or an asset in certain circumstances.

It is clear that what is now section 384A(4) of ICTA was drafted to catch schemes or arrangements involving transfers of trades or assets being made to create artificial benefits to traders. But one part of it, section 41(2)(a)(ii) of FA 1976 (now section 384A(4)(b) of ICTA), could also potentially catch a transfer of an asset by an employee. But this is simply because the loss provisions apply across trades, professions, vocations and employments.

The ability of an employee to acquire an asset qualifying as machinery or plant in respect of which first-year allowances are available is limited, given the wholly, exclusively and necessarily rule that ensures that only assets necessary for carrying out the duties of the employment can qualify. There is, therefore, very little potential for an employee to enter into a scheme for the reduction of a liability to tax by acquiring an asset which enables a claim for first-year allowances (which can be set off against employment income) to create a loss.

So, in the context of rewriting the loss provisions for employments separately from those for trades, professions and vocations, this provision has not been rewritten for the purposes of the employment loss provisions.

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

Change 20: Share loss relief and community investment tax relief: omit the words "for full consideration": sections 131 and 361

This change deletes the words "for full consideration" which qualify "by way of a bargain made at arm's length". It removes words which are not in practice applied to impose any additional requirement and creates consistency, for individuals, between the provisions relating to withdrawal or reduction of EIS relief, VCT relief and CITR.

There are three places in the Tax Acts where the words "by way of a bargain made at arm's length" are qualified by the words "for full consideration". These are:

for both income tax and corporation tax:

- section 575(1)(a) of ICTA (relief for losses on unquoted shares in trading companies); and
- paragraph 29(4)(a) of Schedule 16 to FA 2002 (community investment tax relief);

and for corporation tax only:

- paragraph 46(2)(a) of Schedule 15 to FA 2000 (the corporate venturing scheme).

Paragraph 46(2)(a) of Schedule 15 to FA 2000 is also applied for the purposes of paragraph 67 of that Schedule by paragraph 67(3).

Section 575(1)(a) of ICTA and paragraph 67 of Schedule 15 to FA 2000 are concerned with the circumstances in which an allowable loss incurred on a disposal of shares may be claimed as a relief in calculating taxable income for income tax or corporation tax purposes.

The phrase "for full consideration" has not caused practical difficulty in relation to claims for relief by individuals under section 574 of ICTA or by companies under section 573 of that Act or paragraph 67 of Schedule 15 to FA 2000.

Case law (Berry v Warnett (1982), 55 TC 92 HL[3] and Bullivant Holdings Limited v CIR (1998), 71 TC 22 ChD[4]) confirms that a bargain may be made at arm's length if a full and fair price is paid. Whether the price is full and fair is to be determined by reference to the circumstances of the disposal and it is clear that the price paid may be full and fair notwithstanding that it is substantially below open market value.

If the words "for full consideration" mean no more than that a full and fair price is paid in the circumstances of the disposal, the words are otiose. If they have independent meaning, this may require that the price paid is not less than market value, if market value is greater than the amount which is a full and fair price in the circumstances of the disposal. But in practice no such requirement is imposed.

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[3] [1982] STC 396

[4] [1998] STC 905

Accordingly the words "for full consideration" have been omitted from section 131(3)(a) in rewriting section 575(1) of ICTA for income tax purposes.

Paragraph 29 of Schedule 16 to FA 2002 and paragraph 46 of Schedule 15 to FA 2000 are concerned with the withdrawal or reduction of tax relief previously obtained. These paragraphs contrast with the only other provisions in the Tax Acts dealing with the withdrawal or reduction of investment reliefs. In those provisions, the words "by way of a bargain made at arm's length" appear without any qualification.

The provisions in the source legislation and the sections where they are rewritten in this Act are:

- section 299(1)(a) and (b) of ICTA (withdrawal or reduction of EIS relief), rewritten as section 209(2) and (3); and
- paragraph 3(2) and (3) of Schedule 15B to ICTA (withdrawal or reduction of VCT relief), rewritten as section 266(2)and (3).

In practice, the provisions for the withdrawal or reduction of CITR are operated on the same basis as the similar provisions relating to EIS relief and VCT relief - see paragraph 7020 of HMRC's Community Investment Tax Relief Manual (CITM 7020). Omitting the words "for full consideration" from section 361(4)(a) brings the text of all three rewritten income tax provisions into line.

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

Change 21: Share loss relief: transfer of shares between spouses or civil partners: effect of earlier application of section 135(3) or (4): section 135

This change introduces into section 135(3)(a) a reference to A being treated under section 135(3) or (4) as having subscribed for the shares, in order to deal explicitly with cases of the issue of corresponding bonus shares and sequential transfers of shares between spouses or civil partners.

The cases in question are those involving:

- corresponding bonus shares which are treated under section 135(4) as having been subscribed for by A in consideration of money or money's worth (see *Change 23*); and
- shares which have been subscribed for by an individual in consideration of money or money's worth and which are treated as subscribed for by A as a result of the operation of section 135(3) on a previous transfer to A by that individual at a time when that individual was A's spouse or civil partner (whether that individual is B or another).

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

Change 22: Share loss relief: transfer of shares between spouses or civil partners: time at which spouses or civil partners are living together: section 135

This change makes it explicit that, if shares are transferred between spouses or civil partners, they must be living together at the time of the transfer but need not have been spouses or civil partners at the time of the subscription for the shares.

Section 574(3)(b) of ICTA provides that:

> an individual shall be treated as having subscribed for shares if his spouse or civil partner did so and transferred them to him by a transaction inter vivos.

Section 576(5) of ICTA provides that:

> "civil partner" refers to one of two civil partners who are living together (construed in accordance with section 282)
>
> "spouse" refers to one of two spouses who are living together (construed in accordance with section 282)

Section 574(3)(b) of ICTA does not provide explicitly that the only time relevant for the purpose of determining whether the transferor and transferee are living together is the time of the transfer. In practice, however, this is how it has been applied.

Section 135(3)(c) (read with the definitions of "spouse" and "civil partner" in section 151(1)) makes this explicit. Section 1011, which rewrites section 282 of ICTA, explains the meaning of "living together".

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

Change 23: Share loss relief: corresponding bonus shares: sections 135 and 151

This change legislates the practice that corresponding bonus shares are qualifying shares for share loss relief.

When shares are issued by way of bonus, they are not issued for consideration. Bonus shares do not, therefore, meet the requirements of section 574(3)(a) of ICTA (rewritten as section 135(2) of this Act) that the individual has subscribed for the shares in consideration of money or money's worth.

In practice, where ordinary shares in the same company, of the same class and carrying the same rights as shares for which an individual has subscribed are issued by way of bonus, claims for relief on the disposal of the shares issued by way of bonus are accepted.

Accordingly, section 135(4) provides that, where an individual who has subscribed in consideration of money or money's worth for shares in a qualifying trading company is issued with bonus shares in that company which are of the same class and carry the same rights (corresponding bonus shares), the individual is treated as having also subscribed for the corresponding bonus shares in consideration of money or money's worth.

This means that the corresponding bonus shares are shares which have been subscribed for by the individual for the purposes of section 131(2)(b).

The definitions of bonus shares and corresponding bonus shares are in section 151(1) and (2).

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

Change 24: Share loss relief: resolution of conflicting provisions: sections 136 and 145 and Schedule 2 Part 6 (disposals of new shares and relief after an exchange of shares for shares in another company)

This change makes clear that the provisions of section 136 do not apply to an exchange of shares to which section 145 applies. It resolves an apparent conflict between section 304A of ICTA, rewritten in sections 145 and 146, and section 575(2) of ICTA, rewritten in section 136, which arises from the way in which section 575(2) of that Act achieves its purpose.

Section 575(2) of ICTA is an anti-avoidance provision. Its purpose is to prevent a person from obtaining share loss relief by swapping shares in a company (Oldco) that are not capable of being qualifying shares for shares in another company (Newco), except to the extent that the person gives additional consideration for the shares in Newco. For example, the shares in Oldco may not be capable of being qualifying shares because they were purchased from another shareholder. This provision has existed since the introduction of share loss relief in 1980.

Section 304A of ICTA was first applied for the purposes of share loss relief as part of the changes to the meaning of "qualifying trading company" made by FA 1998. It deals with the continuity of the requirements to be met by Newco following an exchange of shares in Oldco for shares in Newco without change of ownership.

Section 575(2) of ICTA applies to the issue of ordinary shares ("new shares") by Newco in an exchange or scheme of reconstruction within section 135 or 136 of TCGA relating to shares ("old shares") in Oldco. The new shares are in these circumstances "issued in consideration of … money's worth", that is the transfer or cancellation of the old shares. Accordingly, if Newco is a qualifying trading company, the new shares will be capable of being qualifying shares (see section 574(3)(a) of ICTA rewritten in section 135(2) of this Act). This is the case whether or not the old shares are capable of being qualifying shares.

Section 575(2)(a) of ICTA operates to prevent share loss relief being obtained on the disposal of the new shares where the old shares were not themselves capable of being qualifying shares by requiring the following assumptions to be made:

- first, that section 127 of TCGA does not apply to the exchange or scheme of reconstruction, so that there is a disposal of the old shares for the purposes of capital gains tax; and
- second, that on that assumed disposal an allowable loss would have been incurred for those purposes.

Section 575(2)(a) of ICTA then requires that share loss relief would have been obtainable on the assumed disposal on the basis that it was a disposal by way of a bargain made at arm's length. This is a consequence of the express reference in section 575(2)(a) of ICTA to the individual incurring an allowable loss "in disposing of [the old shares] as mentioned in subsection (1)(a) above". Section 575(1) of ICTA sets out the categories of disposal in respect of which a claim for share loss relief may be made, including in paragraph (a) a disposal "by way of a bargain made at arm's length for full consideration". This requirement is rewritten in section 131(3)(a). See the commentary on section 131 and *Change 20*.

Unless, on the assumptions described, share loss relief would have been obtained on the assumed disposal of the old shares, share loss relief may not be obtained on the disposal of the new shares, except to that extent that any "new consideration" has been given for the new shares (see section 575(2)(b) of ICTA rewritten in section 136(4) and (5)).

Section 304A of ICTA is one of the provisions applied by section 576(4A) of that Act with modifications for the purposes of defining a qualifying trading company by reference to the requirements of section 293 of ICTA. Section 304A of ICTA has been rewritten with the required modifications in sections 145 and 146 (see the commentary on those sections and *Change 25*).

Section 304A of ICTA relates to an exchange of securities within section 135 of TCGA. The type of exchange to which section 304A of ICTA applies is one which involves no change of ultimate ownership. It typically occurs when a new holding company is placed above a previously loss making company as one of the steps in obviating difficulties arising under company law in relation to distributable profits.

The effect of section 304A of ICTA as modified and applied by section 576(4A) of that Act is that, if the exchange meets the requirements of section 304A(1) of ICTA, the requirements for Newco to be a qualifying trading company are to be applied as if Oldco and Newco were one and the same company in determining whether the new shares are capable of being qualifying shares. In particular, the unquoted status requirement in section 293(1A) of ICTA (rewritten in section 143) and the gross assets requirement in section 293(6A) of ICTA (rewritten in section 142) are to be met only in relation to Oldco at the time of issue of the old shares by Oldco.

But if the assumptions required by section 575(2)(a) of ICTA are to be applied to an exchange falling within section 304A(1) of that Act, the requirement that the assumed disposal arises by way of a bargain made at arm's length is unlikely to be capable of being met. This would prevent a claim for share loss relief on the disposal of the shares in Newco and make the application of section 304A of ICTA ineffective for the purposes of share loss relief.

This change resolves that apparent conflict by providing in section 145(3) that nothing in section 136(2) applies to an exchange falling within section 145(1).

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

Change 25: Share loss relief: removal of mandatory requirement for pre-clearance of share exchange: section 145, Schedule 1 (section 576J of ICTA) and Schedule 2 Part 6 (relief after an exchange of shares for shares in another company)

This change removes the requirement in section 304A(1)(f) of ICTA, as applied to sections 573 and 574 of that Act by section 576(4A) of that Act, that a clearance must have been obtained before section 304A of that Act can apply.

Section 304A(1)(f) of ICTA provides that:

> before the issue of the new shares the Board have, on the application of the new company or the old company, notified that company that the Board are satisfied that the exchange of shares-
>
> (i) will be effected for bona fide commercial reasons, and

(ii) will not form part of any such scheme or arrangements as are mentioned in section 137(1) of the 1992 Act.

Section 145(1)(e) of this Act and the new section 576J(1)(e) of ICTA introduced by Schedule 1 to this Act replace section 304A(1)(f) of ICTA with a requirement that:

> by virtue of section 127 of TCGA 1992 as applied by section 135(3) of that Act, the exchange of shares is not to be treated as involving a disposal of the old shares or an acquisition of the new shares.

These provisions also omit section 304A(8) of ICTA which applies section 138(2) of TCGA for the purposes of section 304A(1)(f) of ICTA.

The mandatory requirement contained in section 304A(1)(f) of ICTA for clearance to be obtained in advance of the issue of the new shares is necessary in the context of a provision which permits EIS income tax relief attributable to shares in a company to continue to be attributed to shares in a new holding company issued under an exchange of shares which meets the other requirements of that subsection.

Where EIS income tax relief is not attributable to the old shares, it is likely that in practice advance clearance will have been sought, and given, under section 138 of TCGA in advance of the exchange of shares. There may, however, be a minority of cases where such a clearance was not sought but, if it had been sought, would have been given. One case in which such a clearance might not have been sought is if no person held more than 5% of the shares in the old company (see section 137(2) of TCGA).

Paragraph 8(1) of Schedule 5B to TCGA which deals with EIS re-investment relief is in similar terms to section 304A(1) of ICTA with the exception of paragraph (f). That paragraph does not require there to be advance clearance but requires that the anti-avoidance provisions of section 137 of TCGA do not apply so as to prevent the no disposal treatment under section 127 of that Act applying to the old shares.

Section 145(1)(e) of this Act and the new section 576J(1)(e) of ICTA are in similar terms to paragraph 8(1) of Schedule 5B to TCGA, with the result that, in the minority of cases where an advance clearance under section 138 of TCGA has not been sought, share loss relief under Chapter 6 of Part 4 or relief under section 573 of ICTA is not denied solely because of the failure to have obtained such a clearance.

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

Change 26: Share loss relief: restrictions on the amount of relief available: section 147

This change refines and extends the provision in section 576(1) of ICTA which restricts the amount of share loss relief available in a case where qualifying shares forming part of a holding are disposed of.

Section 576(1) of ICTA provides that, if an individual disposes of qualifying shares forming part of a holding, the amount of relief must not exceed the sums which would be allowed as deductions in computing the allowable loss if the shares had not been part of the holding.

For capital gains tax purposes, where shares are pooled in a section 104 holding (see section 104 of TCGA) or a 1982 holding (see section 109 of TCGA), the total consideration given for all the shares in the pool is averaged across the shares. This means that, when there is a part disposal of shares out of the holding, a proportion of this consideration is deducted in

computing the chargeable gain pro-rata to the number of shares disposed of over the total number of shares in the pool. This may result in an allowable loss on the disposal of such shares being greater than it would have been if the shares had not been pooled.

This provision is designed to limit the share loss relief available in such cases to no more than what would have been the amount allowable as a deduction in calculating the loss if the shares had not been pooled. Ignoring incidental costs of acquisition and disposal, this will equate in most cases to the amount subscribed for the shares. It is a general rule, but is of special relevance to the case where some of the shares in the pool are not qualifying shares.

To cater for the abolition of pooling in relation to shares issued on or after 6 April 1998 and the changes in section 148 described in *Change 29*, section 147 refines the circumstances in which the provision applies. The circumstances are:

- where the qualifying shares disposed of form part of a section 104 holding or a 1982 holding at the time of the disposal or formed part of such a holding at any earlier time (subsections (1) and (2));
- where both qualifying shares and shares that are not capable of being qualifying shares are acquired on the same day and are treated by virtue of section 105(1)(a) of TCGA for the purposes of capital gains tax as acquired by a single transaction (subsections (3) and (4)); and
- where the qualifying shares in a company are treated by virtue of section 127 of TCGA for the purposes of capital gains tax as the same asset as other shares in the same company that are not capable of being qualifying shares or as debentures of the same company (subsections (5) and (6)).

The section has the following effects:

- Subsections (1) and (2) rewrite the provision in section 576(1) of ICTA with two changes.
- The first change is that subsection (2) only applies to shares which are pooled in a section 104 holding or a 1982 holding. It requires the allowable deductions for the qualifying shares to be re-calculated as if the qualifying shares did not form part of the section 104 holding or the 1982 holding. But it does not affect the calculation of the allowable deductions in any other way. For example, if there has been an issue of corresponding bonus shares in respect of original qualifying shares, the re-calculated allowable deductions will be apportioned in the usual way across the original shares and the corresponding bonus shares.
- The second change is that subsection (2) expressly applies if an individual disposes of all the shares in the section 104 holding or the 1982 holding and at some time those shares and other shares which have been disposed of earlier formed part of the same holding (see subsection (1)(b)(ii)). This deals with the effect on the pool allowable cost where the other shares were acquired at a different price from that of the shares now being disposed of. It is a clarification of the scope of the provision in section 576(1) of ICTA.
- Subsections (3) to (6) are new. They are limited to mixed holdings (see the commentary on section 148 and *Change 27*) and deal with the residual situations

where the cost of shares which are not within a section 104 holding or a 1982 holding are still averaged. The general provision in subsection (1) is not required for shares which do not form part of a pool. It is only in the case of shares in such a holding that acquisitions and disposals of other shares which at any time formed part of the holding will affect the allowable cost of the qualifying shares disposed of.

- Subsections (3) and (4) deal with the circumstances where the cost of qualifying shares and shares that are not capable of being qualifying shares acquired on the same day are subject to averaging.
- Subsections (5) and (6) ensure that the limit is calculated separately in relation to the qualifying shares in the case of a reorganisation, such as a rights issue, involving qualifying shares and shares that are not capable of being qualifying shares or debentures. In those circumstances, the allowable deductions by reference to which the limit is to be calculated in accordance with this subsection are likely to differ from the cost of acquisition of the qualifying shares calculated in accordance with section 129 of TCGA.

Subsection (8) explains what is meant by "shares that are not capable of being qualifying shares" for the purposes not only of this section but also section 148. See *Change 27* for a detailed explanation of why a mixed holding has been defined in terms of a holding which includes such shares. Subsection (9) extends this meaning for the purposes only of subsection (5) to cover re-organisations involving the issue of shares of a different class.

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

Change 27: Share loss relief: meaning of a mixed holding: section 148

This change substitutes for the meaning of a mixed holding in section 576(1) of ICTA a new definition of a mixed holding.

Section 576(1) of ICTA contains a rule for identifying shares disposed of by a person out of a holding which comprises:

(a) shares for which he has subscribed ("qualifying shares"); and

(b) shares which he has acquired otherwise than by subscription.

This distinction has remained unchanged since the introduction of this provision by section 37 of FA 1980. At that time and at the time of its consolidation in 1988 as section 576(1) of ICTA, the wording was adequate to distinguish between shares which would qualify for share loss relief and those which would not.

Following the changes to the definition of qualifying trading company made by FA 1998 and FA 2001, the fact that this is the distinction made by section 576(1) of ICTA has become less evident.

At the time of a disposal of shares to which EIS relief is not attributable from a holding, those or other shares in the holding may be known to be incapable of ever being qualifying shares, even though they were subscribed for. This can be because:

- the company failed to meet either the gross assets requirement or the unquoted status requirement at the time of issue of the shares; or

- the company has failed to meet the condition that it has carried on its business wholly or mainly in the United Kingdom in relation to the shares. If the failure in relation to those shares was only during a period that ended more than 12 months before other shares in the holding were issued, it will not cause the other shares to be incapable of being qualifying shares.

Section 148(1), accordingly, provides that a mixed holding is one which, at the time of the disposal in question, includes shares that are not capable of being qualifying shares and "other shares", that is shares which at that time may or may not qualify for relief on their disposal. Shares to which EIS relief is attributable will always be capable of being qualifying shares and so, for the purpose of determining whether there is a mixed holding, fall into the category of "other shares".

Shares that are not capable of being qualifying shares are defined in section 147(8) as not only shares to which EIS relief is not attributable acquired otherwise than by subscription, but also such shares in relation to which the gross assets requirement or the unquoted status requirement or the requirement as to the carrying on of business wholly or mainly in the United Kingdom has not been met.

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

Change 28: Share loss relief: identification of which shares are disposed of: section 148

This change legislates the practice that, if the identification rule in section 576(1) of ICTA identifies that some but not all of the qualifying shares in the mixed holding are disposed of, the rule is also applied to determine which of the qualifying shares are disposed of.

It is stated explicitly in section 148(2)(b) that the rule as amended by *Change 27* so applies.

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

Change 29: Share loss relief: identification of shares disposed of out of a mixed holding: section 148

This change expands and clarifies the rules for identifying the shares disposed of, in cases where an individual disposes of some only of the shares in a mixed holding. As to what constitutes a mixed holding, see *Change 27*.

Section 576(1) of ICTA sets out a general rule that, where shares are disposed of by an individual out of a mixed holding, the shares disposed of are to be identified on a last in first out (LIFO) basis.

This rule is modified by section 576(1A) and (1B) of ICTA in the case of a mixed holding which includes shares to which EIS income tax relief, EIS deferral relief or BES relief is attributable.

At the time of the introduction of this provision by section 37 of FA 1980 and of its consolidation in 1988 as section 576(1) of ICTA, share pooling applied generally for the purposes of capital gains tax. Under share pooling, shares of the same class acquired by the same person in the same capacity are regarded as indistinguishable parts of a single asset.

Thus, the consideration given for the shares in the pool is spread evenly across the shares and there is no need for capital gains tax purposes to identify the specific shares disposed of.

The LIFO identification rule is, therefore, necessary for the purposes of section 574(1) of ICTA to identify whether, on the disposal of some only of the shares out of a pool consisting partly of shares that are not capable of being qualifying shares, the shares disposed of are qualifying shares.

Share pooling continues for capital gains tax purposes in relation to shares acquired before 6 April 1998 (see sections 104 and 109 of TCGA), but from that date sections 105(2) and 106A of TCGA substitute rules for identifying shares disposed of as between shares acquired on different dates falling on or after 6 April 1998 and as between shares acquired on or after that date and shares acquired before that date.

In practice the rule in section 106A(6) of TCGA applies in the majority of cases. This provides that shares disposed of are to be identified with shares acquired at a later time, rather than with shares acquired at an earlier time. Shares acquired before 6 April 1998 remain pooled.

This is a LIFO rule and so, as regards shares acquired on or after 6 April 1998, does not differ from the rule in section 576(1) of ICTA.

Where all the shares have been acquired on or after 6 April 1998 by single acquisitions on different days, the capital gains tax rules in section 106A of TCGA serve, in practice, to identify the shares disposed of without need for recourse to the rules in section 576(1) of ICTA.

Section 105 of TCGA also contains rules in relation to shares acquired on the same day. Those rules are modified by section 105A of TCGA in relation to certain shares acquired on or after 6 April 2002. Section 105A is supplemented by section 105B of TCGA. In general, shares of the same class acquired by an individual on the same day are pooled.

In practice, if some but not all of the shares of the same class acquired on the same day are shares that are not capable of being qualifying shares and if some only of the shares acquired on that day are disposed of, the question whether and to what extent the shares disposed of are qualifying shares is determined for the purposes of section 574 of ICTA on a just and reasonable basis; normally pro rata to the number of shares acquired on that day.

In rewriting the rule in section 576(1) of ICTA, the approach taken in section 148 of this Act is that:

- so far as the rules in sections 105 to 105B and 106A of TCGA serve conclusively to identify whether and to what extent the shares disposed of out of a mixed holding are qualifying shares, those rules are explicitly applied (see subsections (3)(a)(i) and (4));
- so far as shares acquired on different days are treated as a single asset for capital gains tax purposes under section 104 of TCGA (a “section 104 holding”), the LIFO rule in section 576(1) of ICTA is applied separately to the shares in the section 104 holding (see subsections (3)(a)(ii) and (5)); and
- so far as shares acquired on different days are treated as a single asset for capital gains tax purposes under section 109 of TCGA (a “1982 holding”), the LIFO rule in section

576(1) of ICTA is applied separately to the shares in the 1982 holding (see subsections (3)(a)(ii) and (5)).

In a case where the mixed holding includes shares to which EIS income tax relief, EIS deferral relief or BES relief is attributable, subsections (3)(a), (4) and (5) are displaced by subsections (3)(b) and (6). Subject to the change described in *Change 30*, the rules applied by those subsections are the same as those applied by section 576(1A) and (1B) of ICTA.

So far as the preceding rules do not conclusively determine whether and to what extent the shares disposed of are qualifying shares, for example where some but not all of the shares of the same class acquired on the same day are shares that are not capable of being qualifying shares, subsection (7) states explicitly that the determination is to be made on a just and reasonable basis.

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

Change 30: Share loss relief: identification of shares disposed of where shares acquired on the same day include approved-scheme shares: section 149

This change ensures that the identification rules for the purposes of share loss relief follow the identification rules for the purposes of capital gains tax in cases to which section 105A of TCGA applies.

On a disposal of shares forming part of a mixed holding which includes shares to which EIS income tax relief, EIS deferral relief or BES relief is attributable, section 576(1B)(b) of ICTA applies the rules in section 299(6) to (6D) of that Act to determine whether and if so to what extent the shares disposed of are qualifying shares. These provisions have been rewritten in section 148(3)(b) and (6) of this Act as described in *Change 29*. Section 148(6)(b) and (c) apply the rules relating to holdings including shares to which EIS relief is attributable in section 299(6) to (6D) of ICTA and in section 246 of this Act which rewrites those subsections of ICTA in relation to shares issued on or after 6 April 2007.

Section 150A of TCGA applies where EIS income tax relief is attributable to any shares disposed of. Subsection (4) provides that:

> Any question as to—
>
> (a) which of any shares acquired by an individual at different times a disposal relates to, being shares to which relief is attributable, or
>
> (b) whether a disposal relates to shares to which relief is attributable or to other shares,
>
> shall for the purposes of capital gains tax be determined as for the purposes of section 299 of [ICTA]…

Section 299(6A) of ICTA provides that:

> Where shares of any class in a company have been acquired by an individual on the same day, any of those shares disposed of by him shall be treated for the purposes of this section as disposed of in the following order, namely—
>
> (a) first any to which neither relief under this Chapter nor deferral relief is attributable;
>
> (b) next any to which deferral relief, but not relief under this Chapter, is attributable;
>
> (c) next any to which relief under this Chapter, but not deferral relief, is attributable; and
>
> (d) finally any to which both relief under this Chapter and deferral relief are attributable;

and in this subsection and subsection (6C) below "deferral relief" has the same meaning as in Schedule 5B to the 1992 Act.

Section 105A(4)(b) of TCGA modifies section 299 of ICTA for the purposes of section 150A(4) of TCGA where an individual acquires shares of the same class, on the same day and in the same capacity ("relevant shares") and:

- some of the relevant shares are "approved-scheme shares" (as defined in section 105A(1)(b) of TCGA) and
- the relevant shares include shares to which EIS income tax relief or deferral relief is attributable.

The modification permits the individual to make an election, the principal effect of which is that the approved-scheme shares falling with any of paragraphs (a) to (d) of section 299(6A) of ICTA are treated for capital gains tax purposes as disposed of after the other relevant shares falling within the same paragraph.

The modification is not made to section 299 of ICTA for all purposes, as it is not necessary for the purpose of determining the amount of relief to be withdrawn or reduced.

By applying the rules in section 299(6) to (6D) of ICTA without applying the modification where appropriate, there may be cases where the shares identified as disposed of for the purposes of share loss relief are not, in whole or in part, the shares identified as disposed of for the purposes of capital gains tax. In that event, share loss relief will not be available in respect of any shares which are not treated as disposed of for capital gains tax purposes, as no allowable loss will have arisen in relation to those shares.

In order to avoid this mismatch and ensure that the identification rules for the purposes of share loss relief follow the identification rules for the purposes of capital gains tax, section 149(1) applies section 299 of ICTA and section 246 of this Act with the modification made by section 105A(4) of TCGA in a case falling within section 105A of that Act.

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

Change 31: Share loss relief: shares to which section 127 of TCGA applies: section 149

This change makes explicit the time at which, among others, corresponding bonus shares are treated as issued for the purposes of section 148. It is, in part, consequential on the inclusion of section 135(4) (see *Change 23*) which treats corresponding bonus shares as subscribed for by an individual.

The time at which such shares are treated as issued to or acquired by the individual claiming relief needs to be ascertained for a number of purposes. See section 150(3) and *Change 34*. The sections to which section 150(3) applies relate only to shares to which EIS relief is not attributable.

The time at which corresponding bonus shares are treated as issued to or acquired by the individual claiming relief also needs to be ascertained for the purpose of determining which shares are disposed of in accordance with the identification rules in section 576(1) to (1B) of ICTA, rewritten in section 148.

Section 149(2) has been included for this purpose. A different approach from that in section 150(3) has been adopted, as section 148 applies both to shares to which EIS relief is attributable and to those to which it is not.

Section 149(2) follows the wording in section 246(6) which applies to shares to which EIS relief is attributable issued on or after 6 April 2007. Section 246(6) is based on section 299(6D) of ICTA which applies to such shares issued before that date but not before 1 January 1994. Section 299(6D) of ICTA is in the same terms as section 299(4C) of ICTA which applies to shares issued before 1 January 1994 to which BES relief is attributable

Section 148(6) applies section 299(4C) or section 299(6D) of ICTA or section 246(6) of this Act if the mixed holding includes shares to which BES relief or EIS income tax relief or deferral relief is attributable. Section 149(2) ensures that the same provision also applies if the mixed holding does not contain any of such shares.

But sections 149(2) and 246(6) (and the equivalent provisions of ICTA) do not apply only to issues of corresponding bonus shares. They also apply to allotments of shares for payment, for example by way of rights, which meet the requirements of section 126(2)(a) of TCGA and to which section 127 of that Act applies.

This ensures that, if neither BES relief nor EIS income tax relief nor EIS deferral relief is attributable to the shares in the existing holding or the new shares, new shares issued by way of rights within section 126(2)(a) of TCGA are treated for the purposes of section 148 as acquired at the same time as the shares in the existing holding.

But if any such relief is attributable to the shares in the existing holding or to new shares allotted for payment, section 149(2) does not apply to the allotment. This is because TCGA provides that, if there is such an allotment for payment and any of such reliefs is attributable either to the shares in the existing holding or to the allotted shares, section 127 of that Act does not apply (see sections 150(9) and 150A(7) of and paragraph 7 of Schedule 5B to TCGA).

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

Change 32: Share loss relief: nominees and bare trustees: section 149

This change makes clear that, if shares of the same class are held as to some directly by the individual and as to the others by a nominee or bare trustee for the individual, all the shares are included in a single holding of the individual for the purposes of section 148.

An individual who has subscribed for shares may subsequently wish to transfer the shares into the name of a nominee or bare trustee for the individual. On a disposal of the shares on behalf of the individual by the nominee or bare trustee, the allowable loss for capital gains tax purposes and the entitlement to relief under section 574 of ICTA is that of the individual not that of the nominee or bare trustee.

Section 311 of ICTA (rewritten as section 250 of this Act) includes provisions equivalent to those in section 149(3). Section 311 of ICTA applies to shares to which EIS relief is attributable for the purposes of share loss relief, by virtue of section 305A of that Act. This change expressly also applies those provisions to shares to which EIS relief is not attributable.

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

Change 33: Share loss relief: time of issue of shares transferred between spouses or civil partners: section 150

This change inserts an explicit provision determining the time at which shares issued to an individual (A) and transferred to A's spouse or civil partner (B) are treated as issued to B.

Section 574(3)(b) of ICTA, which is rewritten as section 135(3) of this Act, treats shares subscribed for by A and transferred to B as having been subscribed for by B. See *Changes 21* and *22*.

The time at which such shares are treated as issued to B needs to be ascertained for the purposes of determining in relation to shares issued on or after 6 April 1998:

- the beginning of the period during which the company must carry on its business wholly or mainly in the United Kingdom (section 576(4)(c) of ICTA);
- the time at which the unquoted status requirement is to be met in accordance with section 293(1A) of ICTA as applied by section 576(4A) of that Act; and
- the time at which the gross assets requirement is to be met in accordance with section 293(6A) of ICTA as so applied.

Section 576(4)(c) of ICTA provides that the period begins one year before the shares in respect of which the relief is claimed are issued or, if later, the date of incorporation of the company. This links the beginning of the period to the date of issue of the shares to A.

In the other cases, no explicit link is made, but it is the practice, in those cases, also to treat the shares that are treated as subscribed for by B as having been issued to B at the time they were issued to A.

In order to provide an explicit link, section 150(2) applies for the purpose of determining:

- the beginning of the period during which the company must carry on its business wholly or mainly in the United Kingdom (section 134(5)(a));
- the time at which the gross assets test is to be conducted (section 142(1)(a) and (2)(a)); and
- the time at which the unquoted status requirement is to be met (section 143(1)).

As a consequence of the introduction of sections 145 and 146, it is necessary to determine the date on which the new shares are to be treated as having been issued for the purposes of section 146(2)(b). Accordingly, section 150(2) also applies for that purpose.

These changes are adverse to some taxpayers and favourable to others in principle. But they are expected to have no practical effect as they are in line with current practice.

Change 34: Share loss relief: time of issue of corresponding bonus shares: section 150

This change inserts an explicit provision determining the time at which corresponding bonus shares are treated as issued. It is consequential on the inclusion of section 135(4) (see *Change 23*) which treats corresponding bonus shares as subscribed for by an individual.

The time at which such shares are treated as issued to the individual claiming relief needs to be ascertained for the purposes of determining:

- the beginning of the period during which the company must carry on its business wholly or mainly in the United Kingdom (section 134(5)(a));
- the time at which the gross assets requirement is to be met (section 142(1)(a) and (2)(a));
- the time at which the unquoted status requirement is to be met (section 143(1)); and
- if section 145 applies, the time at which the new shares are to be treated as having been issued for the purposes of section 146(2)(b).

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

Change 35: Share loss relief: time of disposal: section 151

This change makes explicit the tax year in which the disposal is to be treated as occurring for the purpose of share loss relief.

The availability of share loss relief is dependent upon an allowable loss being incurred for capital gains tax purposes and this can only be incurred on a disposal within the meaning given in TCGA.

The provisions of TCGA which determine in which tax year a disposal occurs, including in particular section 28 of that Act, do not apply to sections 574 to 576 of ICTA. Share loss relief is given in practice for the tax year in which the disposal is made or treated as made for the purposes of capital gains tax in accordance with TCGA.

Section 151(8) contains explicit provision to this effect.

Although this change in principle affects the timing of relief and could be favourable to some taxpayers and adverse to others, it is entirely in line with current practice and so will have no practical effect.

Change 36: EIS: claim in respect of less than the total number of shares, on which claimant is eligible for EIS relief, in a single issue: sections 158, 201, 210, 218, 219, 220, 226, 227, 228 and 229

This change provides that, in relation to a single issue of shares, an individual may claim EIS relief in respect of fewer than the total number of shares in respect of which the individual is eligible for relief (see *Change 37* for cases where there is a cap on the EIS relief). The change also makes it clear what happens if there are multiple issues of shares.

There are consequential changes to deal with any recovery of relief in cases where an individual makes a restricted claim.

Section 289A of ICTA says:

> (1) Where an individual eligible for relief in respect of any amount subscribed for eligible shares makes a claim, then, subject to the following provisions of this Chapter, the amount of his liability for the year of assessment in which the shares were issued ("the current year") to income tax on his total income shall be the following amount.

(2) That amount is the amount to which he would be so liable apart from this section less whichever is the smaller of-

(a) an amount equal to tax at the lower rate for the current year on the amount or, as the case may be, the aggregate of the amounts subscribed for eligible shares issued in that year in respect of which he is eligible for relief, and

(b) the amount which reduces his liability to nil.

Those two subsections are silent on whether an individual, who is eligible for relief on more than one issue of shares, can claim relief in relation to one issue but not the other one (*multiple issues*). The subsections are also silent on whether, in relation to a single issue of shares, a restricted claim may be made (*restricted claims*).

Multiple issues

The provisions of section 306 of ICTA (claims) can operate to give different times from which an individual may claim relief in respect of separate issues of shares. From this (and other provisions) it seems clear, and is in line with HMRC practice, that an individual may claim relief in respect of one issue of shares but not another. The references in section 158(1) and (2) of this Act respectively to:

"the issue" and "and claims EIS relief"

make it clearer that relief can be claimed on one issue of shares but not another.

Restricted claims on a single issue of shares

There is no indication that other provisions of ICTA contemplate restricted claims.

In fact other provisions, such as section 289B(2)(b) of ICTA (attribution of relief to shares) appear to assume that restricted claims cannot be made. That is because the attribution of relief by section 289B(2)(b) between issues of shares on which relief is claimed is based on:

the amounts subscribed by the individual for each issue.

This attribution under section 289B(2)(b) of ICTA would give arbitrary results if a restricted claim were possible. It would be illogical to attribute relief between issues of shares on the basis of 100% of the claimant's subscriptions for each issue while calculating the relief itself by reference to different percentages of each subscription.

Also, under section 289B(3)(a), where an amount of any reduction of income tax is attributed to an issue of shares, ("the original issue"):

(a) a proportionate part of that amount shall be attributed to each share comprised in the original issue

So if for example there is a subscription for shares of £500,000 in 2006-07 which exceeds the maximum of £400,000 for which relief can be obtained and there is a disposal of £100,000 of this holding, the relief attributed to the shares disposed of will be one fifth of the relief obtained.

Whatever the position in ICTA there are good reasons for allowing restricted claims. There could be cases where an individual might reasonably wish to restrict such a claim (perhaps to ensure that the benefit of personal allowances is secured or to obtain the most favourable tax treatment for a part disposal of shares).

The references in section 158(1) of this Act to:

> all or some of the shares included in the issue

permit a restricted claim.

Consequentials of restricted claims

Consequential changes are made to sections 201(2), (3) and (4), 210(1), 218(2), 219(2), 220(1), 226(2), 227(2), 228(2) and 229(1) of this Act. Their intention is that recovery of relief operates correctly if a restricted claim has been made.

Thus section 201(2) refers to the amounts:

> claimed by the individual in respect of each issue.

The equivalent reference in section 289B(2) of ICTA is to the amounts:

> subscribed by the individual for each issue.

In addition section 201(3), rewriting section 289B(3)(a) of ICTA, states:

> If under this section an amount of any reduction of income tax is attributed to an issue of shares…. a proportionate part of that amount is attributed to each share in respect of which the claim is made.

An investor issued with shares of £500,000 in 2007-08, which exceeds the maximum of £400,000 on which relief can be obtained, can make a claim for relief on £400,000 worth of the shares. If there is a disposal of £100,000 of this holding, the identification rules in section 246(3) of this Act would apply.

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

Change 37: EIS: limit is on the amount of relief in a year: section 158

This change provides that the limit on EIS relief for a tax year is a limit on the amount by which the individual's income tax liability may be reduced. It is not a limit on the amount of subscriptions in respect of which the individual is eligible for relief, and which may be included in a claim, for the tax year.

Section 290(2) of ICTA says that for a tax year an individual shall:

> …not be eligible for relief… in respect of any amount… exceeding £400,000…

From those words it might be thought that an individual may not make a claim in respect of shares, whether relating to an issue by one company or several companies, for an amount in excess of £400,000.

Paragraphs 25430 and 26020 of HMRC's Venture Capital Schemes Manual show that this is not the practice. A claim may be made in respect of amounts over £400,000 but any income tax reduction is capped at £400,000 multiplied by the lower tax rate.

Other provisions that proceed on the basis that section 290(2) of ICTA caps the relief (rather than the amounts on which a claim may be made) also support this practice. Those provisions include section 299(4) of ICTA (although that provision also caters for cases where a claim has been made in respect of an amount below £400,000) and section 150A(3) of TCGA.

Section 158(2)(b) of this Act places a cap on the amount of entitlement to EIS relief rather than on the amount of subscriptions in respect of which claims may be made.

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

Change 38: EIS: individuals connected with issuing company: section 166

This change makes it explicit when the definition of an individual being connected with the issuing company applies.

Section 291(2) of ICTA applies the definition solely for section 291 of that Act. But the expressions in section 291A(5)(b)(i) of ICTA:

> [at time when he had never been] connected with the issuing company

and section 291B(5) of ICTA:

> that or any other individual who is a party to the arrangement is connected

also depend on whether an individual is connected with the issuing company (or is not connected with the issuing company).

It might be thought that sections 291A(5)(b)(i) and 291B(5) of ICTA use some alternative meaning of an individual being connected with the issuing company. But it is not obvious what alternative meaning would apply for these provisions or why any alternative is needed. Also section 312(2) of ICTA provides that the definition of "connected persons" in section 839 of ICTA, rewritten in section 993, does not apply to sections 291, 291A(1), (4) and (5) and 291B of ICTA. So there is a strong indication that the definition of "connected" in section 291 applies to sections 291A(5) and 291B(5).

Section 166(1) of this Act applies the definition of "connected with the issuing company" to Chapter 2 of Part 5 of this Act with the exception of section 168(4). This means that the definition of an individual being connected to the issuing company also applies to sections 169(3)(a) and 171 (deriving from sections 291A(5)(b)(i) and 291B(5) of ICTA respectively). Section 166(2) provides a signpost to section 257(2) of this Act which explains what definition of connection applies in section 168(4).

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

Change 39: EIS: clarification of the definition of related person in section 291A(2)(i) of ICTA: section 168

This change eliminates a possible ambiguity in section 291A(2)(i) of ICTA as to the subsidiaries referred to in that provision.

Section 291A(1) of ICTA provides that an individual is not connected with the issuing company in some cases. But section 291A(1) does not apply in some cases involving a related person of the issuing company.

Section 291A(2)(i) of ICTA includes in the definition of "related person" in relation to the issuing company (emphasis added):

> *any company* of which the individual or his associate is a director and *which is a subsidiary or a partner of the issuing company or of a subsidiary,…*

The emphasised words may be capable of being read as including both:

- a subsidiary of the issuing company; and

- a subsidiary of a subsidiary [of the issuing company].

Section 291A(6) of ICTA defines "subsidiary" purely in relation to the issuing company. That is an indication that the emphasised words do not extend as far as the second bullet point above. And policy and practice (see eg the guidance material in Venture Capital Schemes Manual paragraph 25060) has been to treat the emphasised words as not extending to a subsidiary of a subsidiary of the issuing company.

The words in section 168(4)(a)(i) of this Act:

> …subsidiary or partner of the issuing company, or a partner of a subsidiary of the issuing company

represent a change in accordance with this policy and practice.

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

Change 40: EIS: carrying on qualifying business activity for four months is a condition of eligibility for EIS relief rather than a condition for claiming it: section 176

This change makes the requirement, that the qualifying business activity is to be carried on for a certain minimum period, one of the conditions that must be met in order for an individual to be *eligible* for EIS relief. In ICTA the corresponding requirement is a condition that must be met in order for an individual to *claim* EIS relief.

Section 289(1) of ICTA contains a number of conditions that must be met in order for an individual to eligible for relief. The opening words of section 289(1) say that an individual:

> …is eligible for relief… if…

Section 289A(6) and (7) of ICTA then contains additional conditions that must be met before the individual may claim the relief for which that individual is eligible. Section 289A(6) says that a:

> …claim for relief … shall not be allowed unless….

This distinction in ICTA seems to be a legacy of the scheme in Chapter 2 of Part 4 of FA 1981 (relief for investment in new corporate trades) where:

- there had to be a new company;
- there had to be a new trade; and
- no claim could be made to the Inland Revenue (for it to give effect to the relief) until the tax year following that in which the shares were issued.

There is no reason for the enterprise investment scheme to split conditions between (a) those that must be met to be *eligible* for relief and (b) those that must be met to *claim* relief.

Section 176(1) of this Act removes this split by making the requirement, that the qualifying business activity be carried on for a certain minimum period, an additional condition of eligibility for EIS relief. Section 202(1)(a) (time for making claims for EIS relief) preserves the position that claims may not be made until the qualifying business activity has been carried on for the required period.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 41: EIS, VCT and share loss relief: research and development (R&D) benefiting qualifying trade of a group company: sections 137, 179, 181, 290 and 300, Schedule 1 (section 576B of ICTA) and Schedule 2 Part 6 (the trading requirement) and Part 8 (the trading requirement and meaning of "qualifying trade")

This change permits R&D that benefits a qualifying trade to meet the requirements in EIS and VCT in prescribed circumstances. The change aligns these schemes more closely with the corporate venturing scheme (CVS).

EIS

Section 289(2)(b) of ICTA permits the carrying on of R&D to be a qualifying business activity. But this permission is limited to cases where it is intended that a future qualifying trade will be derived from that R&D. Section 289(2)(b) says:

> Research and development ….from which it is intended that a qualifying trade …will be derived …

Paragraph 25(2) of Schedule 15 to FA 2000 (CVS) is the provision that broadly corresponds with section 289(2)(b) of ICTA. But in CVS this corresponding provision goes further by also allowing the R&D to benefit an existing or future qualifying trade within the company or group concerned. Paragraph 25(2) says (emphasis added):

> … intended that…a connected qualifying trade will be derived *or benefit*…

In practice, R&D that benefits an existing trade falls, in many cases, within section 289(2)(a) of ICTA as the R&D is part of preparing to carry on, or carrying on a qualifying trade. But basing section 179(4)(b)(ii) and (5)(b) of this Act on paragraph 25(2) of Schedule 15 to FA 2000 by adding a reference to R&D benefiting a trade makes it clearer that this kind of R&D may be a qualifying business activity.

For the purpose of determining what is the business of a trading group, section 293(3D)(b) of ICTA provides that the holding and managing of property used by the company or any of its subsidiaries in certain cases is disregarded in considering what are the activities of a member of the group. This includes property used for R&D:

> from which it is intended that a qualifying trade to be carried on by the company or any of its subsidiaries will be derived.

To be consistent with the change made in the definition of a qualifying business activity and with CVS (where the meaning of qualifying trade in paragraph 25 of Schedule 15 to FA 2000 is carried over into paragraph 23(7)(b) for the purposes of a parallel disregard) section 181(6)(d) of this Act provides as follows:

> …the holding and managing of property used by a group company for the purpose of research and development from which it is intended -
>
> (i) that a qualifying trade to be carried on by a group company will be derived, or
>
> (ii) that a qualifying trade carried on or to be carried on by a group company will benefit.

VCT

Paragraph 4(1)(b) of Schedule 28B to ICTA provides that the carrying on of any activities of R&D is treated as the carrying on of a qualifying trade where it is intended that:

> there will be derived a trade that will comply with this paragraph.

Paragraph 25(2) of Schedule 15 to FA 2000 (CVS) shares some elements with the VCT sub-paragraph. But in CVS the provision goes further by also allowing the R&D to benefit an existing or future qualifying trade within the company or group concerned. Paragraph 25(2) says (emphasis added):

> …intended that…a connected qualifying trade will be derived *or benefit*…

In practice, in many cases, R&D that benefits an existing trade falls within paragraph 3(3)(b) of Schedule 28B to ICTA as the R&D is part of preparing to carry on a qualifying trade. But basing section 300(2) of this Act on paragraph 25(2) of Schedule 15 to FA 2000 by adding a reference to R&D benefiting a trade makes it clearer that this kind of R&D may be a qualifying business activity.

The rewritten provision, section 300(2)(b), provides that the carrying on of R&D from which it is intended:

> …a trade will benefit which …is or will be a qualifying trade … is to be treated as the carrying on of a qualifying trade.

For the purpose of determining what is the business of a trading group, paragraph 3(9)(b) of Schedule 28B to ICTA provides that the holding and managing of property used by the company or any of its qualifying subsidiaries, in certain cases, is disregarded in considering what are the activities of a member of the group. This includes property used for R&D:

> from which it is intended that a qualifying trade to be carried on by the company or any of its qualifying subsidiaries will be derived.

To be consistent with the change made in the definition of a qualifying trade and with CVS (where the meaning of qualifying trade in paragraph 25 of Schedule 15 to FA 2000 is carried over into paragraph 23(7)(b) for the purposes of a parallel disregard) section 290(5)(d) of this Act provides as follows:

> …the holding and managing of property used by a group company for the purpose of research and development from which it is intended—
>
> (i) that a qualifying trade to be carried on by a group company will be derived, or
>
> (ii) that a qualifying trade carried on or to be carried on by a group company will benefit.

Share loss relief

Section 137, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576B of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, correspond to section 181, with modifications.

The change in section 181(6)(d) is, accordingly, replicated in section 137(5)(d) of this Act and in section 576B(5)(d) of ICTA. See also Schedule 2 Part 6 (the trading requirement).

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

Change 42: EIS, VCT and share loss relief: meaning of "qualifying business activity" and the trading requirement: sections 137, 179 and 181, Schedule 1 (section 576B of ICTA) and Schedule 2 Part 6 (the trading requirement)

This change enables certain requirements to be met in circumstances where the issuing company acquires a company after the issue of the relevant shares.

There are three aspects to this change.

The Change in section 179(7)

Section 289(1)(b) of ICTA, rewritten as section 174, requires that the relevant shares be issued in order to raise money for the purpose of a qualifying business activity. Section 179 of this Act is based on section 289(2) and (3A) of ICTA and explains what is a qualifying business activity at the date of the issue of the shares.

The categories of qualifying business activity that consist of a trade in preparation and of R&D are described as follows in section 289(2) of ICTA (emphasis added):

> In this Chapter "qualifying business activity", in relation to a company, means—
>
> (a) the company or any qualifying 90% subsidiary of that company—
>
> (i) …
>
> (ii) preparing to carry on, or carrying on, a qualifying trade which, on that date, is intended to be carried on wholly or mainly in the United Kingdom by the company *or any such subsidiary* and which is begun to be carried on by the company *or any such subsidiary* within two years after that date,
>
> …, or
>
> (b) the company *or any qualifying 90% subsidiary* of that company carrying on research and development—
>
> (i) which, on the date the shares are issued, the company *or any such subsidiary* is carrying on or which the company *or any such subsidiary* begins to carry on immediately afterwards, and
>
> (ii) from which it is intended that a qualifying trade which the company *or any such subsidiary* will carry on wholly or mainly in the United Kingdom will be derived,…

There is an indication in section 289(3A)(a) of ICTA that participation in the qualifying business activity is not restricted to existing subsidiaries in relation to the commencement of the trade in section 289(2)(a)(ii) of that Act.

This is also the intention behind the references to "any such subsidiary" in section 289(2)(a)(ii) and (b)(ii) of ICTA. This phrase includes a subsidiary that is acquired after the date the shares are issued so long as other requirements such as those in section 289(1A) to (1E) of ICTA, rewritten in section 183, are met.

But to make this clearer, section 179(7) of this Act provides an interpretation of references to a qualifying 90% subsidiary:

> References in subsection (2)(b)(i) or (4)(b) to a qualifying 90% subsidiary of the company include references to any existing or future company which will be such a subsidiary at any future time.

Section 179(2)(b)(i) rewrites the part about intention in section 289(2)(a)(ii) of ICTA. Section 179(4)(b) rewrites the part about intention in section 289(2)(b)(ii) of ICTA, (with *Change 41* which extends the R&D in the frame to R&D that will benefit a qualifying trade).

The Change in section 181(7)

Section 293(3D) of ICTA says (emphasis added):

> Activities of a company or of any of its subsidiaries shall be disregarded for the purposes of subsections (3A) to (3C) above to the extent that they consist in—
>
> (a) …

> (b) the holding and managing of property used by the company or any of its subsidiaries for the purposes of—
>
> (i) research and development from which it is intended that a qualifying trade to be carried on by the company *or any of its subsidiaries* will be derived; or …

Consistent with the interpretation of section 289(2)(b)(ii) of ICTA, “any of its subsidiaries” in section 293(3D) of that Act applies to a subsidiary that is acquired after the date the shares are issued.

The provision is rewritten in section 181(6)(c) and (d) (with “group company” instead of “any of its subsidiaries” and again with *Change 41* which extends the R&D in the frame to R&D that will benefit a qualifying trade).

Section 181(7) of this Act provides an interpretation of “group company”, (as defined in section 257(1)), which makes it clear that here this includes future group companies:

> Any reference in subsection (6)(d) (i) or (ii) to a group company includes a reference to any existing or future company which will be a group company at any future time.

The Change in section 181(3)

Section 181 rewrites the requirement in section 293 of ICTA for the parent company of a trading group.

Section 293(2) of ICTA requires that (emphasis added):

> The company must throughout the relevant period be -
>
> (a) a company which exists wholly for the purpose of carrying on one or more qualifying trades….or
>
> (aa) the parent company of a trading group.

The parent company of a trading group is defined in section 293(3A) of ICTA:

> For the purposes of this section a company is the parent company of a trading group if—
>
> (a) it has one or more subsidiaries;
>
> (b) each of its subsidiaries is a qualifying subsidiary of the company; and
>
> (c) the requirements of subsection (3B) below are fulfilled by what would be the business of the company and its subsidiaries if all the activities, taken together, of the company and its subsidiaries were regarded as one business.

This is rewritten in section 181(4) of this Act (and in section 187 and, by the definition of parent company, in section 257(1)).

An extension of *Change 42* in section 181(3) ensures that an issuing company can qualify as a parent company where there is the intention that one or more companies will become a qualifying subsidiary:

> If the company intends that one or more other companies should become its qualifying subsidiaries with a view to their carrying on one or more qualifying trades—
>
> (a) the company is treated as a parent company for the purposes of subsection (2)(b), and
>
> (b) the reference in subsection (2)(b) to the group includes the company and any existing or future company that will be its qualifying subsidiary after the intention in question is carried into effect.
>
> This subsection does not apply at any time after the abandonment of that intention.

Note

Section 181(3) and (7) of this Act do not specify that the company that is not yet part of the group has to be a qualifying 90% subsidiary. But an issuing company has also to comply with other requirements such as those in section 179, section 175 and section 183. This will determine whether the new subsidiary is required to be a qualifying subsidiary or a qualifying 90% subsidiary.

VCT (the Venture Capital Trust Scheme)

There are similar changes in Part 6, VCT, see *Change 61*.

Share loss relief

Section 137, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576B of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, correspond to section 181, with modifications.

The changes in section 181(3) and (7) are, accordingly, replicated in section 137(2) and (6) of this Act and in section 576B(2) and (6) of ICTA. See also Schedule 2 Part 6 (the trading requirement).

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

Change 43: EIS, VCT and share loss relief: the trading requirement: sections 137, 181, 194, 290 and 305, Schedule 1 (section 576B of ICTA) and Schedule 2 Parts 6 and 8 (excluded activities: leasing of ships)

This change extends the scope of EIS and VCT relief by relaxing the way in which a restriction relating to the leasing of ships operates. This affects in a minor way the rules that determine whether a parent company and its group meets the trading requirement.

To meet the trading requirement, the business of the group must not consist wholly or as to a substantial part in carrying on non-qualifying activities. Non-qualifying activities consist of activities carried on otherwise than in the course of a trade and excluded activities.

Leasing is an excluded activity but there is an exception or let-out for certain types of ship leasing. The change concerns the way that this let-out is reflected in sections 137, 181, and 290 of this Act.

EIS

Section 293(3B) of ICTA lists activities that must not form a substantial part of a group's business if the parent company is to be regarded as the parent company of a trading group. Section 293(3B)(a) includes as such activities:

> activities falling within section 297(2)(a) to (g) but not within subsection (3C) below …

Section 297(2)(e) of ICTA refers to the activity of:

> leasing (including letting ships on charter or other assets on hire) or…

So leasing is an activity that is excluded in section 293(3B)(a) subject to exceptions provided by section 293(3C)(b) for certain types of ship leasing:

> the letting of ships … in circumstances where the requirements in paragraphs (a) to (d) of section 297(6) are satisfied in relation to the company so letting them

The reference in section 293(3C)(b) of ICTA to *paragraphs (a) to (d) of section 297(6)* means that the let-out for ship leasing from excluded activities does not extend to *the part of section 297(6) of ICTA which follows paragraphs (a) to (d)*:

> but where any of the requirements mentioned in paragraphs (a) to (d) above are not satisfied in relation to any lettings of such ships, the trade shall not thereby be treated as failing to comply with this section if those lettings and any other activity of a kind falling within subsection (2)(a) to (g) above do not, when taken together, amount to a substantial part of the trade.

In principle therefore when determining whether a parent company and its group meet the trading requirement, a trade of leasing ships would be an excluded activity if it failed to meet the requirements of section 297(6)(a) to (d) of ICTA even if the degree of failure was insubstantial.

The way in which sections 181(8), 192 and 194 of this Act interact changes the position.

The definition of "non-qualifying activities" in section 181(8) refers to "excluded activities". Section 192 defines "excluded activities" (based on the list in section 297(2) of ICTA) and also lists provisions that supplement the definitions.

One of these provisions is section 194 (excluded activities: leasing of ships), which provides a let-out for certain types of ship leasing. Section 194(7) extends the let-out in the same way as the latter part of section 297(6) of ICTA.

The effect of this is that the definition of "non-qualifying activities" in section 181(8) of this Act includes all the circumstances in section 194 including those in section 194(7).

VCT

Paragraph 3(7) of Schedule 28B to ICTA lists activities that must not form a substantial part of a group's business if the parent company is to be regarded as the parent company of a trading group. Paragraph 3(7)(a) includes as such activities:

> activities falling within paragraph 4(2)(a) to (f) below but not within sub-paragraph (8) below …

Paragraph 4(2)(d) of that Schedule refers to the activity of:

> leasing (including letting ships on charter or other assets on hire) or…

So leasing is an activity that is excluded in paragraph 3(7) of Schedule 28B to ICTA subject to exceptions provided by paragraph 3(8)(b) for certain types of ship leasing:

> the letting of ships … in circumstances where the requirements in paragraphs (a) to (d) of paragraph 4(7) below are satisfied in relation to the company so letting them

The reference in paragraph 3(8)(b) of Schedule 28B to ICTA to *paragraphs (a) to (d) of paragraph 4(7)* means that the exception for ship leasing from excluded activities does not extend to *the part of paragraph 4(7) of that Schedule which follows paragraphs (a) to (d)*:

> but where any of the requirements mentioned in paragraphs (a) to (d) above are not satisfied in relation to any lettings, the trade shall not thereby be treated as failing to comply with this paragraph if those lettings and any other activity of a kind falling within sub-paragraph (2)(a) to (f) above do not, when taken together, amount to a substantial part of the trade.

In principle therefore when determining whether a parent company and its group meet the trading requirement, a trade of leasing ships would be an excluded activity if it failed to meet

the requirements of paragraph 4(7)(a) to (d) of Schedule 28B to ICTA even if the degree of failure was insubstantial.

The way in which sections 290(7), 303 and 305 of this Act interact changes the position.

The definition of "non-qualifying activities" in section 290(7) refers to "excluded activities". Section 303 defines "excluded activities" (based on the list in paragraph 4(2) of Schedule 28B to ICTA) and also lists provisions that supplement the definitions.

One of these provisions is section 305 (excluded activities: leasing of ships), which provides a let-out for certain types of ship leasing. Section 305(7) extends the let-out in the same way as the latter part of paragraph 4(7) of Schedule 28B to ICTA.

The effect of this is that the definition of non-qualifying activities in section 290(7) of this Act includes all the circumstances in section 305 including those in section 305(7).

Share loss relief

Section 137, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576B of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, correspond to section 181, with modifications. They both include in subsection (7) a definition of "non-qualifying activities" which is identical to that in section 181(8) and a definition of "excluded activities" which by cross reference to section 192 is identical to that applying for the purposes of section 181.

The change made in section 194 is, accordingly, replicated in the definition of "non-qualifying activities" for the purposes of section 137 of this Act and section 576B of ICTA. See also Schedule 2 Part 6 (excluded activities: leasing of ships).

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

Change 44: EIS and share loss relief: companies controlled by the issuing company must be its own qualifying subsidiaries: sections 139 and 185, Schedule 1 (section 576D of ICTA) and Schedule 2 Part 6 (the control and independence requirement)

This change makes it explicit that during period B the issuing company cannot control (alone or with connected persons) companies which are not qualifying subsidiaries of the issuing company.

EIS

Section 293 of ICTA contains various conditions that the issuing company must meet if it is to be a "qualifying company" in relation to an issue of shares. Section 293(8)(a) requires that throughout the relevant period the issuing company must not:

> control (whether on its own or together with any person connected with it) any company which is not a qualifying subsidiary …

Despite the absence of explicit words to that effect, the context of section 293 of ICTA indicates that section 293(8)(a) is referring to a qualifying subsidiary of the issuing company.

The reference to relevant period in section 293(8)(a) of ICTA is also indicative of this interpretation.

Section 293(3) of ICTA defines "qualifying subsidiary" as follows (emphasis added):

> *in relation to a company*, means a subsidiary of a kind which that company may hold by virtue of section 308.

This is in line with section 312(1) of ICTA, which defines a subsidiary as follows (emphasis added):

> *in relation to any company*, (except in the expression "51% subsidiary" or where otherwise defined) means a subsidiary of that company of a kind which that company may hold under section 308.

Section 308 of ICTA is framed in terms of a qualifying company and a relevant period as it provides (emphasis added):

> A *qualifying company* may, in the relevant period, have…

So although a qualifying subsidiary is defined as a subsidiary in relation to a company which is not identified, the reference to "the relevant period" in section 293(8) of ICTA links the qualifying subsidiary here to the company (the issuing company in the rewritten sections) which is a qualifying company if it meets the requirements in section 293 of ICTA.

There is a similar requirement in relation to "the relevant company", the equivalent in this context to the issuing company in the venture capital trust (VCT) scheme. In paragraph 9(1)(a) of Schedule 28B to ICTA, the Schedule dealing with the meaning of qualifying holdings for VCTs, the wording is (emphasis added) that the relevant company must not be a company which:

> controls (whether on its own or together with any person connected with it) any company that is not a qualifying subsidiary of *the relevant company.*

The form EIS 1 which contains the company statement, (required under section 306(3) of ICTA) interprets section 293(8)(b) of that Act to mean that the qualifying subsidiary is a qualifying subsidiary of the company.

This interpretation of section 293(8)(b) of ICTA, that the qualifying subsidiary is a qualifying subsidiary of the issuing company, is reflected in section 185(1)(a) of this Act.

Share loss relief

Section 139, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576D of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, correspond to section 185, with modifications.

The change in section 185(1)(a) is, accordingly, replicated in section 139(1)(a) of this Act and in section 576D(1)(a) of ICTA. See also Schedule 2 Part 6 (the control and independence requirement).

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

Change 45: EIS, VCT and share loss relief: excluded activities: wholesale and retail distribution: sections 193 and 304 and Schedule 2 Parts 6 and 8 (excluded activities: wholesale and retail distribution)

This change substitutes references to "the company" with references to "the trader" in the EIS and VCT provisions that define an ordinary trade of wholesale and retail distribution. The new wording makes it clear that these provisions apply whether or not the person holding the goods is a company. In principle this is a change that could be adverse to a taxpayer, but it is unlikely that circumstances have arisen, or will arise, where this point is in question.

EIS

Section 297 of ICTA defines a "qualifying trade" and lists a number of activities that may prevent a trade being a qualifying trade. The list includes in section 297(2)(b) the activity of:

> dealing in goods otherwise than in the course of an ordinary trade of wholesale or retail distribution

Section 297(3) of ICTA interprets an ordinary trade of wholesale or retail distribution. Section 297(3)(d) of ICTA refers to "the trader" in each of its sub-paragraphs (i), (ii), (iii), (iv), (vi) and (viii) that deal with identity. The reference in section 297(3)(d)(iii) to the "case of a trade carried on by *a company*" concerns a distinct subset of "the trader".

Section 297(3)(c)(ii) is an exception to the rest of section 297(3) of ICTA because it refers to goods held by the company:

> A substantial proportion of goods is held by the company for a period…

This wording could restrict the application of section 297(2)(g) of ICTA to section 297(3)(c)(ii) of that Act.

Section 297(2)(g) of ICTA concerns the activity of:

> providing services or facilities for any trade carried on by another person … which consists to any substantial extent of activities within any of paragraphs (a) to (fe) above and in which a controlling interest is held by a person who also has a controlling interest in the trade carried on by the company ...

The reference in this sub-paragraph to a "trade carried on by another *person*" means that section 297(2)(g) of ICTA is clearly applicable in the case where the person carrying on that trade is not a company. But it is not as clearly applicable to a non-corporate person in the particular circumstances of section 297(3)(c)(ii) of ICTA.

The rewrite of section 297(3)(c)(ii) of ICTA in section 193(5)(b) is as follows:

> a substantial proportion of those goods are held for a period which is significantly longer than the period for which the trader would reasonably be expected to hold them while trying to dispose of them at their market value.

VCT

Paragraph 4 of Schedule 28B to ICTA defines a "qualifying trade" and lists a number of activities that may prevent a trade being a qualifying trade. The list includes in paragraph 4(2)(b) the activity of:

> dealing in goods otherwise than in the course of an ordinary trade of wholesale or retail distribution

Paragraph 4(3) and (4) of Schedule 28B to ICTA interpret an ordinary trade of wholesale or retail distribution. Paragraph 4(4) refers to "that person" in sub-paragraphs (a) to (h): "that person" is the person who carries on the trade. The reference in paragraph 4(4)(c) to the "case of a trade carried on by *a company*" concerns a distinct subset of "the trader".

Paragraph 4(3)(c)(ii) of Schedule 28B to ICTA is an exception to paragraph 4(4) of that Schedule because it refers to goods held by the company:

> A substantial proportion of goods is held by the company for a period…

This wording could restrict the application of paragraph 4(2)(f) of Schedule 28B to ICTA to paragraph 4(3)(c)(ii) of that Schedule.

Paragraph 4(2)(f) of Schedule 28B to ICTA concerns the activity of:

> providing services or facilities for any such trade carried on by another person … (which) consists to a substantial extent, in activities within any of paragraphs (a) to (ee) above and is a trade in which a controlling interest is held by a person who also has a controlling interest in the trade carried on by the company providing the services or facilities.

The reference in this sub-paragraph to a "trade carried on by another *person*" means that paragraph 4(2)(f) of Schedule 28B to ICTA is clearly applicable in the case where the person carrying on that trade is not a company. But it is not as clearly applicable to a non-corporate person in the particular circumstances of paragraph 4(3)(c)(ii) of that Schedule.

In section 304(5)(b) of this Act the rewrite of paragraph 4(3)(c)(ii) of Schedule 28B to ICTA is as follows:

> a substantial proportion of those goods are held for a period which is significantly longer than the period for which the trader would reasonably be expected to hold them while trying to dispose of them at their market value.

Share loss relief

Section 137, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576B of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, both include a definition of "excluded activities" by reference to section 192 (read with sections 193 to 199). This is identical to that applying for the purposes of section 181.

Schedule 2 Part 6 (excluded activities: wholesale and retail distribution) includes a transitional provision relating to this change in section 193 as that section applies for the purposes of section 137 of this Act and section 576B of ICTA. No such transitional provision is required for section 193 as it applies for the purposes of section 181 (see section 1034(3) for the commencement of section 193 as it applies for that purpose).

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

Change 46: EIS and share loss relief: excluded activities: the meaning of trade in relation to the provision of services or facilities for another business: section 199 and Schedule 2 Part 6 (excluded activities: provision of services or facilities for another business)

This change simplifies the application of the definition of "trade" in section 298(3) of ICTA.

EIS

Section 297 of ICTA is concerned with the meaning of a qualifying trade. Section 298 of ICTA contains provisions that supplement section 297 of that Act. In particular, section 298(3) of ICTA contains an intricate definition of trade:

> References in this section and in section 297 to a trade shall be construed without regard to so much of the definition of "trade" in section 832(1) as relates to adventures or concerns in the nature of trade; but the foregoing provisions do not affect the construction of references in section 297(2)(g) or subsection (1) above to a trade carried on by a person other than the company and those references shall be construed as including a reference to any business, profession or vocation.

Section 297(2) of ICTA lists a number of activities (called "excluded activities" in the draft rewritten sections) that may prevent a trade being a qualifying trade.

Section 297(2)(g) of ICTA concerns services provided to other businesses and the activities it refers to are:

> providing services or facilities for any trade carried on by another person … which consists to any substantial extent of activities within any of paragraphs (a) to (fe) above and in which a controlling interest is held by a person who also has a controlling interest in the trade carried on by the company …

Section 298(1) of ICTA gives the meaning of a controlling interest in a trade.

So the definition of trade in section 298(3) of ICTA differs depending on whether references are to "the company" or "to a person other than the company". "The company" here is the company which provides the services or facilities.

The way the definition applies has been simplified. The meaning of "trade" has been rewritten separately in section 189(2) of this Act (meaning of qualifying trade) as:

> References in this section and sections 192 to 198 to a trade are to be read without regard to the definition of "trade" in section 989.

Section 989 of this Act rewrites section 832(1) of ICTA.

Section 189(2) does not apply to section 199 which rewrites sections 297(2)(g) and 298(1) of ICTA. So section 989 applies to define the reference to "trade" in section 199(5)(b). There is no differentiation in section 199 between "a person other than the company" and "the company".

In section 199 of this Act there are consistent references to "business" rather than "trade". This includes references to "the business carried on by the company". Paragraph 33 of Schedule 15 to FA 2000 (corporate venturing scheme) has been used as a model for this.

Instead therefore of interpreting a trade as including a reference to "any business, profession or vocation", the approach in section 199(5)(b) is the other way round:

> "business" includes any trade, profession or vocation.

As with the application of section 989 of this Act to "trade" in section 199(5)(b), there is here no differentiation between "the company" and "a person other than a company"; but here it is in relation to the interpretation that (in effect) trade encompasses a business, profession and vocation.

It appears that this change can have no effect. The "trade carried on by the company" in section 297(2)(g) of ICTA is the trade of providing services or facilities. In whatever way "trade" is interpreted in relation to the provider of the services or facilities in section 199 of this Act, the activity of the provider, (whether this is the issuing company or a qualifying subsidiary) is required to be a qualifying trade for the other purposes of Chapter 4 of Part 5 of this Act.

The change is similar but not identical to *Change 64* in section 310 of this Act (the venture capital trust scheme). The changes get rid of an extra layer of complexity and have little or no practical effect.

Share loss relief

Section 137, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576B of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, both include a definition of "excluded activities" by reference to

section 192 (read with sections 193 to 199). This is identical to that applying for the purposes of section 181.

Schedule 2 Part 6 (excluded activities: provision of services or facilities for another business) includes a transitional provision relating to this change in section 199 as that section applies for the purposes of section 137 of this Act and section 576B of ICTA. No such transitional provision is required for section 199 as it applies for the purposes of section 181 (see section 1034(3) for the commencement of section 199 as it applies for that purpose).

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

Change 47: EIS: HMRC to give notice of decisions on compliance certificates: section 204

This change requires an officer of Revenue and Customs to notify his or her decision to a company that requests permission to issue compliance certificates to investors. The change is in line with practice.

Section 306(4) of ICTA prevents a company from issuing a compliance certificate without the permission of an officer of Revenue and Customs. Section 306(10) allows the company to appeal to an independent tribunal against the refusal by an officer of Revenue and Customs to give permission. But there is nothing in section 306 of ICTA obliging an officer of Revenue and Customs to tell the company whether or not permission is given.

Section 204(5) of this Act sets out that:

> If an officer of Revenue and Customs—
>
> (a) has been requested to give or renew an authority to issue a compliance certificate, and
>
> (b) has decided whether or not to do so,
>
> the officer must give notice of the officer's decision to the issuing company.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 48: EIS: "gross amount" of EIS relief used to determine whether maximum relief was obtained and adjustment where bonus shares issued: sections 210, 220 and 229

This change makes it explicit that the "gross amount" of EIS relief is used in determining whether the investor has obtained full relief on the amount subscribed for the relevant shares. That determination may affect the rate at which EIS relief is reduced because of matters such as a receipt of value by the investor.

In certain cases, section 299(4) of ICTA reduces the amount of value that is used to calculate the withdrawal or reduction of EIS relief that was obtained by an individual. The cases are where the claim for EIS relief resulted in the individual obtaining a tax reduction of less than the amount in respect of which relief was claimed, multiplied by the lower rate for the tax year in question.

Section 312(4)(a)(ii) of ICTA provides that for EIS the references to the reduction of relief attributable to any shares includes a reference:

> where no relief has yet been given, to the reduction of the amount which apart from the provision would be the relief.

Section 312(4)(a)(ii) means that EIS relief can be "netted off" in an assessment if some reduction of EIS relief occurs before the assessment is final.

For example, assume the investor is eligible for EIS relief on the issue of shares for which £20,000 was subscribed and that the investor has received value of £5,000 from the issuing company. That value of £5,000 may have been received before the investor's self-assessment (which includes a claim for EIS relief on the subscription of £20,000) is final (or even submitted). Assume also that the investor has a tax liability, ignoring the claim for EIS relief, which is greater than £20,000 multiplied by the lower rate of tax (say 20%) for the year in which the shares are issued. The investor will obtain a "net amount" of EIS relief of £3,000 in the self-assessment.

That relief is composed of a "gross amount" of relief of £4,000 (being the £20,000 subscription multiplied by 20%) less a reduction of that relief of £1,000 (being £5,000 value received multiplied by 20%). The change clarifies that it is the gross amount of £4,000 that must be considered in deciding whether the investor has had relief at the maximum rate and therefore whether section 299(4) of ICTA applies.

If it were not the case that the gross amount of relief is considered for section 299(4) of ICTA then different results could follow according to whether a receipt of value occurred before or after the investor's self-assessment was finalised.

Different results could also follow for investors in a single issue according to the dates on which their individual self-assessments were final for the year concerned.

Finally, in the example given above the 20% rate of reduction to apply to the £5,000 receipt was found by dividing the gross relief (£4,000) by the amount in respect of which relief had been given (£20,000). There would be circularity if the rate of reduction to apply depended on some figure for net relief. That is because the rate of reduction to apply to the £5,000 must be known before one can calculate any figure for net relief.

Sections 210(3), 220(2) and 229(3) of this Act make explicit that regard is to be had to the gross amount of EIS relief in deciding whether or not to multiply value-received etc by the formula $\frac{A}{B}$ in those sections.

For one special case, each of sections 210(4), 220(3) and 229(4) of this Act provide an exception to the subsection that it follows. That special case is where EIS relief attributable to the relevant shares is reduced and reattributed because of a bonus issue and not because of a receipt of value.

There are corresponding explicit provisions in Schedule 15 to FA 2000 (corporate venturing scheme) - at paragraphs 46(5) and (6) (disposal of shares), 52(2) and (3) (cases where maximum investment relief not obtained) and 56(7) and (8) (value received by other persons).

This change aligns the enterprise investment scheme more closely with the corporate venturing scheme. It will prevent future contentions that regard should be had to something other than the gross amount of EIS relief.

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

Change 49: EIS: value received or repayment of share capital reduces EIS relief that was given for two separate tax years: sections 219 and 228

This change provides detailed steps to calculate the withdrawal or reduction of EIS relief in cases where the relief being withdrawn or reduced was obtained for two separate tax years. It applies where the investor receives an amount of value or where a repayment etc of share capital is made to someone other than the investor.

Receipt of value by the investor

Section 300 of ICTA withdraws or reduces EIS relief if the investor receives an amount of value from the issuing company within a certain period. Section 300(1A)(a) says that the amount of any reduction is the amount given by section 300(1B).

The reduction given by section 300(1B) of ICTA is clear in the simplest case (i) where full EIS relief was obtained and (ii) where that EIS relief was obtained for the year in which shares were issued. In such a case, section 300(1B) effectively gives an amount of:

$$R \times L$$

where

R is the value received by the investor

L is the lower rate of tax for the year in which the share issue took place.

For more complicated cases, section 300(1B) says:

> and section 299(4) above applies for the purposes of this subsection as it applies for the purposes of [section 299(2)].

Those words are clear enough to deal with the case where the investor obtains EIS relief for the year in which the shares were issued but at a rate lower than L.

But those words are not clear as to how section 300(1B) of ICTA deals with cases where EIS relief was obtained both for the tax year in which the shares were issued and for the preceding tax year (carry back cases). In carry back cases, different lower tax rates might apply for the two years involved (and the investor may not have obtained maximum relief for one or both of the years involved).

Section 300(1B) of ICTA contains one indication that it is meant to cater for carry back cases. That indication is the reference in section 300(1B) to L being the lower rate of tax for the tax year:

> for which the relief was given.

There is a second indication that section 300(1B) of ICTA is meant to cater for carry back cases. In the context of an investor treating part of a share issue as having taken place in the previous tax year, section 289B(5) of ICTA says:

> section[s] 299(4) …shall have effect as if that part and the remainder were separate issues.

That second indication is (a) the reference in section 300(1B) of ICTA (quoted earlier) to section 299(4) taken with (b) the reference in section 289B(5) of ICTA to section 299(4) applying as if the issue to the investor was two deemed separate issues in the years

concerned. It is unlikely that R is to be used in the withdrawal or reduction calculation for both those deemed issues. That would double count the value received. But none of section 300(1B), section 299(4) or section 289B(5) of ICTA has an explicit apportionment of R between the two deemed issues.

Section 219 of this Act deals explicitly with cases where EIS relief, obtained for two separate years, is reduced as a result of value received in a certain period by the investor. This explicit treatment prevents an alternative construction being put forward (whether adverse or favourable to taxpayers) as to what happens in such cases.

Repayment etc of share capital to someone other than the investor

Section 303 of ICTA withdraws or reduces EIS relief from the investor in cases where someone other than the investor receives certain repayments etc of share capital within a certain period.

In this case section 303(1C) also refers (like section 300(1B) of ICTA) both to:

> lower rate for the year … for which the relief was given

and:

> section 299(4) applies for the purposes of this subsection as it applies for the purposes of [section 299(2)].

Carry back cases may involve different lower tax rates for the two years for which the investor obtains EIS relief (and the investor may have not have obtained maximum relief for one or both of the years involved).

Section 228 of this Act in relation to repayments etc of share capital to someone other than the investor, also deals explicitly with carry back cases. This explicit treatment prevents an alternative construction (whether adverse or favourable to taxpayers) being put forward as to what happens in such cases.

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

Change 50: EIS: value received by other persons: prevent multiple reductions of EIS relief: section 224

This change introduces a provision reducing the chances of one receipt of value causing more than one restriction of EIS relief.

It also brings the enterprise investment scheme into closer alignment with the corporate venturing scheme in Schedule 15 to FA 2000. That is because section 224(6) of this Act is based on paragraph 58(1) of Schedule 15 to FA 2000:

> Any repayment shall be disregarded for the purposes of … to the extent to which investment relief attributable to any shares has already been reduced or withdrawn on its account.

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

Change 51: EIS: repaying share capital of nominal value equal to the authorised minimum if eligible shares are issued before registrar's certificate: section 230

This change extends the exception from reduction of EIS relief in certain cases where other persons receive value on the repayment of subscriber shares.

Section 303(9) of ICTA and paragraph 58(5) and (6) of Schedule 15 to FA 2000 (corporate venturing scheme) (CVS) provide nearly identical exceptions from section 303 of ICTA and paragraph 56 of that Schedule.

Both exceptions apply in the context of the repayment within a year of issue of shares which were issued to meet certain requirements of company law (the requirements in section 117 of the Companies Act 1985). But there is a minor difference between these two provisions relating to when eligible shares have to be issued.

Section 303(9)(b) of ICTA says (emphasis added):

> *after* the registrar has issued the company with a certificate under section 117, *it issues eligible shares.*

Paragraph 58(5)(b) of Schedule 15 to FA 2000 says:

> the registrar of companies issues the company with a certificate under section 117.

So paragraph 58(5)(b) can be met even if eligible shares are not issued after the registrar has issued a certificate whereas section 303(9)(b) cannot be satisfied in such a case.

There is no reason why the conditions in section 303(9)(b) of ICTA should be more restrictive than paragraph 58(5)(b) of Schedule 15 to FA 2000 (CVS). Section 230(1)(b) of this Act omits the additional requirement in section 303(1)(b) of ICTA that eligible shares be issued *after* the registrar issues the company with a certificate under section 117 of the Companies Act 1985. That marginally widens the scope of the exception in section 303(9)(b) of ICTA and brings EIS into closer alignment with CVS.

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

Change 52: EIS: cases where assessment not to be made after disposal of all shares to which EIS relief is attributable: section 238.

This change limits the shares that need to be taken into account in deciding whether an individual is protected from being assessed by reason of events happening after the individual has disposed of all the shares to which EIS relief is attributable.

Section 307(4) of ICTA says:

> Where a person has, by a disposal or disposals to which section 299(1)(b) applies, disposed of all the eligible shares issued to him by a company, no assessment for withdrawing relief in respect of any of those shares shall be made by reason of any subsequent event unless it occurs at a time when he is connected with the company within the meaning of section 291.

Section 307(4) presents no problems for the majority of cases for which it may be relevant. Those are straightforward cases of an investor whose only connection with a company is a single subscription for shares that are later sold at arm's length in a single transaction. But issues could arise in less straightforward cases.

First, the reference to "*section 299(1)(b) applies*" may suggest that all eligible shares issued to the investor must be disposed of before the end of the relevant period related to their issue (section 312(1A)(a) of ICTA). Consider a case where the investor holds one or more of those shares at the end of the relevant period in question. The investor arguably could never benefit from section 307(4) of ICTA in relation to a later issue of shares by the company concerned.

Second, "*eligible shares*" are referred to but it is not always possible to say at particular times, before the termination date, that a share is an eligible share. That is because section 289(7) of ICTA requires the shares to meet certain conditions over a period of time relating to the date on which the share was issued.

The reference to "eligible shares" might be intended to limit section 307(4) of ICTA to a consideration of just those shares on which it was possible for EIS relief to be claimed by the individual. But eligible shares issued for non-cash consideration would, for instance, not be eligible for EIS relief and could not have EIS relief attributed to them. It would therefore not be possible to dispose of such shares in a way that "*section 299(1)(b) applies*" to the disposal. It is accordingly not clear what the word "eligible" adds or that it is helpful or necessary.

Section 238(2) of this Act is a change from section 307(4) of ICTA . It ignores any shares for which period A (corresponding to the relevant period in the source legislation) has ended. It also ignores shares to which EIS relief is not attributable (whether it is because they are not eligible shares or for some other reason).

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

Change 53: EIS: Interest and Self Assessment: section 239

This change omits provisions that do not fit with Self Assessment in relation to charging interest on assessments. The omitted provisions are sections 306(9) and 307(6)(a) and (aa) and (7) of ICTA.

Section 306(9) of ICTA says:

> For the purposes of section 86 of the Management Act (interest on overdue tax), tax charged by an assessment—
>
> (a) shall be regarded as due and payable notwithstanding that relief from the tax (whether by discharge or repayment) is subsequently given on a claim for the relief; but
>
> (b) shall, unless paid earlier or due and payable later, be regarded as paid on the date of the making of the claim on which the relief is given;
>
> and section 91 of that Act (effect on interest of reliefs) shall not apply in consequence of any discharge or repayment for giving effect to the relief.

Apart from immaterial differences, section 306(9) of ICTA is the same as section 61(7) of FA 1981 (the provision from which it originates). FA 1981 was enacted approximately 15 years before Self Assessment came into force.

In 1981 it was standard practice for separate Schedular assessments (often estimated) to be made by HMRC (then the Inland Revenue). At that time, parts of the income tax liability of an individual for a single year could have different due and payable dates. Different due dates could arise because:

- of the Schedule under which parts of the individual's total income fell; and
- of the date that each part of that total income was (separately) assessed by the HMRC.

HMRC would typically make an assessment to income tax and issue a notice of that assessment to the individual showing when the assessed tax was due and payable. Interest on

overdue income tax was determined by reference to the date on which the assessed tax was due and payable under the assessment.

The individual might later claim that, say, relief under Chapter 2 of Part 4 of FA 1981 (relief for investment in new corporate trades, but referred to in this note as BSS (business start-up scheme) relief) should be given. If satisfied that relief was due, HMRC might:

- send the individual notice of an amended assessment incorporating BSS relief; and
- repay the amount, if any, that had been paid by the individual in relation to the original notice of assessment but which was no longer due under the amended assessment.

HMRC were therefore heavily involved in making assessments to income tax and in giving effect to claims for relief against that tax. That meant HMRC knew from their records when:

- an assessment to income tax had been made and notice of it given to the individual;
- a claim for relief against income tax had been made;
- a revised assessment had been made to give effect to the relief; and
- a repayment had been made as a result of the revised assessment.

It is significant that section 61(1)(a) of FA 1981 then prevented claims for BSS relief during the tax year to which they related (an in-year claim). This rule meant that BSS relief was not allowed in the form of a PAYE coding adjustment either.

This prevention of in-year claims in turn raised issues related to the possibility of different payment dates existing for parts of an individual's income tax liability by reason of Schedular assessing. For instance, Schedule A assessments for a tax year normally had a payment date in the tax year (an in-year payment date). It would have been inconsistent to prevent in-year claims to relief and yet allow some individuals to achieve the same effect as an in-year claim by claiming BSS relief against, say, Schedule A assessments that had in-year payment dates.

That potential inconsistency was overcome by section 61(7) of FA 1981 providing that, despite section 91 of TMA (effect on interest of reliefs), interest would continue to be charged on tax due under an assessment until the date that a claim for BSS relief was made to HMRC.

The rule against making in-year claims was relatively short-lived. In relation to the relief in Schedule 5 to FA 1983 (business expansion scheme - BES) which replaced BSS relief, the rule was not reproduced in paragraph 13(1) of Schedule 5 (claims). And paragraph 13(7) of Schedule 5 even contemplated BES relief being given in the form of a PAYE coding adjustment.

Self Assessment made significant changes to the system that had applied in 1981. Three such changes are mentioned here:

- the individual now makes most assessments as part of the individual's tax return;
- tax payment dates no longer vary with the type of income involved; and
- much less HMRC involvement is required for claims as they can form part of the individual's self-assessment.

Section 306(9) of ICTA has not been rewritten, as it is not readily compatible with Self Assessment. Omitting this provision will result in claims for EIS relief being treated in the same way for Self Assessment as any other claim. In principle, this part of the change is favourable to taxpayers as section 91 of TMA may operate to relieve them of liabilities to interest that were not previously relievable. In practice, this change is expected to have no impact.

Section 307(6)(a) and (aa) and (7) of ICTA say:

> (6) In its application to an assessment made by virtue of this section, section 86 of the Management Act (interest on overdue tax) shall have effect as if the relevant date were—
>
> (a) in the case of relief withdrawn by virtue of section 289(6) or 299B(1)—
>
> (i) so far as effect has been given to the relief in accordance with PAYE regulations, 5th April in the year of assessment in which effect was so given;
>
> (ii) so far as effect has not been so given, the date on which the relief was granted;
>
> (aa) in the case of relief withdrawn by virtue of section 289(1)(c) or (d), the date on which the relief was granted;
>
> (7) For the purposes of subsection (6) above the date on which the relief is granted is the date on which a repayment of tax for giving effect to the relief was made or, if there was no such repayment, the date on which the inspector issued a notice to the claimant showing the amount of tax payable after giving effect to the relief.

Section 62(6) and (7) of FA 1981 had rules about charging interest on a withdrawal of BSS relief by a separate assessment (later assessment) made after BSS relief had been given against an earlier assessment (original assessment). In most cases interest ran from the date of the event that caused the later assessment to be made.

But in one case (avoidance), the withdrawal of BSS relief was in broad terms intended to restore the position to the same as if the relief had never been given. In that case, the later assessment could not simply provide for interest to run from the normal date on which interest would have been chargeable under the original assessment. That was because interest might have been charged in relation to the original assessment up to the date that BSS relief was claimed (see earlier discussion on section 61(7) FA 1981). The later assessment had to take account of such a possibility.

So a concept of "the date on which the relief is granted" was defined and used as the date from which interest would be charged in this case. That concept naturally used typical pre-Self Assessment actions of HMRC issuing a notice of assessment giving effect to the claim or making a repayment of income tax to give effect to the claim.

Section 307(6)(a) and (aa) of ICTA set out the cases in which withdrawal of EIS relief is intended, broadly, to restore the position to the same as if the relief had never been given. And the pre-Self Assessment concept of "the date on which the relief is granted" lingers on in section 307(7) of ICTA. This concept does not fit with Self Assessment.

With the omission of section 306(9) of ICTA (see earlier) the reason for the provisions in section 307(6)(a) and (aa) and (7) of ICTA cease to exist. So the rules in section 307(6)(a) and (aa) and (7) have not been rewritten either.

This means there will be no special rule about assessments that withdraw relief in the cases set out in section 307(6)(a) and (aa) of ICTA (avoidance: pre-arranged exits and time limit

for use of money). Such assessments will be dealt with under Self Assessment in the same way as any other assessments.

In principle this part of the change is unfavourable to taxpayers as it will prevent them contending that the legislation is deficient in such a way that interest should not be charged in relation to matters contemplated by section 307(6)(a) and (aa). But it is unlikely that such cases will be met.

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

Change 54: EIS: information provided by the issuing company and persons connected with the issuing company in respect of certain events: section 241

This change provides a link between (i) the requirement that the issuing company and any person connected with the issuing company provide notices of certain events and (ii) the requirement that the issuing company provides information in a compliance statement (covered by section 205) of this Act. The change also gives the issuing company a longer period to provide a notice to an officer of Revenue and Customs in one particular case.

The change aligns EIS more closely with a similar provision in the corporate venturing scheme (CVS).

Section 241 of this Act is based on section 310 of ICTA. Section 310(2) of ICTA says that:

> (2) Where an event occurs by reason of which any relief in respect of any shares in a company falls to be withdrawn by virtue of section 289(1)(ba), (c) or (d), 293, 300, 302 or 303, or would fall to be withdrawn under section 300 were it not for the application of section 300A,—
>
> (a) the company; and
>
> (b) any person connected with the company who has knowledge of that matter;
>
> shall within 60 days of the event or, in the case of a person within paragraph (b) above, of his coming to know of it, give a notice to the inspector containing particulars of the event ...

From those words it may be thought that the company and connected person are expected to know whether an individual investor has obtained EIS relief. Alternatively it may be thought that information of the specified events must be provided to the officer of Revenue and Customs (i) whether or not any investor has obtained relief and (ii) whether or not the company has provided a statement under section 306(3) of ICTA. EIS relief cannot be obtained without the issuing company having provided a statement under section 306(3) to the officer of Revenue and Customs.

Section 241(1) of this Act resolves these difficulties by tying the requirement to provide notice of the events listed to:

- the submission by the issuing company of a compliance statement; and
- a supposition that EIS relief has been obtained.

This follows paragraph 65(1) of Schedule 15 to FA 2000 (CVS).

Section 310(2) of ICTA provides for the case of a connected person having no initial knowledge of an event. The connected person is given 60 days from when that person comes to know of the event. Section 310 does not provide for the case of an issuing company having

no initial knowledge of a receipt of value, under section 300 of ICTA, from a person connected to the company.

Section 241(4)(b) of this Act provides an alternative period of notice for the issuing company if the event is a receipt of value, within section 216(2), from a person connected to the company under section 221. This follows paragraph 65(4)(b)(ii) of Schedule 15 to FA 2000 (CVS).

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 55: EIS: share transfers between spouses or civil partners: section 245

This change expands the assumptions that are made in relation to transfers between spouses or civil partners of shares to which EIS relief is attributable. Section 245(2)(b) and (d) and subsection (3) ensure that the step in shoes treatment works in all situations in relation to any subsequent event.

Section 304(2)(a) of ICTA provides that the transferee is treated as though he or she had subscribed for the shares. Section 245(2)(b) of this Act makes it explicit that the transferee is treated as having subscribed for the shares *the amount* that was subscribed by the transferor.

Section 304(2)(b) of ICTA says that the transferee's liability to income tax is treated as having been reduced for the same year as the transferor's liability to income tax was reduced. Section 245(2)(d) of this Act makes it explicit that this deemed reduction in the transferee's liability should be the same as the reduction obtained by the transferor.

Change 48 discusses the clarification of what the gross amount is in cases where, for instance, the transferor receives value from the issuing company before the transferor obtains EIS relief. Section 245(3) of this Act provides that the effect on EIS relief in these circumstances is unaffected by a transfer of shares between a husband and wife and civil partners. It does this as follows:

- Subsection (3)(a) carries over to the transferee any reduction in the EIS relief attributable to the shares in respect of the transferred shares.
- Subsection (3)(b) provides that the transferee's treatment will be the same as the transferee's would have been in cases where sections 210(3), 220(2) and 229(3) are relevant. These are concerned with the reduction of EIS attributable to relevant shares before EIS relief is obtained in cases involving disposal, the receipt of value by the investor and the receipt of value by other persons. Since these are three distinct cases, the required effect in subsection (3) is achieved by cross-referring to those provisions rather than attempting to reproduce their contents.

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

Change 56: EIS, VCT and share loss relief: the meaning of "a company being in administration": sections 252 and 331, Schedule 1 (section 312(2A) of ICTA and paragraph 11(10) of Schedule 5 to ITEPA) and Schedule 2 Parts 6 and 8 (meaning of company being "in administration")

This change updates and extends the definition of administration by referring to the meaning within Schedule B1 to the Insolvency (Northern Ireland) Order 1989 (SI 1989/2405 (NI 19)) and adapting this and the meaning within Schedule B1 to the Insolvency Act 1986 to provide for a similar interpretation of an administration outside the UK. The result is that the meaning of a company "in administration" is widely drawn whichever rules on administrations apply.

The change applies to the enterprise investment scheme (EIS) and to venture capital trusts (VCT). The relevant provisions in ICTA are section 312(2A)(a) (EIS) and paragraph 11A(2)(a) of Schedule 28B (VCT). The change also applies to enterprise management incentives (EMI) under Schedule 5 to ITEPA and to share loss relief under Chapter 6 of Part 4 of this Act, because these provisions use the EIS definition of "in administration".

Paragraph 11(10) Schedule 5 to ITEPA applies section 312(2A) of ICTA to EMI.

Section 576(4A) of ICTA (share loss relief) reads across into the EIS provisions in section 293 of that Act. In rewriting that read across in Chapter 6 of Part 4 of this Act, section 138(5) applies section 252. Section 141(2) applies the definition of "qualifying 90% subsidiary" in section 190 and sections 137(7), 139(2), 140(2) and 142(4) all apply the definition of "qualifying subsidiary" in section 191. Sections 190 and 191 both in turn apply section 252.

Schedule B1 to the Insolvency (Northern Ireland) Order 1989 (SI 1989/2405 (NI 19)) was inserted by Schedule 1 to the Insolvency (Northern Ireland) Order 2005, (SI 2005/1455 (NI 10)) with a commencement date of 27 March 2006 under SR (NI) 2006 No.21 (CI). This new Schedule B1 is the equivalent to Schedule B1 to the Insolvency Act 1986 inserted by the Enterprise Act 2002. Paragraph 1(2) of both Schedules B1 provides that:

(a) a company is "in administration" while the appointment of an administrator of the company has effect,

(b) a company "enters administration" when the appointment of an administrator takes effect.

So the references to an administration order under Part 3 of the Insolvency (Northern Ireland) Order 1989 in the definition of a company in administration in section 312(2A)(a)(i) of and paragraph 11A(2)(a)(i) of Schedule 28B to ICTA are now out of date.

To remedy this, the opening words and sub-paragraph (i) of section 312(2A)(a) of and paragraph 11A(2)(a) of Schedule 28B to ICTA are replaced in sections 252(2)(a) and 331(2)(a) of this Act by:

A company is "in administration" if-

(a) it is in administration within the meaning of Schedule B1 to the Insolvency Act 1986 *or Schedule B1 to the Insolvency (Northern Ireland) Order 1989*

The reference to a "corresponding order" under the law of a country or territory outside the United Kingdom in section 312(2A)(a)(ii) of and paragraph 11A(2)(a)(ii) of Schedule 28B to ICTA is no longer appropriate since there is no reference to "order" in the UK context. The intention is to provide for equivalent legislation so far as this can be expressed. Sections 252(2)(b) and 331(2)(b) of this Act, therefore, provide:

(b) There is in force in relation to it [the company] under the law of a country or territory outside the United Kingdom any appointment corresponding to an appointment of an administrator under either of those Schedules.

There is a similar example of the drafting providing for equivalent legislation outside the UK, so far as this is possible, in section 12(7ZA) of ICTA.

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

Change 57: EIS: conditions to be met over a period: section 257

This change makes it explicit that EIS relief can be obtained even though future events could mean that the relief is not due. That is consistent with practice and the corporate venturing scheme (CVS).

Whether an individual is eligible for EIS relief in respect of an issue of shares normally depends on certain conditions being met for at least three years after the issue has taken place.

The framework of the EIS scheme indicates, in various places, that claims for the relief may be made even though the relief may ultimately not be available because of future events, so on a provisional basis. One example is that section 307(1) of ICTA contemplates an assessment being made to withdraw:

relief … which is subsequently found not to have been due…

Predecessors to the EIS scheme were more explicit about the existence of a provisional basis. Thus for the business expansion scheme (BES), section 289(9) and (10) of ICTA (prior to any later amendments) read:

(9) A claim for relief may be allowed … if the conditions for relief are then satisfied.

(10) In the case of a claim allowed before the end of the relevant period, the relief shall be withdrawn if by reason of any subsequent event it appears that the claimant was not entitled to the relief allowed.

CVS addresses this aspect by referring, where appropriate, to requirements "being met for the time being" and paragraph 102(7)(a) of Schedule 15 to FA 2000 (CVS) says:

In the case of a requirement that cannot be met until a future date—

(a) references…to a requirement being met for the time being are to nothing having occurred to prevent its being met.

Section 257(8) of this Act is based on this extract from paragraph 102(7)(a) of Schedule 15 to FA 2000 (CVS). The wording of section 204(1)(b) (compliance certificates) and section 205(1)(a) (compliance statements) has been adapted so that section 257(8) applies: the references to requirements for EIS relief being "for the time being met". This makes explicit the operation of the provisional basis for EIS.

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

Change 58: VCT: definition of eligible shares for VCT relief: section 273 and Schedule 2 Part 8 (interpretation of Chapter 2)

This change prevents the contention that section 73(1)(b) of FA 1998 was ineffective in deleting the word "preferential" from the definition of "eligible shares" in paragraph 6(1) of Schedule 15B to ICTA.

Paragraph 6(1), in common with section 842AA(14) of ICTA, originally defined "eligible shares" in terms of shares in a company which:

> carry no present or future preferential right to dividends or…assets on its winding up and no present or future *preferential* right to be redeemed.

Section 73(1)(b) of FA 1998 omitted the italicised reference to "preferential". Section 73(6) of FA 1998 provided that the omission had effect:

> for the purpose of determining whether shares or securities are, as at any time on or after 6th April 1998, to be regarded as comprised in a company's qualifying holdings…

Section 73(1)(a) of FA 1998 made a similar omission of the word "preferential" from section 842AA(14) of ICTA .

Section 73(6) of FA 1998 sits well with section 73(1)(a) because section 842AA deals with a company's qualifying holdings; but paragraph 6(1) is in Part 1 of Schedule 15B to ICTA which deals with whether or not an individual is eligible for VCT relief on particular shares.

FA 1998 also omitted the word "preferential" in relation to other provisions associated with venture capital schemes. These omissions were from:

- section 289(7) of ICTA (enterprise investment scheme);
- section 150(8A) of TCGA (business expansion scheme);
- section 150A(8A) of TCGA (enterprise investment scheme); and
- paragraph 9(2) of Schedule 5B to TCGA (enterprise investment scheme: reinvestment).

Section 74(3) of FA 1998 provided that those omissions had effect:

> in relation to shares issued on or after 6th April 1998.

It seems likely that similar wording should have been used in relation to the omission in section 73(1)(b) of FA 1998.

The words quoted earlier from section 73(6) FA 1998 are not reproduced in relation to section 273(1) of this Act. This prevents the contention that section 73(1)(b) of FA 1998 was ineffective in omitting the word "preferential" in paragraph 6(1) of Schedule 15B to ICTA.

Part 8 of Schedule 2 to this Act (interpretation of Chapter 2) ensures that this change does not apply to shares issued before 6 April 2007.

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

Change 59: VCT: conditions relating to value of investments: sections 278 and 285 and Schedule 2 Part 8 (conditions relating to value of investments)

This change makes clear how the test in section 842AA(2)(d) of ICTA (referred to in this note as the 15% test) operates. It also makes clear how definitions in section 842 of ICTA apply for the purposes of 842AA(5) of that Act, which itself defines the value of a holding for the purposes of the tests in section 842AA(2) (b) to (d).

Section 842AA(11) of ICTA applies certain provisions of section 842 of ICTA to section 842AA and these have been included in the rewrite of section 842AA.

The opening words of section 842AA(11) are:

> The following provisions of section 842 shall apply for the purposes of this section as they apply for the purposes of that section,…

Section 842AA(11)(a) provides that the conditions relating to the 15% test in section 842 shall apply to the equivalent test in section 842AA(2)(d):

> subsections (1A) and (2) of that section [section 842] shall apply in relation to subsection (2)(d) above (but with the omission of subsection (2)(a) of that section) as they apply in relation to subsection (1)(b) of that section.

Section 842AA(11)(c) then further provides:

> without prejudice to their application in relation to provisions applied by paragraph (a) or (b) above, subsections (3) and (4) of that section [section 842] shall apply in relation to any reference in this section to a holding or an addition to a holding as they apply in relation to any such reference in that section.

Section 842(3) defines a holding for the purpose of section 842(2). It states that:

> "holding" means the shares or securities (whether of one class or more than one class) held in any one company.

Section 842(3) also defines an addition to a holding and explains what happens if there is a scheme of reconstruction.

It is not clear how the definitions in section 842(3) apply to section 842AA(5). Section 842AA(5) deals with the valuation of a holding and the circumstances under which this is revalued for the purpose of the conditions in section 842AA(2)(b) to (d).

It is possible to read the definitions in section 842(3) as applying only to the 15% test in section 842AA(2)(d) since the definition is of a holding "in any one company". Section 842AA(2)(d) refers to a holding "in any company" and there are no other examples of this sort of phraseology in section 842AA. In addition the definition in section 842 is of shares or securities (*whether of one class or more than one class*) while section 842AA(5) refers to a holding "of investments *of the same description*" and additions to such holdings. Furthermore it is not obvious how both the applied provisions in section 842 and section 842AA(5) can apply to this test given the wording of section 842AA(11)(c).

But the wording of section 842AA(11)(c) "any reference in this section to a holding or an addition to a holding" suggests that there is more than one such reference to which section 842(3) applies. In addition, if section 842(3) does not apply to section 842AA(5), there is no explicit guidance on the interpretation of an addition to a holding of investments. Also section 842AA(5) applies to all the percentage tests (the 70%, 30% and 15% tests).

In practice the provisions have been interpreted on the basis that it is necessary to establish whether or not a holding has been added to in accordance with section 842(3), when an investment of any description is added to a holding of shares or securities.

Then the rules in section 842AA(5) are applied to revalue only the holding of investments of the same description as the investment added when applying the 15% test in section 842AA(2)(d).

The sections of this Act are based on this approach and remove the possible doubt about the way in which section 842 and section 842AA of ICTA interact.

Section 277 of this Act sets out the section 842 of ICTA rules about when and how the 15% test applies. (In Part 6 of this Act the 15% test is called "the 15% holding limit condition".)

In section 278 of this Act which rewrites section 842AA(5) of ICTA and is concerned with the way a holding is valued when there is an addition, the section 842(3)(b) and (c) and section 842(4) definitions are adapted to the terminology in section 842AA(5).

The effect of this is that the rules in section 278 apply to the 15% holding limit condition when there is an addition to investments of any description in the same way as they apply to the 70% qualifying holdings condition and the 30% eligible shares condition. A revaluation is required only of the holding of investments of that description. This is in line with interpretation and practice.

There is a transitional provision in Schedule 2 the purpose of which is to preserve the effect of section 842AA(11)(c) of ICTA on the 15% test where there is an addition to investments held by a company before 6 April 2007.

Section 285

This Change also has an impact on the interpretation of references to investments in section 285 of this Act.

Paragraph 8 of Schedule 14 to FA 2006 provides an interpretation of the references to a company's investments in section 842AA of ICTA. Paragraph 8(1) also provides that the interpretation applies to references to investments in section 842(2)(b) of ICTA as this provision is applied to section 842AA.

The FA 2006 provisions do not extend this interpretation explicitly to the definitions in section 842(3) of ICTA which section 842AA(11)(c) applies to section 842AA.

The interpretation of investments in section 285(4) to (6) of this Act applies to the whole of Chapter 3 of Part 6. It therefore covers the reference to investments in section 278(4), which is derived in part from section 824(3) of ICTA. This subsection provides a definition of an addition of a holding for the purposes of valuing a holding of investments of any description. Applying the interpretation to this reference accords with the intention that the FA 2006 interpretation would be applied consistently in section 842AA of ICTA.

The transitional provision for section 285 in Schedule 2 to this Act, is based on the commencement rule in paragraph 8(2) of Schedule 14 to FA 2006 and applies the interpretation from 6 April 2007.

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

Change 60: VCT: excess over the maximum qualifying amount: section 287 and Schedule 2 Part 8 (the maximum qualifying investment requirement)

This change provides that an investment in excess of the maximum qualifying investment is ignored in relation to later investments in the same company.

Paragraph 7 of Schedule 28B to ICTA prevents an issue of shares or securities (the relevant holding) from being a "qualifying holding" to the extent that the "maximum qualifying investment" is exceeded for the "relevant period" at the time of the issue. Paragraph 7(2) and (5) define "maximum qualifying investment" and the beginning of the "relevant period" as follows:

> the maximum qualifying investment for any period is exceeded to the extent that the aggregate amount of money raised in that period by the issue to the trust company during that period of shares in or securities of the relevant company exceeds £1 million.

and:

> For the purposes of this paragraph the relevant period is the period beginning with whichever is the earlier of
>
> (a) the time 6 months before the issue of the relevant holding; and
>
> (b) the beginning of the year of assessment in which the issue of that holding took place.

The following example illustrates how paragraph 7 operates in relation to issues of shares or securities by company A to a VCT in the amounts and on the dates shown.

Relevant period starts	Issue date	£ Amount raised by A from VCT on issue date	£ Amount(s) raised by A from VCT in relevant period	£ Excess of Y over maximum qualifying investment. = "excess part of X"	£ Amount of X within maximum qualifying investment
		X	Y	Z	X less Z
6/4/04	31/3/05	600,000	600,000	nil	600,000
3/12/04	3/6/05	800,000	1,400,000	400,000	400,000
6/4/05	31/12/05	500,000	1,300,000*	300,000	200,000

The intention was that the cumulative amount raised (column Y in the table) should only include earlier amounts raised to the extent that those amounts had fallen within the final column. So the asterisked total in the final row should be £900,000 and all of the £500,000 raised on 31 December 2005 should fall within the final column. Practice has reflected that intention.

Section 287(3)(b) of this Act reflects the practice of not "double counting" an amount that represents an excess over the maximum qualifying investment within a relevant period.

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

These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007.
These notes are published in three volumes.

Change 61: VCT: the trading requirement and the carrying on of a qualifying trade requirement: sections 290, 291 and Schedule 2 Part 8 (the trading requirement and the carrying on of a qualifying activity requirement)

This change enables certain requirements to be met in circumstances where the relevant company acquires a company after the issue of the relevant shares.

There are three aspects.

The change in section 290(2)

Paragraph 3(2) of Schedule 28B to ICTA requires that:

> The relevant company must be one of the following -
>
> (a) a company which exists wholly for the purpose of carrying on one or more qualifying trades….or
>
> (aa) the parent company of a trading group.

This is rewritten in section 290(1) of this Act.

The parent company of a trading group is defined in paragraph 3(6):

> For the purposes of this paragraph a company is the parent company of a trading group if—
>
> (a) it has one or more subsidiaries;
>
> (b) each of its subsidiaries is a qualifying subsidiary of the company; and
>
> (c) the requirements of sub-paragraph (7) are fulfilled by what would be the business of the company and its qualifying subsidiaries if all the activities, taken together, of the company and its qualifying subsidiaries were regarded as one business.

This is rewritten in section 290(3) of this Act (and in section 298, the qualifying subsidiaries requirement, and in section 332, by the definition of "parent company").

Change 61 ensures that a relevant company can qualify as a parent company if there is the intention that one or more companies will become a qualifying subsidiary.

The new provision in section 290(2) states:

> If the relevant company intends that one or more other companies should become its qualifying subsidiaries with a view to their carrying on one or more qualifying trades—
>
> (a) the relevant company is treated as a parent company for the purposes of subsection (1)(b), and
>
> (b) the reference in subsection (1)(b) to the group includes the relevant company and any existing or future company that will be its qualifying subsidiary after the intention in question is carried into effect.
>
> This subsection does not apply at any time after the abandonment of that intention.

The change in section 290(6)

R&D is covered by the deeming provision in paragraph 4(1) of Schedule 28B to ICTA:

> the carrying on of any activities of research and development from which it is intended there will be derived a trade … shall be treated as the carrying on of a qualifying trade.

There are no requirements in this provision as to which company carries on the trade deriving from R&D.

Paragraph 3(9)(b)(i) of Schedule 28B to ICTA says (emphasis added):

> (9) Activities of a company or of any of its qualifying subsidiaries shall be disregarded for the purposes of sub-paragraphs (6) to (8) above to the extent that they consist in—

(a) …

(b) the holding and managing of property used by the company or any of its qualifying subsidiaries for the purposes of—

(i) research and development from which it is intended that a qualifying trade to be carried on by the company *or any of its qualifying subsidiaries* will be derived; or …

The provision is rewritten in section 290(5)(d) of this Act (with "a group company" instead of "the company or any of its qualifying subsidiaries" and with the impact of *Change 41* which extends the R&D in the frame to R&D that will benefit a qualifying trade).

Section 290(6) of this Act provides an interpretation of group company (as defined in section 332), which makes it clear that here this includes future group companies:

> Any reference in sub-paragraph (i) or (ii) of subsection (5)(d) to a group company includes a reference to any existing or future company which will be a group company at any future time.

Note

Section 290(2) and (6) of this Act do not specify that the company that is not yet part of the group has to be a qualifying 90% subsidiary. But the relevant company in section 290 has also to comply with other requirements such as those in sections 291, 293 and 294. This will determine whether the new subsidiary is required to be a qualifying subsidiary or a qualifying 90% subsidiary.

The change in section 291(8)

Section 291 of this Act is based on paragraph 3(3), (4), (5), (5A) and (5B) of Schedule 28B to ICTA.

Paragraph 3(3)(b) and (4)(a) of Schedule 28B to ICTA set out certain required activities for a qualifying company (emphasis added):

(3) Subject to sub-paragraph (4) below, when the relevant holding was issued and at all times since, a qualifying company (whether or not the same such company at every such time) must have been either

…. or

(b) preparing to carry on a qualifying trade which at the time when the relevant holding was issued was intended to be carried on wholly or mainly in the United Kingdom by *a qualifying company*

(4) The requirements of sub-paragraph (3) shall not be capable of being satisfied by virtue of paragraph (b) of that sub-paragraph at any time after the end of the period of 2 years beginning with the issue of the relevant holding unless

(a) the intended trade was begun to be carried on by *a qualifying company* before the end of that period, and …

A "qualifying company" is defined in paragraph 3(5A) as:

> the relevant company or any relevant qualifying subsidiary of that company.

A relevant qualifying subsidiary is defined in paragraph 5A of Schedule 28B to ICTA. This is rewritten as a qualifying 90% subsidiary in section 301 of this Act.

There is an indication in paragraph 3(5B) of Schedule 28B to ICTA that participation as a qualifying company is not restricted to existing subsidiaries (this is in relation to the commencement of the trade in paragraph 3(4)(a) of that Schedule).

This is also the intention behind the references to a qualifying company in paragraph 3(3)(b) of Schedule 28B to ICTA, rewritten in section 291(3). This phrase includes a subsidiary that is acquired after the date the shares are issued so long as other requirements such as those in paragraph 6 (2B) to (2AG) of that Schedule, rewritten in section 294 of this Act, are met.

But, to make this clearer, section 291(8) of this Act provides an interpretation of the reference in subsection (7) to a qualifying company which is a qualifying 90% subsidiary:

> The reference in subsection (7) to a qualifying company which is a qualifying 90% subsidiary of the relevant company includes, in its application to subsection (3), a reference to any existing or future qualifying company which will be a qualifying 90% subsidiary of the relevant company at any future time.

EIS (the enterprise investment scheme) and share loss relief

There is a parallel to these changes in Part 5 (EIS) and to the changes in section 290(2) and (6) in section 137(2) and (6) of this Act and new section 576B(3) and (7) of ICTA relating to share loss relief.

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

Change 62: VCT: trades whose carrying on by other persons prevents the relevant holding being a qualifying holding: section 294 and Schedule 2 Part 8 (the relevant company to carry on the relevant qualifying activity requirement)

This change identifies more clearly the cases in which the carrying on of trades etc by other persons prevents a relevant holding from being a qualifying holding for the purposes of Chapter 3 of Part 6 (VCT approvals). The trade etc which is later carried on by other persons must be one for which money was raised by the issue of the relevant holding.

Paragraph 6(1) of Schedule 28B to ICTA (so far as relevant) provides that (emphasis added):

> The *requirements of this paragraph are* that…the money raised by the issue of the relevant holding…been employed wholly for the purposes of *the trade* by reference to which the requirements of paragraph 3(3)…are satisfied…

From paragraph 6(2) and (2AA) it is reasonably clear that *the trade* in question must either have been carried on when the relevant holding was issued or have been one for which preparations to carry it on were then being made.

There is nothing preventing the relevant company from carrying on, or preparing to carry on, more than one trade when it issues the relevant holding. In such a case, if the relevant holding is issued to raise money for one of those trades (the funded trade), that trade will be *the trade* and the other trade(s) (unfunded trade(s)) will not.

Paragraph 6(2AB) of Schedule 28B (so far as relevant) provides that (emphasis added):

> The *requirements of this paragraph are not satisfied if…the trade* by reference to which the requirements of paragraph 3(3) are satisfied, and any preparations for that trade falling within paragraph 3(3)(b)…, are carried on…by a person other than the relevant company or a relevant qualifying subsidiary of that company.

Paragraph 6(2AB) refers to *the trade* for the purpose of determining if the requirements of paragraph 6 are not met. Paragraph 6(1) refers to *the trade* for the purpose of determining if the requirements of paragraph 6 are met. There is no explicit link between the trades referred to in each of these sub-paragraphs.

So it is arguable that, under paragraph 6(2AB), the subsequent carrying on of an unfunded trade by another person (not the relevant company or a relevant qualifying subsidiary of that company) prevents the relevant holding from satisfying paragraph 6; and that this result is unaffected by the relevant company continuing to carry on the funded trade.

But, in context, it is likely that paragraph 6(2AB) is limited to cases where the trade in question is the funded trade (the one that allowed the requirement of paragraph 6(1) to be met). That appears to be the more rational result and it is how HMRC interpret paragraph 6(2AB) of Schedule 28B to ICTA.

And a broadly similar provision in section 289(1A) of ICTA (enterprise investment scheme) looks at who is carrying on the various activities for which money has been raised by an issue of shares.

Section 294(1) of this Act rewrites paragraph 6(2AB) of Schedule 28B to ICTA on the basis that its restrictions about trades etc only apply to trades etc that allow the requirement of paragraph 6(1) of Schedule 28B to ICTA to be met. That removes the possibility of HMRC contending in future that paragraph 6(2AB) was meant to operate independently of paragraph 6(1).

Part 8 of Schedule 2 to this Act (the relevant company to carry on the relevant qualifying activity requirement) provides that this change does not apply to shares or securities issued before 6 April 2007.

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

Change 63: VCT: preparing to carry on research and development (R&D) is not treated as preparing to carry on a qualifying trade: section 300 and Schedule 2 Part 8 (meaning of "qualifying trade")

This change makes it clear that preparing for R&D is not a "qualifying activity".

Paragraph 3(3) of Schedule 28B to ICTA requires that a qualifying company must have been involved, at the time the relevant holding is issued and at all times since, in one of two activities. One is set out in paragraph 3(3)(a):

> carrying on a qualifying trade wholly or mainly in the United Kingdom.

Paragraph 4(1)(b) of Schedule 28B provides that the carrying on of any activities of R&D is treated as the carrying on of a qualifying trade where it is intended that:

> there will be derived a trade that will comply with this paragraph.

This means that the carrying on of any activities of R&D can meet the requirement in paragraph 3(3)(a) of Schedule 28B.

Paragraph 3(3)(b) refers to:

> preparing to carry on a qualifying trade which at the time when the relevant holding was issued was intended to be carried on wholly or mainly in the UK by a qualifying company.

There is no explicit guidance in paragraph 3 or paragraph 4 of Schedule 28B to ICTA about *preparing* to carry on R&D. But it has not been considered that the deeming provision in paragraph 4(1)(b) extends to the requirement in paragraph 3(3)(b). So preparing to carry on

R&D does not count as preparing to carry on a trade. This interpretation has been set out in the Venture Capital Schemes Manual.

In the enterprise investment scheme (EIS) and the corporate venturing scheme (CVS) the position is clearer. For EIS section 289(2)(b) of ICTA deals with R&D and in contrast to section 289(2)(a), which covers the carrying on of a qualifying trade, there is no mention of preparations. The VCT scheme was intended to follow EIS in this respect.

In paragraph 25(2) of Schedule 15 to FA 2000 (CVS) there is a deeming provision similar to the one in VCT. The final line states:

> But preparing to carry on such activities does not count as preparing to carry on a qualifying trade.

In practice there is an uncertain distinction between R&D and preparation for R&D but it seems sensible to put this matter beyond doubt and to match VCT with EIS and CVS.

Section 300(2) of this Act, (which is also subject to *Change 41*) states:

> The carrying on of any activities of research and development from which it is intended-
>
> (a) that a trade will be derived which-
>
> (i) will be a qualifying trade, and
>
> (ii) will be carried on wholly or mainly in the United Kingdom, or
>
> (b) that a trade will benefit which-
>
> (i) is or will be a qualifying trade, and
>
> (ii) is or will be carried on wholly or mainly in the United Kingdom,
>
> is to be treated as the carrying on of a qualifying trade.

Section 300(3) of this Act uses the same wording as that quoted from the CVS paragraph 25(2):

> But preparing to carry on such activities does not count as preparing to carry on a qualifying trade.

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

Change 64: VCT: excluded activities: the meaning of trade in relation to the provision of services or facilities for another business: section 310 and Schedule 2 Part 8 (excluded activities: provision of services or facilities for another business)

This change adapts the definition of "trade" in paragraph 5(4) of Schedule 28B to ICTA.

Paragraph 4 of Schedule 28B to ICTA is concerned with the meaning of a qualifying trade. Paragraph 5 contains provisions that interpret paragraph 4. Paragraph 5(4) contains a definition of trade:

> References in paragraph 4 above or this paragraph to a trade, except the references in paragraph 4(2)(f) to the trade for which services or facilities are provided, shall be construed without regard to so much of the definition of "trade" in section 832(1) as relates to adventures or concerns in the nature of trade; and those references in paragraph 4(2)(f) above to a trade shall have effect, in relation to cases in which it is carried on by a person other than a company, as including references to any business, profession or vocation.

Paragraph 4 of Schedule 28B to ICTA defines a "qualifying trade" and lists a number of activities (called "excluded activities" in the rewritten sections) that may prevent a trade being a qualifying trade. Paragraph 4(2)(f) concerns the activity of:

> providing services or facilities for any such trade carried on by another person … [which] consists, to a substantial extent, in activities within any of paragraphs (a) to (ee) above and is a trade in which a controlling interest is held by a person who also has a controlling interest in the trade carried on by the company providing the services or facilities.

Paragraph 5(2) and (3) interpret a "controlling interest".

As noted, under paragraph 5(4) of Schedule 28B to ICTA the reference to the trade in paragraph 4(2)(f) is governed by the definition in section 832(1) of ICTA, *in relation to the trade for which services or facilities are provided.*

Section 989 of this Act rewrites section 832(1) for income tax. There are two references to that section in Chapter 4 of Part 6 of this Act.

First in section 300(4) (meaning of "qualifying trade"):

> References in this section to a trade are to be read without regard to the definition of "trade" in section 989.

Secondly in section 313(3) (interpretation of Chapter):

> References in sections 303 to 309 to a trade are to be read without regard to the definition of "trade" in section 989 (see also section 300(4)).

These sections do not apply to section 310 (provision of services or facilities for another business) which rewrites paragraph 4(2)(f) and paragraph 5(2) to (4). So section 989 of this Act applies to define "trade" in section 310. The interpretation applies to all the references to "business" in section 310 and not only to the business for which services or facilities are provided.

The other part of paragraph 5(4) of Schedule 28B to ICTA states that references in paragraph 4(2)(f) of that Schedule to a trade include references to any business, profession or vocation in relation to some cases. These are the cases in which *a person other than a company* carries on the trade.

In section 310 of this Act there are consistent references to "business" rather than "trade". This includes references to the business carried on by a company. Paragraph 33 of Schedule 15 to FA 2000 (corporate venturing scheme) has been used as a model for this.

Instead of interpreting a trade as including a reference to "any business, profession or vocation", the approach in section 310(5)(b) is the other way round. It provides:

> "business" includes any trade, profession or vocation.

In effect therefore, in this section, a trade includes a business, profession or vocation, whether it is carried on by "a company" or "a person other than a company".

The first part of the change (in relation to the definition in section 989) simplifies things. In whatever way "trade" is interpreted in relation to the provider of the services or facilities in section 310, the activity of the relevant company or a qualifying subsidiary is required to be a qualifying trade for the other purposes of Chapter 4 of Part 6 of this Act.

In theory the second part of the change extends the scope of this excluded activity to a business, profession or vocation carried out by a company for which *the services are provided*. In practice it is unlikely that the activity of this company, which constitutes an excluded activity within paragraph 4(2)(a) to (ee) of Schedule 28B to ICTA, would be other than a trade.

The change is similar but not identical to *Change 46* in section 199 of this Act (the enterprise investment scheme). The changes get rid of an extra layer of complexity and have little or no practical effect.

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

Change 65: VCT: meaning of "company" and "shares" in Part 6: section 332 and Schedule 2 Part 8 (meaning of "company", "shares" and "research and development" in Part 6)

This change provides that "company" and "shares" have the same meaning in Part 6 of this Act (Venture capital trusts) as, by section 842(4) of ICTA, they have in section 842 of ICTA (Investment trusts).

Background

Section 842AA(11)(c) of ICTA provides that:

> without prejudice to their application in relation to provisions applied by paragraph (a) or (b) above, subsections (3) and (4) of [section 842] shall apply in relation to any reference in [section 842AA] to a holding or an addition to a holding as they apply in relation to any such reference in [section 842].

That provision is very compressed and therefore difficult to follow.

The definition of "company" in section 288(1) of TCGA (the TCGA definition), as provided for by section 842(4) of ICTA, differs from that in section 832(1) and (2) of ICTA (the ICTA definition). In broad terms the TCGA definition's treatment of most unit trusts as companies (see section 99(1) of that Act) means that it is wider in one sense than the ICTA definition. The ICTA definition does not automatically apply for the whole of ICTA since section 832(2) provides that it does not apply where:

> the context otherwise requires because some other definition of "company" applies

The definition of "shares" in section 288(1) of TCGA and the treatment of rights of unit holders as shares in section 99(1) of TCGA has no counterpart in section 832 of ICTA. Individual provisions of ICTA give whatever meaning of "shares" is appropriate to the provision in question (section 842(4) is an example of that in relation to investment trusts).

Companies invested in

It seems clear from section 842AA(11)(a) of ICTA (read with section 842(4) of ICTA) that references in section 842AA to a *holding in a company* contemplate that "company" and "shares" use the TCGA definition. And similarly from section 842AA(11)(c) it seems clear that references in section 842AA to *investments of any description*, in a company, contemplate that "company" and "shares" use the TCGA definition.

The two concepts in section 842AA of *holding in a company* and *investments of any description* relate to things in which the investing company that is, or may be, a venture capital trust has an interest. It would be reasonable from that context to suppose that "company" and "shares" in Schedule 28B to ICTA (venture capital trusts: meaning of "qualifying holding" in section 842AA) also use the TCGA definition.

The general use of the TCGA definition is probably one of the intended effects of section 842AA(11)(c) of ICTA but, as noted earlier, that provision is difficult to follow. The

definition of “company” and “shares” in paragraph 17 of Schedule 33 to FA 2002 (Venture capital trusts winding up and mergers etc) appears to have proceeded on the basis that Schedule 28B of ICTA uses the TCGA definition.

Investing company

In the case of the investing company that is, or may be, a venture capital trust it seems to make no difference whether “company” uses the TCGA definition or the ICTA definition. The investing company must be an entity capable of having an accounting period (see section 842AA(2) of ICTA) and that requires the investing company to be a company within the meaning of ICTA (see section 12 of ICTA).

That is a characteristic shared with an investing company which is, or may be, an investment trust. Section 842(4) of ICTA uses the TCGA definition of “company” and “shares” for the investing company (or any other company).

Conclusion

There appears to be no reason for section 842AA of ICTA to have two different definitions of “company” and “shares”.

Section 332 of this Act provides that the TCGA definition of “company” and “shares” applies in Part 6 (Venture capital trusts). That is a change because there is no such explicit provision in the source legislation.

Schedule 2 Part 8 (meaning of “company”, “shares” and “research and development” in Part 6) ensures that the change will not apply to any holding of investments of a particular description held by a company at the end of 5 April 2007. But the change will apply from any later time at which the holding of investments of that particular description ceases to be held by that company.

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

Change 66: Interest relief: loans partly meeting requirements: section 386

This change introduces a rule to apportion the amount of interest paid where a mixed loan is partly repaid.

Section 367(4) of ICTA deals with a loan in respect of which only a part is used for qualifying purposes (a mixed loan). The rule is that the interest eligible for relief is the percentage of the total equal to the percentage of the mixed loan that was originally applied to qualifying purposes.

It is not made explicit in section 367(4) of ICTA how the interest should be apportioned when a mixed loan is partly repaid. Where the repayment is less than the non-qualifying part of the mixed loan, so that the reduced loan is still mixed, the original percentage is applied. The result is that the repayment is apportioned rateably between the qualifying and non-qualifying parts. But the position is uncertain where the reduced loan is less than the original qualifying part as it could be argued that the reduced loan is no longer mixed and that section 367(4) has no application.

The fairest solution appears to be that all repayments should be applied rateably between the qualifying and non-qualifying parts, so that the percentage of interest eligible for relief is

fixed for that loan at the outset. Accordingly, section 386(3) and (4) provide such a rule. The rule confirms the treatment that has been applied in practice.

A different rule applies where capital has been recovered from the investment funded by the qualifying part of a loan. In such a case, by virtue of section 363(1) of ICTA, the qualifying part of the loan is treated as repaid to the extent of the recovery. A signpost to that rule, which is in section 406(5), is provided in section 386(3).

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

Change 67: Interest relief: exclusion of double relief: finality: section 387

This change makes clear when the amount of interest allowed as a business expense is finally determined for the purposes of rewriting section 368(3) of ICTA. It corresponds to Change 12 in Annex 1 to the Explanatory Notes accompanying ITTOIA in relation to the rewrite of section 368(4) of ICTA.

Section 353 of ICTA provides for interest to be claimed as a relief. In limited circumstances that relief may also qualify as a deduction in calculating the profits of a trade or property business. Section 368(3) of ICTA provides that relief is not given under section 353 of ICTA if a deduction for the interest has been taken into account as a business expense.

Section 368(3) of ICTA is subject to section 368(6) of ICTA. Section 368(6) provides that references to an amount taken into account are references to an amount taken into account in an assessment that has been finally determined.

The term "finally determined" does not fit well with Self Assessment. Section 387(7) makes clear that it means when the interest allowed as a deduction in an assessment can no longer be varied.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 68: Interest relief: loan to buy plant or machinery for partnership use: sections 388 and 389

This change clarifies the scope of section 359(1) of ICTA as including relief for interest on a loan to a partner for capital expenditure on assets used in a property business carried on by the partnership.

Section 359(1) of ICTA provides relief for interest on a loan to a partner who invests the proceeds in assets used by a partnership which is entitled to capital allowances under section 264 of CAA in respect of them. Section 264 gives entitlement to allowances for assets used in a qualifying activity carried on by a partnership. "Qualifying activity" is defined in section 15 of CAA and extends not only to trades and professions (which are clearly within the scope of section 359(1)) but also to other activities, one of which is an ordinary property business.

On the face of it, therefore, partnerships which carry on ordinary property businesses or those other activities come within the scope of this provision. But that view does not sit comfortably with section 359(2) of ICTA, which provides for relief to be apportioned but only where the business use is for the purposes of a trade or profession, not any other activity.

In fact, the reference to section 264 of CAA was substituted by paragraph 27(1)(a) of Schedule 2 to CAA for the previous reference to section 44 of CAA 1968. That section had itself been repealed by CAA 1990, a consolidation Act, but the need to amend section 359(1) of ICTA so as to substitute a reference to CAA 1990 for the reference to CAA 1968 was overlooked. So the text remained unaltered, although the references to the provisions in CAA 1968 were to be read as references to the re-enacted provisions by virtue of section 17(2)(a) of the Interpretation Act 1978.

In this case, the re-enacted provision was section 65 of CAA 1990, which related only to partnerships carrying on a trade (although, by virtue of section 27 of CAA 1990, section 65 of CAA 1990 applied to professions too, and it is clear from the mention of professions in section 359(2) of ICTA that they are within that section). But section 28A of CAA 1990, inserted by FA 1997, treated Schedule A businesses as trades for the purposes of Part 2 of CAA 1990 (including section 65). So it is arguable that section 359(1) of ICTA then applied to assets used in Schedule A businesses.

There is, however, a contrary argument, that the reference in section 359(1) of ICTA to section 44 of CAA 1968 (and hence to section 65 of CAA 1990) should have been read without the gloss on the reference to "trade" given by section 28A of CAA 1990. In general a reference in one enactment to another is to be read as a reference to that other Act as amended or applied by a later enactment, unless there is a clear intention that it should not be so read. (See section 20(2) of the Interpretation Act 1978.)

In this case, it is possible to discern such a contrary intention; FA 1997 did not, for example, amend section 359(2) of ICTA to make it clear that Schedule A businesses were covered by it. And the fact that section 359(1) of ICTA still actually referred to section 44 of CAA 1968, rather than a provision falling into Part 2 of the CAA 1990, is another indication that no intention to gloss this reference should be inferred.

CAA amended section 359(1) of ICTA by substituting a reference to section 264 of CAA for the reference to section 44 of CAA 1968. As mentioned above, this apparently extended section 359(1) of ICTA to all qualifying activities. On either of the views about section 28A of CAA 1990 mentioned above, that would have been a change in the law. But CAA was a Tax Law Rewrite Project Act and as such the starting point must be to assume that it did not change the law, except where such changes were acknowledged. It is considered therefore that a court would lean in favour of an interpretation that did not result in any such change, and accordingly might read section 359(2) of ICTA as imposing a restriction cutting back section 359(1) to its original scope.

In practice, it appears that loans for assets used for ordinary property businesses may have been given relief in some cases, but relief has not been given where the assets are used for the other qualifying activities ostensibly included by the amendment made by CAA.

In view of the uncertainty about the current law, section 359 of ICTA has been rewritten so as to include loans for assets used for trades, professions and ordinary property businesses carried on by partnerships, but not the other qualifying activities in section 15 of CAA. See sections 388(2)(a) and (4) and 389(4).

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

Change 69: Interest relief: loan to buy machinery or plant: sections 388 and 390

This change ensures that interest paid on a loan to a partner or employee to buy machinery or plant for use in a partnership or an employment is eligible for relief for so long as the machinery or plant is within the capital allowances regime.

Section 359(1) of ICTA provides relief for interest on a loan to a partner to buy machinery or plant for use in a trade or profession carried on by a partnership. Section 359(3) provides relief to an employee or office-holder to buy machinery or plant for use in an employment or office. In both cases eligibility for relief depends on the individual being "entitled to a capital allowance or liable to a balancing charge" in respect of the plant or machinery for the period of account or tax year concerned.

In any particular period while the asset continues to be used, it may be that the individual is not entitled to a capital allowance. The obvious such case is where the individual claimed a 100% first year allowance in an earlier period. In practice, loan interest relief is treated as continuing to be available in these circumstances. Sections 388(3) and 390(3) give effect to this practice by treating the individual as entitled to a capital allowance until a disposal value in respect of the asset is brought into account.

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

Change 70: Interest relief: loan to invest in partnership: meaning of "member of partnership": sections 399 and 409

This change gives statutory effect to Statement of Practice A33.

Section 362 of ICTA provides that an individual who is a member of a partnership may obtain relief for interest paid on money borrowed to invest in the partnership. In the predecessor to section 362 (section 21 of FA 1969) there was no requirement to be a partner, but only personally to act in the trade etc carried on by the partnership. The new wording, introduced by section 25 of FA 1981, was intended to relax the work condition, for example by including sleeping partners, but also raised doubts as to whether certain individuals who are not true equity partners no longer qualified.

Statement of Practice A33 addresses the eligibility of individuals who are commonly termed salaried partners. It provides:

> The Board are advised that [sections 362 and 363 of ICTA] extend to salaried partners in a professional firm who are allowed independence of action in handling the affairs of clients and generally so to act that they will be indistinguishable from general partners in their relationships with clients.

Section 399(5) gives effect to this Statement of Practice. That section is also applied by subsection (3) of section 409, which gives effect to ESC A43.

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

Change 71: Interest relief: loan to invest in co-operative: section 401 and Schedule 2 Part 9 (interest: loans for investing in co-operatives)

This change omits the condition that the loan must have been made after 10 March 1981.

Section 361(2)(a) of ICTA specifies that interest on a loan which is invested in a co-operative is only eligible for relief if the loan is made after 10 March 1981. As it is considered unlikely that loans made for this purpose prior to that date still exist, this condition has not been included in the rewritten legislation. But if, exceptionally, there were such loans then this change means that relief would be due provided the other conditions for relief are met.

In addition, where an original loan invested in a co-operative has been replaced by a new loan the condition that the original loan must have been made after 10 March 1981 no longer applies. That is reflected in the provision relating to section 401 in Schedule 2.

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

Change 72: Interest relief: loan to pay inheritance tax: section 403

This change amends and simplifies the condition in section 364(1)(a) of ICTA for interest on money borrowed to pay inheritance tax to be eligible for relief.

Interest on loans to personal representatives to pay inheritance tax is eligible for tax relief subject to certain conditions. The condition in section 364(1)(a) of ICTA is that the loan to the personal representatives is to meet:

> before the grant of representation or confirmation, … inheritance tax payable on the delivery of the personal representatives' account and attributable to the value of personal property to which the deceased was beneficially entitled immediately before his death and which vests in the personal representatives or would vest in them if the property were situated in the United Kingdom.

The wording of this provision derives from the rules regarding estate duty payable in respect of personal property in the estate which the personal representatives were required to pay before they could obtain a grant of representation or confirmation. Duty on personal property was payable on death, whereas duty on real property was due on the first anniversary of the death. So relief was available on a loan to meet the tax payable before grant of representation or confirmation, but not tax payable later.

Under the inheritance tax rules, tax attributable to liquid or easily realisable assets is due six months after the end of the month in which death occurred, whereas payment of the tax attributable to other assets may be spread over ten years. Section 226(2) of IHTA requires personal representatives applying for a grant of representation or confirmation to pay all the tax for which they are liable on delivery of their account. In practice, this means all non-instalment tax and any instalments already due. So to give relief for interest on a loan to meet tax payable before grant of representation or confirmation it is only necessary to refer to tax payable under section 226(2). The reference to "personal property" is no longer apt.

Therefore section 403(2), which rewrites the condition in section 364(1)(a) of ICTA, simply refers to tax that the personal representatives are obliged to pay under section 226(2) of IHTA.

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

Change 73: Interest relief: omission of section 368(2) of ICTA: section 404

This change omits the requirement under section 368(2) of ICTA that relief for interest under section 353 of ICTA is not to be given against income of a company except where the company is not UK resident and it cannot be taken into account in computing corporation tax.

Section 368(2) of ICTA contains two rules. First, it provides that no relief under section 353 of ICTA is to be given against income chargeable to corporation tax, except where the company is not UK resident and the interest cannot be taken into account in computing corporation tax.

But the only persons now entitled to claim interest relief under section 353 are individuals, except that personal representatives (PRs) may claim for relief under section 364 of ICTA (loan to pay inheritance tax). Companies acting as PRs do so in a fiduciary capacity and profits arising to companies in that capacity are liable to income tax rather than corporation tax by virtue of section 8(2) of ICTA. So if company PRs take out a loan to pay inheritance tax, the interest is a deduction in the income tax computation of the estate, not a deduction for corporation tax purposes.

The second rule in section 368(2) provides that relief under section 353 shall not be given against *any other income of a company*, (ie income not liable to corporation tax) except where the company is not UK resident and the interest cannot be taken into account in computing corporation tax.

Originally, this enabled a non-resident company receiving rents from property in the United Kingdom to obtain relief for interest on loans to acquire property in the United Kingdom, despite the fact that it could not obtain a deduction from income within Schedule A. It could also have referred to income arising to companies in their capacity as PRs or trustees (and so subject to income tax) or to income beneficially owned by the company but not chargeable to corporation tax for some reason, like distributions from UK resident companies.

As noted above, however, the rule in section 368(2) could now only be relevant in the case of company PRs borrowing to pay inheritance tax. So, the only sort of "other income of a company" that could be in point now is income arising to companies in their capacity as PRs. But there is no reason to prevent relief on such loans being given to UK resident companies, while allowing it to non-UK resident companies. And it is not thought that in practice this relief has been denied to UK resident companies acting as PRs.

Accordingly section 368(2) has not been rewritten.

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

Change 74: Interest relief: recovered capital: section 406

This change amends the rule in section 363 of ICTA about the effect on the amount of loan interest eligible for relief when capital is recovered from the business entity in which the proceeds of the loan were invested.

Section 363 of ICTA applies where the interest on a loan to an individual qualifies for relief under section 353 of ICTA because it meets the conditions in section 360 (loan to buy interest in close company), section 361 (loan to buy interest in co-operative or employee-controlled

company) or section 362 (loan to buy into partnership) and subsequently the individual recovers capital in the circumstances set out in section 363(2), *but does not use that capital in repaying that amount of the loan.*

In such a case the individual is treated as if he or she had repaid the loan to the extent of the recovered capital, with the result that the interest eligible for relief is correspondingly reduced. Where only part of the loan qualified for relief, the notional repayment is set against the qualifying part.

Sections 360, 361 and 362 of ICTA each contain another provision under which relief is lost completely if the individual recovers capital that is not taken into account under section 363. (See, for example, section 362(2)(b)). It follows that if the individual has recovered capital that is in fact used to repay *part* of the loan, then, since section 363 does not apply, the individual loses relief completely. This result was not intended. The correct result is achieved if section 363 applies where any capital recovery within that section occurs, whether or not the recovered capital is used to repay the loan. Then the provisions like section 362(2)(b) only bite where capital is recovered in circumstances not within section 363.

Accordingly, section 363(1) of ICTA has been rewritten in section 406 without the words which restricted its application to cases where the recovered capital was not used in repayment of the loan. And so the rule providing for a corresponding reduction in the interest eligible for relief, where only part of the loan qualified for relief, has been modified to ensure that the reduction is made from the amount of interest that would be payable and eligible for relief if no repayment, whether deemed or actual, had been made.

There may be cases in practice in which relief has been given (wrongly in law) for interest paid where the amount recovered was used to repay part of the loan. To the extent that the recovery has been set against the qualifying part of the loan then this change legislates that practice, which is generally in taxpayers' favour.

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

Change 75: Interest relief: partnership changes and business successions: sections 409 and 410

This change gives statutory effect to ESC A43 and extends it to cover partnership changes generally.

The text of ESC A43 is as follows:

> 1 Under sections 360-363, ICTA 1988, income tax relief is available for interest paid by an individual on a loan taken out to invest in, or on-lend to, a partnership, a co-operative, a close company, or an employee-controlled company. The relief is subject to various conditions, and ceases to be available when those conditions are no longer met.
>
> 2 Relief is also reduced or withdrawn (following section 363) if the borrower recovers any capital from the business without using it to repay the loan – for example by selling or exchanging the interest or shares in that business. Strictly, therefore, relief ceases to be due where:
>
> (a) a partnership is incorporated into a co-operative, a close company, or an employee-controlled company; or
>
> (b) shares in a co-operative, a close company, or an employee-controlled company are exchanged for, or replaced by, shares in any one of these kinds of company; or

(c) there is a partnership reconstruction involving a merger or demerger.

3 Under the terms of this concession, relief for interest on a loan to an individual will not be discontinued in the three kinds of circumstances described above where, in relation to that individual, the conditions for relief would have been met if the loan had been a new loan taken out by that person to invest in the new business entity. The rules restricting or withdrawing relief where the borrower recovers any capital from the business continue to apply in the normal way.

Paragraph 2(c) of the concession refers to a merger or demerger of a partnership, but does not attempt to define either term. The circumstances considered to be in point are set out in section 409(1). That section also allows relief to continue in cases where there are partnership changes not amounting to a merger or demerger. In practice, relief is such circumstances is also allowed on what is (in strictness) considered to amount to concessionary treatment.

Cases within paragraphs 2(a) and (b) of the concession concern other types of business succession. Section 410 gives effect to the concession by allowing relief to continue in those cases and also where the original investment was by way of loan.

If the individual recovers any capital from the business then the normal rules apply.

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

Change 76: Gift aid: a qualifying donation cannot be a deductible expense in computing income from any source: section 416

This change clarifies that a "qualifying donation" for gift aid purposes does not include a payment that is deductible in computing an individual's income from any source.

Until the gift aid rules were introduced by FA 1990, a donation could only qualify as a charitable donation if it was an annual payment, eg under a covenant. And section 74(1)(m) of ICTA was generally taken to mean that an annual payment was not a deductible expense in computing trading income. The practical result was that, except in the case of payments falling within ESC B7 (benevolent gifts by traders), a charitable donation could not be a deductible expense of a trader.

Section 25 of FA 1990 introduced the gift aid rules. As a result, a single donation of money to a charity could be made, and give rise to an income tax repayment for the charity and relief for the donor, even if (unlike a payment under a covenant) it was not made as a result of a legal obligation.

Section 25(6) of FA 1990, in its original form, provided that the Income Tax Acts were to have effect as if such payments were covenanted payments to charity. Because such payments were not annual payments, later subsections re-enacted various operative provisions of sections 348 to 350 of ICTA to apply to gift aid payments. This legislation, with amendments, ran side by side with the rules for true covenanted payments until FA 2000. But there was no enactment in section 25 of FA 1990 that applied section 74(1)(m) of ICTA to prevent a gift aid payment from being a trading deduction. So it became theoretically possible for such a payment to be an allowable deduction, depending on the applicability of other provisions of section 74(1).

Section 39 of FA 2000 radically amended section 25 of FA 1990, in effect abolishing the old regime of covenanted annual payments and taking all charitable donations out of the ambit of sections 348 to 350 of ICTA. But, again, section 74(1)(m) was not specifically applied to gift

aid payments. Further, section 74(1)(m) was not rewritten at all in ITTOIA, because it was considered to be without content.

This change restores the position in strict law to what has been established practice before and after the FA 1990 and FA 2000 changes. Double relief, under the rules for deductible expenditure and as a qualifying donation for gift aid, was never intended and has not been given in practice. It follows that, if a donation is allowable under any rule of deduction from income, it will not be a qualifying donation for gift aid purposes.

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

Change 77: Gift aid: gifts and benefits linked to periods of less than 12 months: priority between methods of calculating annualised amounts of gifts and benefits: section 419 and Schedule 2 Part 9 (gift aid: restrictions on associated benefits)

This change clarifies the operation of the rules about annualising the amounts of gifts and benefits in the various different sets of circumstances which can arise, by providing a priority rule to cater for certain cases where more than one of the statutory rules could apply in relation to a given set of circumstances.

If an individual makes a donation of money to a charity, and receives a benefit in consequence of making the donation, that benefit may affect whether the donation is "qualifying" (section 416(7)). And that in turn will affect whether the individual obtains tax relief for the donation under section 414(2). It will also affect whether the charity may obtain repayment of the tax treated as deducted from the donation under section 521(1) and (4) of this Act, or under section 25(10) of FA 1990 and section 505(1)(c)(ii) of ICTA.

The source legislation (section 25(5B) to (5D) of FA 1990) contains rules to counter tax advantages from fragmentation of the time periods attaching to donations or to consequent benefits. In particular, section 25(5D) (rewritten in section 419(8) of this Act) lays down the method of annualising either the gift, or both the gift and the benefit, in different circumstances. Those circumstances are set out in section 25(5B) and (5C), rewritten in section 419(2) to (5) of this Act as Conditions A to D.

But the source legislation does not set out what is to happen if the circumstances fall within one of Conditions C and D and within one of Conditions A and B, which in theory can occur.

This change provides a priority rule to cater for such cases, which is located in Step 2 of section 419(8). It provides that, in such a case, the rule relating to Conditions C and D takes priority.

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

Change 78: Gift aid: omission of section 25(9)(c) of FA 1990: sections 423 and 425

This change clarifies the way in which the total amount of income tax and capital gains tax to which an individual is charged is calculated (amount B in section 423, adjusted to amount C in section 424).

There are two places in which the source legislation provides for the "amount of income tax and capital gains tax with which the donor is charged" to be calculated.

The first (in section 25(6)(c) of FA 1990) is used to determine whether any personal and other allowances in Chapter 1 of Part 7 of ICTA should be restricted in order to ensure that the donor is charged with an amount of tax equal to the tax treated as deducted from the gift. This is "amount B" in the rewritten legislation (section 423).

The second (in section 25(9) of FA 1990) is used to determine the amount of income tax the donor may have to pay under section 25(8), and presupposes that any restriction of personal reliefs under section 25(6)(c) has already been carried out. This is "amount C" in the rewritten legislation (section 424).

Section 25(9) of FA 1990 provides detailed rules about how this calculation is to be carried out. But there are no such explicit rules in section 25(6)(c) of FA 1990.

The change makes it clear that amounts B and C are both to be calculated following the detailed rules in section 25(9) of FA 1990, subject to taking account of any restriction of personal reliefs when calculating amount C.

In particular, this means it is not necessary to rewrite section 25(9)(c) of FA 1990. That provision was anomalous as although the tax reduction for married couples and civil partners may be restricted under section 25(6)(c), the second calculation disregards that tax reduction but without it being clear how any such restriction is to be taken into account when doing so (section 25(9)(c)).

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

Change 79: Gift aid etc: removal of redundant references to certain charities: sections 430 and 446 and Schedule 1 (section 587B of ICTA and sections 108(4), 620(5) and 628(6) of ITTOIA)

This change omits specific references to the British Museum and the Natural History Museum from the sections treating exempt bodies as charities for the purposes of the rules about gift aid (see section 430) and gifts of shares, securities and real property to charities etc (see section 446). It also omits those references from sections 108(4), 620(5) and 628(6) of ITTOIA.

Both the gift aid rules (in section 25(12) of FA 1990) and those about gifts of shares, securities and real property to charities etc (in section 587B(9) of ICTA) define charity to include the bodies listed in section 507(1) of ICTA.

The list of bodies in section 507(1) of ICTA includes the Trustees of the British Museum and of the Natural History Museum. But the functions of both these bodies are set out in the British Museum Act 1963 and are fully charitable. (It was confirmed that the British Museum was a charity as long ago as 1891, in Special Commissioners for Income Tax v Pemsel (1891), 3 TC 53 HL.)

This does not affect the exemptions from corporation tax afforded to these bodies by section 507 of ICTA, which continue to have effect.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 80: Gifts of land to charities: qualifying interests in land held jointly: sections 442 and 443 and Schedule 1 (sections 587BA and 587C(2) and (3) of ICTA)

This change makes it clear that, in cases where land is held by owners as joint tenants or as tenants in common, the fact that one or more owners may not be eligible for relief does not deny relief to other eligible owners. In doing so it clears up a misunderstanding that could arise from section 587C(2) and (3) of ICTA.

Section 587C(2) of ICTA reads as follows:

> Where two or more persons-
>
> (a) are jointly beneficially entitled to the qualifying interest in land, or
>
> (b) are, taken together, beneficially entitled in common to the qualifying interest in land,
>
> section 587B applies only if each of those persons disposes of the whole of his beneficial interest in the qualifying interest in land to the charity.

And section 587C(3) of ICTA begins with the words:

> Relief under section 587B shall be available to each of the persons referred to in subsection (2) above…

Taken together, this means that, if relief is to be given to any person in respect of the disposal, the land that is to be given to the charity must be owned only by individuals and companies that are not charities. This is not in accordance with the policy of section 587C. The intention is to give relief in such situations to those persons that are eligible, provided that all owners (whether eligible for relief or not) dispose of the whole of their beneficial interests in the land.

This change also clarifies how the relevant formula in section 434(1) or (2) of this Act (as appropriate) is to be applied. The relievable amount is first calculated under section 443(2) of this Act as if all owners (whether eligible for relief or not) were a single individual. The various amounts required by the appropriate formula, including incidental costs, benefits and notional consideration for the purposes of chargeable gains, are pooled. The share of any non-eligible person is then carved out, so that the relievable amount for the disposal does not include that share. It is then for the eligible donors to agree the allocation of that relievable amount between them.

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

Change 81: Charges on income: general approach: sections 24, 89, 425, 448, 449, 505, 900, 901, 903, 942, 946, 964 and 979 and Schedule 1 (sections 51 and 272 of ITTOIA)

Introduction

This change is about the approach adopted in rewriting the provisions about those annual payments and patent royalties which constitute charges on income. It also concerns the approach adopted in the parallel provisions about deemed payments by trustees of unauthorised unit trusts.

The change replaces the present approach to charges on income (which owes its origins to the historic concept of alienation of income) with a deduction in calculating net income, coupled with provision for deduction of tax at source from the payments involved. The tax deducted

will be collected either as a specific element of the payer's tax liability under Self Assessment, or by separate assessment.

This change of approach is fundamental in principle. It changes the structure and simplifies the inner workings of the legislation, greatly reducing the extent to which these provisions, which only concern a very narrow range of payments, have a cross cutting impact across the legislation as a whole. And, by aligning the approach to patent royalties with that for annual payments, it removes the need for complex provisions about the interactions between charges on income and terminal loss relief.

But it does not affect the overall amount of tax anyone pays, and involves only very limited administrative change.

General position in the source legislation

The main source legislation involved is in sections 3, 347A, 348, 349(1) to (1B), 350(1) and 387 of ICTA and section 51 of ITTOIA.

Sections 348 and 349(1) to (1B) of ICTA run in parallel and, supported by section 3 of ICTA, are concerned only with certain annual payments and certain patent royalties. The scope of these sections is much reduced from what it once was, now that they no longer apply to interest and given the interplay of these provisions with section 347A of ICTA.

Section 348 of ICTA applies when the payment is payable wholly out of profits or gains brought into charge to income tax and section 349 of ICTA applies when it is not so payable. Broadly, section 348 applies where the payer is subject to income tax and has sufficient income to cover the charge on income, and section 349 applies where the payer is subject to corporation tax or is exempt or, while subject to income tax, has insufficient income to cover the charge on income.

The concept of alienation of income, which lies in the background to sections 3 and 348 of ICTA, is that an amount of income equal to the amount of the charge on income is regarded as no longer being the income of the payer, but as the income of the payee instead. The tax that the payer deducts (it will always be in the payer's interest to deduct and retain the tax even though it is optional) enables the payee to be regarded as receiving the payment under deduction of tax (see sections 602 and 618 of ITTOIA).

All of the payer's income is subject to tax, without the annuity or other annual payment being deducted (see section 348(1)(a) of ICTA) and without the charge on income consuming any part of the payer's basic rate band (as it is always to be charged at the basic rate: see section 3 of ICTA), to ensure the tax concerned is collected from the payer.

Section 348 of ICTA can only work where the payer has sufficient income. Where this is not the case, section 349 of ICTA applies. Here, deduction of income tax is mandatory and the tax is collected by assessment under section 350(1) of ICTA. There is no relief under the deduction at source regime for payments assessed under section 350 (but the payment may qualify for other relief, eg as a deduction in calculating trading profits).

At the boundary between these two regimes lie cases where the payer has only sufficient income to cover part of the charge on income. In these cases the whole payment falls within section 349(1) of ICTA (and so deduction of tax is mandatory), but it is only the tax on the excess that needs to be collected by assessment under section 350(1) of ICTA (see the

reference there to "on the payment, or on so much thereof as is not made out of profits or gains brought into charge to income tax").

There are then a variety of provisions designed to maximise the extent to which payments can be handled within the scheme of section 348 of ICTA, including those reducing the extent of personal reliefs (see section 276 of ICTA), tax reducer reliefs (see eg section 256(3)(c)(ii) of ICTA), and the availability of terminal loss relief (see the first part of section 388(5) of ICTA). It is only where such measures prove insufficient that the regime of section 349(1) of ICTA comes into play.

Complex features of the present position include:

- the conceptual background of the payer's income being alienated to the payee (an approach which dates from the time when different sources of income were assessed separately without regard to total income);
- the idea of payments being (or not being) made out of profits or gains brought into charge to income tax, the boundary between sections 348 and 349(1) of ICTA, and the need for a payer to know which regime will apply; and
- the resulting multiplicity of provisions across the income tax code which require understanding of charges on income, despite the fact that the range of payments still treated in this way is now very narrow.

Provisions about patent royalties

The source legislation takes a different approach as between annual payments and patent royalties.

The main legislation involved is section 51 of ITTOIA (which denies a trading deduction for patent royalties) and section 387 of ICTA (which, where tax is accounted for on a charge under section 350 of ICTA, enables relief to be given as a carry forward loss instead).

Section 387 of ICTA was introduced in FA 1928 in response to A-G v Metropolitan Water Board (1927), 13 TC 294 CA. That case concerned a payment of interest (interest being a charge on income at that time) which was found not to be payable out of income because the previous year basis of assessment then in force meant that it had been paid in a different year from that in which the corresponding income had arisen, and so the tax deducted was not covered. Section 387 addresses the inequity by allowing the amounts assessed under section 350(1) to count as losses to be carried forward against future profits.

Section 51 of ITTOIA (based on section 74(1)(p) of ICTA) prevents patent royalties from being deductions in computing trading profits. But it is still possible for patent royalties to give rise to a loss under section 387 of ICTA.

But annual payments are not prevented from being trade deductions, as is indicated (in an insurance context) by the case of Gresham Life Assurance Society v Styles (1892), 3 TC 185 HL. And sections 74(1)(m) and 817(1)(b) of ICTA were not rewritten for income tax purposes in ITTOIA, as they were unnecessary.

So any annual payment made wholly and exclusively for the purposes of the trade, profession or vocation (in accordance with the requirement in section 387(1) of ICTA) will already have been deducted in computing the profits of that business. So no further relief will be necessary

or allowed, as section 385 of ICTA ensures that relief is only given under that section if it has not already been obtained elsewhere.

Accordingly, section 387 of ICTA only applies to patent royalties. And if it were not for section 51 of ITTOIA it would not be necessary.

Unauthorised unit trusts (UUTs)

Under section 469(3) of ICTA (and section 548(2) of ITTOIA), trustees of UUTs are treated as making annual payments equal to the amount shown by the UUTs accounts as available for distribution or investment.

The trustees are chargeable with the income arising, and the charge to tax on that income is almost exclusively at the basic rate. But for a number of reasons (eg the availability to the trustees of capital allowances) the amount of the deemed annual payment need not be equal to the amount of the trust's taxable income.

Trustees may therefore be treated (under section 348 of ICTA) as deducting and retaining income tax to the extent that the deemed annual payments do not exceed the taxable income. But it is also possible for trustees to be treated as making a payment not wholly out of taxable income, and thus to incur a liability under section 350 of ICTA. In practice such tax is collected through the UUT's self assessment return. Where there is a liability under section 350 the rules in section 469(5A) to (5D) of ICTA give relief to the extent that, in previous tax years, taxable income has exceeded the deemed annual payments.

The rewritten legislation

The approach adopted removes many of the complexities in the source legislation, by bringing the legislation substantially into line with the computational approach adopted in practice in the comprehensive tax calculation guide that accompanies self-assessment returns (which for example already treats relief for charges as a deduction from income).

General rules

Under this change relief is given for the annual payments and patent royalties previously within section 348 of ICTA as a deduction in calculating net income (but not from "non-qualifying income"): see sections 448(4), 449(5), 1025(2)(a) and 1026. So section 3 of ICTA is not rewritten. That section required the income out of which an annual payment or patent royalty payment is made to be charged at the basic rate. The new approach makes it unnecessary.

Income tax is still deducted (at the basic rate, except in the cases covered by section 902(3)). Rather than this being optional or mandatory depending on the payer's position, it is always mandatory. So section 348(1)(c) of ICTA is not rewritten. The tax deducted from the payment will be collected directly rather than being charged on the income out of which the payment is made.

The tax deducted is then collected as part of the payer's self-assessment (see Chapter 17 of Part 15 of this Act) and the provisions that restrict personal reliefs etc are no longer needed.

The change also means that some payers who under the source legislation have to account for part or all of the deducted tax under a section 350 assessment will now account for it under Self Assessment. This will affect:

- all individuals (section 350 of ICTA will no longer apply to them, regardless of the amount of income they have in the tax year); and
- persons other than individuals whose income is only sufficient to cover part of the charge.

It should normally be less onerous for taxpayers to deal with this on their self-assessment returns than to have to deal with it separately. But a few taxpayers who do not presently require a self-assessment return will need to complete one in future.

In addition, taxpayers will no longer have to worry about which regime applies. This is relevant in relation to taxpayers for whom it is not easy to tell in advance whether their income will or will not be sufficient to cover charges on income.

The change may affect the time at which tax is paid (including payments on account) and the compliance regime applicable. But it will affect only a small number of taxpayers and the amounts involved are correspondingly small.

None of this will affect the position of corporation tax payers, exempt bodies such as local authorities, or income tax payers (other than individuals) who have no income and who would not otherwise have needed to complete a self-assessment form. All these will remain within one or other of the regimes rewritten in Chapters 15 and 16 of Part 15 of this Act.

Specific rules about patent royalties

This change also more fully aligns the mechanics of the legislative approach to patent royalties with that for annual payments.

Patent royalties will in future be deductible in calculating net income where appropriate, but tax will still be deducted and accounted for in respect of such payments. This involves repealing section 387 of ICTA and section 51 of ITTOIA (and the corresponding entry in the table in section 272 of ITTOIA) and, as a consequence, the latter part of section 388(5) of ICTA (interaction of section 387 payments with terminal loss relief).

This is in principle in taxpayers' favour, because of the removal of the restrictions in section 387(2) of ICTA, but should not change things in practice as any payment falling foul of them would be very unlikely to qualify as a trading deduction.

Specific rules for unauthorised unit trusts

In accordance with the general approach, trustees of UUTs will obtain a deduction in calculating net income of the amount of their deemed payments in a tax year (see section 505). Those deemed payments, as now, will be equal to the amount shown in the trustees' accounts as available for distribution or investment.

They are no longer described as annual payments, because the charge on the recipient of them in Chapter 10 of Part 4 of ITTOIA is distinct from the charge on annual payments in Chapter 7 of Part 5 of that Act. But relevant rules relating to annual payments are applied to unauthorised unit trusts where necessary.

This change will make no difference to the amount of tax trustees of UUTs pay or to how it is collected, as it is in all cases collected through trustees' self assessment returns at present.

The relief that applies if, in previous tax years, taxable income has exceeded deemed payments will also remain unchanged. But it is now expressed in terms of tax rather than as an amount by which a deemed payment is reduced: see sections 942(3) to (5) and 943.

Consequential amendments to London Olympic Games legislation

Sections 65, 67 and 68 of FA 2006 remove from certain persons the duty to deduct sums representing income tax from annual payments. The source legislation refers only to section 349(1) of ICTA; it does not refer to section 348(1), but only because that section provides a right to deduct rather than a duty to deduct. Accordingly, consequential amendments are made by Schedule 1 to ensure that no new duty to deduct arises in such cases as a result of this Change replacing the right to deduct under section 348(1) with a duty.

Consequential amendment to provision regarding designated international organisations

Section 582A(1) and (4) of ICTA removes the requirement to deduct sums representing income tax from annual payments and patent royalties within section 349(1) of ICTA made by designated international organisations. It applies to cases where deduction of tax is mandatory. Now that mandatory deduction has been extended to such payments that previously fell within section 348 of ICTA, section 979 (which rewrites section 582A of ICTA) similarly applies to all payments within Chapter 6 of Part 15 of this Act.

Related Changes

There are a number of related Changes, which are concerned with:

- when payments are regarded as being, or not being, made out of profits or gains brought into charge to income tax, not least in the context of trusts (*Change 82*);
- the rate at which tax is to be deducted, depending on the year in which the payment is made (*Change 138*);
- the deduction of tax from patent royalties which are annual payments (*Change 139*); and
- the interplay between charges on income and various reliefs and adjustments that relate to a later year, such as loss relief claims and farmers' and creative artists' averaging (*Change 154*).

This change is in principle favourable to some taxpayers. It also affects when and how tax is paid and administrative requirements. But the numbers affected are expected to be few (and the amounts involved small).

Change 82: Charges on income: when payments are made "out of" profits or gains brought into charge to income tax: sections 450, 505, 1025 and 1026

This change concerns the rewrite of the phrase "out of profits or gains brought into charge to income tax", in the context of the general approach to the rules about charges on income (see *Change 81*).

The question whether a payment is made out of profits or gains brought into charge to income tax is easily answered if a payer has no income subject to income tax (such as a company, an exempt person, or an individual who happens to have no income). The difficulties arise where a payer has some income subject to income tax.

Where a payer does have some such income, a number of questions can arise in deciding whether or not the payment can be said to have been made out of that income, and there is a good deal of case law on the point. The significance of the point, under the new approach, is whether or not the payer can deduct the payment at Step 2 of the tax calculation (see section 23 of this Act).

The first issue is whether or not the income is sufficient overall. And this is the only question which now matters in the case of individuals – see CIR v Plummer (1979), 54 TC 1 HL at page 41 (Lord Wilberforce). So here it is necessary to compare the amount of the individual's "modified net income" (as given by section 1025) with the amount of the payment. For this purpose it is necessary to ignore this relief itself and any "non-qualifying income" as provided by section 1026.

In other instances the position is less straightforward and regard must be had to a number of decided cases. For persons other than individuals, additional tests can be discerned from these cases which outlaw deductions for payments which:

- are reimbursed (unless the reimbursement is taxable);
- can only lawfully be made out of capital or exempt income; or
- are treated by the payer as made out of capital or exempt income (when they need not have been) and this has a real world effect.

The following paragraphs provide more detail on cases that illustrate the three principles mentioned in the bullets above.

As to the first bullet: a number of cases (Dickson v Hampstead Borough Council (1927), 11 TC 691 KBD, Corporation of Birmingham v CIR (1930), 15 TC 172 HL, Scarborough Corporation v CIR (1947), 28 TC 147 KBD) have concerned statutory subsidies for interest payable on borrowings for capital works. (Such interest was then an annual payment.) The subsidies, which were not taxable in the recipients' hands, were for the gross amount of the interest, but in each case the corporation (which had taxed income) sought to obtain relief by retaining the tax deducted from the interest it paid. And in each case the courts held that this was inadmissible, and that the tax should be handed over.

As to the second bullet: in Sugden v Leeds Corporation (1913), 6 TC 211 HL the corporation borrowed money for two purposes: for investment into gasworks, waterworks and tramways ("municipal" undertakings), which were highly lucrative, and into sanitary works, which were not. There was in effect a statutory provision that the two funds could not be mixed. The corporation had insufficient money in the "sanitary" fund to meet the interest, so paid the balance of interest (which then was an annual payment) out of the Consolidated Fund, the income of which was untaxed (the borough rates). It was held that the corporation could not use the income from the "municipal" fund to frank the payment, and was assessable for the tax on the balance of the interest. It was not that the corporation had acted outside its powers, but that, had it made such an actual payment out of the "municipal" fund, it would have been so acting.

As to the third bullet: in Central London Railway Co v CIR (1936), 20 TC 102 HL and Chancery Lane Safe Deposit and Offices Co Ltd v CIR (1965), 43 TC 83 HL the respective companies borrowed money for capital works and charged such interest to capital in their

accounts. It was held that this policy was not a matter of "domestic bookkeeping" but had a real effect on persons' rights and liabilities (absolute or contingent), because the fund of distributable profits was affected. In CIR v Ayr Town Council (1938), 22 TC 381 CS at page 403, Lord Normand said:

> Though the taxpayer is not bound by the mere form of the accounts, he is bound by the accounts so far as they have recorded a decision to debit the various funds in a particular way which has practical results apart from his right to retain Income Tax …

And in the circumstances dealt with in the first two cases mentioned above it was held to be inadmissible for the taxpayer to state that for one purpose it had made a capital payment, while for another it had made the same payment out of taxed income.

Under the approach to rewriting sections 348 and 349(1) of ICTA, the regime that applies for deducting and accounting for tax will no longer depend on whether the payment is made out of income brought into charge to income tax. Accordingly the rules on relief for payments are rewritten without direct appeal to that concept. On this approach, the restrictions on relief for persons other than individuals discerned from the cases mentioned above must be set out explicitly.

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

Change 83: Relief for payments to trade unions and police organisations: claims requirement: sections 457 and 458

This change introduces a claims requirement into the sections giving relief for life insurance related parts of payments to trade unions and police organisations (which are based on section 266(7) of ICTA).

In general, relief for life insurance premiums is given without a claim – section 266(1) of ICTA. This reflects the fact that in relation to qualifying ordinary life insurance policies relief is given at source, by the policyholder paying a reduced premium to the insurance company. But it is less satisfactory in relation to the life insurance related part of payments made gross to trade unions and police organisations for which relief is available in calculating net income, given that other such reliefs, and personal allowances, have to be claimed.

In practice, box 15.10 of the self assessment return does require a claim to this relief. The introduction of a formal claims requirement brings the law into line with this practice and provides a mechanism for resolving disputes.

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

Change 84: Limits to relief for payments to trade unions and police organisations and payments for benefit of family members: sections 457, 458 and 459

This change revises and simplifies the limits to relief for the life insurance related parts of payments to trade unions and police organisations under section 266(7) of ICTA and for payments to secure annuities etc under section 273 of ICTA.

The limits to relief are in section 274 of ICTA. They are in two parts.

Section 274(1) provides an overall limit of the greater of £1,500 and one-sixth of total income to the aggregate amount of premiums and other sums qualifying for relief under section 266. This rule did not impact on claims under section 266(7) and its linkage to other reliefs under section 266 (which are not being rewritten) is a needless complication. Accordingly, this part of the limit has been dropped. It did not apply to payments under section 273.

Section 274(2) and (3) provides a combined limit to relief under sections 266 and 273 in respect of any premiums or other sums that secure benefits other than capital sums payable on death. This is also complex, in that it combines premiums under section 266(1) with other payments under section 266(7) and section 273. Also, in expressing the limit as it applies to payments under section 266(7) in terms of tax at the basic rate, it is inconsistent with the fact that the relief operates as a deduction in calculating net income. Furthermore, relief under section 273 operates differently, as a tax reduction. It is much more natural to have independent limits applying to each provision.

The amounts of relief actually given under section 266(7) are small. While the existing limit to relief applies only to the part of any payment providing certain benefits, it is proposed to apply the limit to the whole of the qualifying payment. Although introducing a limit of £100 (corresponding to a qualifying payment of £200) is adverse in principle it is understood that no existing claims will be affected. And the fact that the relief will operate as a deduction in calculating net income rather than being limited to basic rate is taxpayer-favourable.

For relief under section 273 (ignoring the fact that other payments may have already used up some of the limit), the limit is £100 at basic rate. In strictness, the limit applies only to part of some payments under section 273, so again this aspect of the change is adverse in theory, but most or all payments under section 273 are solely to provide annuities to which the limit does apply. And in practice the limit has always been applied to all payments within that provision.

Each of the three provisions has been rewritten with an independent limit of £100. The exclusion of war insurance premiums from counting towards the limits (section 274(4)) is obsolete and has not been included.

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

Change 85: Settlements: receipts not charged at special trust rates: sections 481 and 873

This change ensures that receipts within section 686A of ICTA are not liable at the special trust rates when they arise to charitable trusts or to certain pension funds. It also ensures that the special trust rates do not apply to such receipts that are accumulated or discretionary income or would be but for being excepted by section 480(3) of this Act.

Certain amounts arising to trustees are liable at either the trust rate or the dividend trust rate regardless of whether or not the trustees would otherwise have accumulation or discretionary income.

Before FA 2006, the provisions applying the special trust rates were in the parts of the income tax code dealing with the types of amount concerned and section 686A of ICTA dealt only with distributions on the purchase by a company of its own shares. With effect from 6 April 2006, substituted section 686A brings together all the charges at the special rates.

Before 6 April 2006, section 686A(4) contained express exemptions from the charge at the special rates for charitable trusts and certain pension funds. These exemptions were not replicated in the substituted section although corresponding exemptions were retained in section 686. The exemptions are re-inserted in the re-write of section 686A (see section 481 of this Act).

The exemptions now apply to all the items within substituted section 686A, not just to distributions arising on the purchase by a company of its own shares. The exemption for charitable trusts is in section 481(1) (see section 686A(4)(c) before 6 April 2006) and that for the pension funds concerned is in section 481(5)(c) (see section 686A(4)(d) before 6 April 2006).

Prior to 6 April 2006, section 686A(4)(a) also ensured that there was no overlap between sections 686 and 686A. That has been replicated in section 481(5)(a) and (b).

What was section 686A(4)(b) prior to 6 April 2006 has not been re-written on the basis that the corresponding exemption in section 686 was repealed by FA 2006.

Trustees liable at one of the special trust rates are subject to the deduction of income tax at source provisions applying to deposit-takers and building societies in Chapter 2 of Part 15 of this Act. To ensure that section 873 also applies in the same way as its source legislation in section 481(4A) of ICTA did prior to 6 April 2006, section 873(2) also reinstates corresponding exemptions.

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

Change 86: Settlements: taxation of amounts taxable under the accrued income scheme: section 482 and Schedule 1 (section 720 of ICTA)

This change ensures that income arising to trustees under sections 628(5) and 630(2) (accrued income profits) is treated in the same way as all other receipts that are taxed at the trust rate.

Section 686A of ICTA, as substituted by FA 2006, brought together those receipts by trustees that are taxable at one of the special trust rates whether or not the trustees would otherwise have accumulation or discretionary income. But it did not include amounts taxable on trustees at the trust rate by virtue of section 720(5) of ICTA. In the interests of simplification, these amounts are included in the re-write of section 686A. See Type 2 in section 482.

The inclusion of these amounts in the list in section 482 means that the exemptions for charitable trusts and specified pension funds apply and that trustees' expenses may be set against the deemed income.

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

Change 87: Settlements: trustees' expenses set against accumulated or discretionary income when incurred: sections 484 and 485 and Schedule 2 Part 10 (trustees' expenses to be set against trustees' trust rate income)

This change alters the way that trustees' expenses are taken into account in measuring the trustees' liability on income liable at the dividend trust rate or at the trust rate, so that this is

done by reference to when the expenses are incurred rather than when they are paid. It also introduces explicit rules about the relief available where the expenses exceed such income.

Accumulation or discretionary income, and certain other receipts of trustees, are liable to income tax at either the trust rate or the dividend trust rate. Section 686(2AA) of ICTA provides that where this "trust rate income" is applied in defraying allowable expenses the income is charged instead at the normal rate appropriate to the income concerned. The word "defraying" is considered to require that the expense must have been paid before it is taken into account.

For settlements in which a beneficiary has an interest in possession, expenses are taken into account when they are *incurred* (see section 500(1) of this Act). This difference can give rise to practical difficulty, eg in relation to settlements that have both types of beneficiary. This change removes the difference, so that the rule in section 484 also uses the "incurred" basis.

Section 485 introduces explicit rules about the relief available where the trustees' expenses exceed the trustees' trust rate income in the tax year concerned. That section also operates by reference to when the expenses are incurred (contrary to present practice). The rule is that excess expenses are carried forward and relief is given as soon as there is sufficient income available.

In general, expenses are not paid before they are incurred. This timing effect will normally be in trustees' favour.

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

Change 88: Settlements: grossing up of trustees' expenses set against accumulated or discretionary income: section 486

This change makes it clear that trustees' expenses are grossed up when set against the amount of income chargeable on the trustees at the trust rate or the dividend trust rate.

Trustees are chargeable under section 686(1) of ICTA at either the trust rate or the dividend trust rate on their accumulated or discretionary income. But section 686(2AA) of ICTA provides that where that income is applied in paying allowable expenses the income is charged instead at the normal rate appropriate to that income.

Since the expenses are regarded as being paid out of income after it has suffered tax at the normal rate, the amount of income arising to trustees which is applied in defraying expenses is an amount of income sufficient to meet both that tax and the expenses. In order to arrive at this amount of income, the expenses have to be grossed up at the appropriate rate. The grossing up of expenses is accepted practice although it is not clear from section 686 of ICTA itself.

In setting out how allowable expenses are taken into account, Steps 3 to 6 of section 486(1) require those expenses to be grossed up at the normal rate for the type of income concerned.

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

Change 89: Settlements: discretionary payments: provisions applying only to UK resident trustees: sections 493 and 497 and Schedule 2 Part 10 (discretionary payments: trustees' tax pool)

This change makes it explicit that the Chapter dealing with the taxation of discretionary payments by trustees applies only to payments made and tax suffered while the trustees are UK resident.

Section 687 of ICTA contains rules regarding the liabilities of the trustees and the beneficiary when the trustees make a payment to a beneficiary in the exercise of a discretion. The rules can only operate sensibly where the payment is chargeable on the beneficiary as an annual payment under Chapter 7 of Part 5 of ITTOIA and it is well established that those provisions only apply where the payment arises in the United Kingdom.

The question can arise as to whether that test is satisfied in cases where UK resident trustees exercise discretion abroad or non-UK resident trustees exercise discretion in the United Kingdom. The approach adopted in practice is that section 687 of ICTA applies only to payments by UK resident trustees. Accordingly, section 493 contains the condition that it only applies to UK resident trustees. It follows that where a payment is made by non-UK resident trustees:

- the payment does not carry any tax credit in the hands of the beneficiary; and
- the trustees are not liable for any tax in respect of the payment.

As a corollary to the provisions of section 687 of ICTA not applying to non-UK resident trustees, tax only enters the trustees' tax pool if it is tax suffered on income arising while the trustees are UK resident – see section 497.

This change does not affect the operation of ESC B18, which enables UK resident beneficiaries who receive discretionary payments to have a credit for the tax paid by non-UK resident trustees on United Kingdom source income.

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

Change 90: Settlements: tax statements for settlors: section 495

This change allows the settlor of a trust to require a statement from the trustees where the income is regarded as that of the settlor rather than a beneficiary.

Section 352 of ICTA applies where trustees make a payment in the exercise of a discretion. It allows the recipient to require the trustees to provide a statement of the actual amount of the payment, the corresponding gross amount (grossing up at the trust rate) and the amount of tax deemed to have been deducted.

This is appropriate where the beneficiary is chargeable on the payment, but in a case where the settlor is chargeable under section 629 of ITTOIA it is that person who will need these details.

Accordingly, section 495 says that it is the person who is treated as having paid the income tax on the payment who may require a statement from the trustees.

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

Change 91: Settlements: trustees' expenses reducing beneficiary's income: sections 500, 503 and Schedule 1 (section 646A of ITTOIA)

This change makes explicit some of the rules about the way expenses incurred by trustees in connection with income to which a beneficiary is entitled reduce the amount of the beneficiary's income for tax purposes.

There are only two provisions in ICTA that concern the tax treatment of expenses in relation to income to which a beneficiary is entitled before it is distributed (where the beneficiary is regarded as having an interest in possession). These are:

- section 689A, which deals with the disregard of some expenses in the case of a non-resident beneficiary; and
- section 689B, which concerns the order in which expenses reduce the beneficiary's income.

While there are additional provisions in section 686(2AA) of ICTA that give some rules on the treatment of trustees' expenses in relation to accumulation or discretionary income, there is no corresponding provision for interest in possession trusts. The practices that have become established and which are reflected in these sections are based on the principle that the income of a beneficiary is the income arising to the trustees so far as the beneficiary is entitled to it.

There are two ways in which this principle operates.

First, if the trustees' expenses are chargeable to income under a provision of the settlement, then irrespective of whether they would be so chargeable in the absence of that provision, the expenses are to be taken into account. This is subject to the existence of any law that in a particular case (for example by way of a court order) overrides the provision in the trust deed.

This is different from the rule that operates in relation to accumulated or discretionary income where the terms of the settlement are to be ignored, and from what it appears that section 689A of ICTA provides for in this context.

If the deed is silent on whether a particular expense is chargeable to income then the expense is taken into account if it would be chargeable to income under general trust law.

These rules are reflected in section 500. They mean that an expense is allowable if it is chargeable to income under the trust deed, even if it would be chargeable to capital under general trust law. Conversely, in cases where general trust law would require an expense to be charged to income, but the trust deed charges it to capital, then the change means that the expense is not allowable.

The second area concerns how trustees' expenses are taken into account in such cases.

The expenses do not affect the amount of income on which the trustees are chargeable to tax, but operate to reduce the amount of the beneficiary's income. It is not that the beneficiary gets relief for the expenses as such; it is simply that the beneficiary is not entitled to the income used to pay the expenses. So, the beneficiary's income (as reduced by allowable

expenses) is grossed up at the normal rate appropriate to that income to arrive at the gross amount which is to be treated as part of the beneficiary's total income.

This is not set out in the source legislation but, based on the decision in CIR v Lord Hamilton of Dalzell (1926), 10 TC 406 CS, it is the accepted way that expenses are taken into account. Section 503 reflects this.

This change also provides rules about cases where the trustees' expenses exceed a beneficiary's income. Section 500(1) applies in relation to the tax year in which the beneficiary's entitlement to income is reduced, whether the expense was incurred in that tax year or an earlier tax year. The reference to an earlier tax year means that the section covers cases where the trustees' expenses in an earlier tax year exceed the income in that earlier year and so the trustees are carrying forward the excess.

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

Change 92: Charitable trusts: exemption for adjustment income and post-cessation receipts of certain trades and property businesses: sections 524, 525, 526, 531 and 539

This change introduces an exemption from income tax, in the case of charitable trusts, for the adjustment income and post-cessation receipts of trades whose profits are exempt, or would be exempt if the trade had not ceased. It also introduces an exemption for the adjustment income and post-cessation receipts of property businesses, and of trades in cases where such income or receipts arise from land.

The general rule for calculating the profits of a trade for tax purposes is that the profits must be calculated on the basis of accounts drawn up in accordance with generally accepted accounting practice (see section 25 of ITTOIA). But an adjustment will be required if there is a change of basis in circumstances where the old basis accorded with law or practice in one period of account and the new basis accords with law and practice in the next period of account (see section 227 of ITTOIA). If the adjustment is positive, it is called adjustment income.

Adjustment income is charged to tax as trading income under section 228 of ITTOIA. There is no exemption for adjustment income in the source legislation for charitable trusts. But HMRC practice is to treat adjustment income in the same way as other trading income. That is, to treat it as exempt if it arises from a trade that benefits from the exemption in section 505(1)(e) of ICTA (rewritten as section 524), or if it arises in a small-scale trade where the income limits in section 46 of FA 2000 (rewritten as section 528) are not breached.

This change provides an exemption for adjustment income of a charitable trade or a small-scale trade. If a trade is treated as two separate trades in accordance with section 525(2) any adjustment income will be apportioned to the two parts (and this could mean completely apportioned to just one part if relating only to that part) and an exemption will then be available for the adjustment income apportioned to the charitable part.

Post-cessation receipts are taxed under Chapter 18 of Part 2 of ITTOIA. There is no exemption for post-cessation receipts in the source legislation for charitable trusts, other than the exemption in section 46 of FA 2000 (rewritten in sections 526 to 528) which applies only if the receipts are below a certain level. But HMRC practice is to treat post-cessation receipts

as exempt from income tax if they arise from a trade that benefited from the exemption in section 505(1)(e) of ICTA (rewritten as section 524).

This change provides an exemption for post-cessation receipts from a charitable trade. If a trade is treated as two separate trades in accordance with section 525(2) any post-cessation receipts will be apportioned to the two parts (and this could mean completely apportioned to just one part if relating only to that part) and an exemption will then be available for the receipts apportioned to the charitable part.

The source legislation (section 505(1)(a) of ICTA, rewritten in section 531) provides an exemption from tax under Parts 2 and 3 of ITTOIA in respect of any profits or gains arising in respect of rents or other receipts from an estate, interest or right in or over any land. The exemption is available only to the extent that the profits or gains arise from land vested for charitable purposes and the profits or gains are applied for charitable purposes. HMRC practice is to treat associated adjustment income and post cessation receipts as eligible for exemption. This change provides such an exemption.

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

Change 93: Charitable trusts: mixed trades: requiring an apportionment to be just and reasonable: section 525

This change requires apportionment of expenses etc of a mixed trade, between the deemed charitable trade and the deemed other trade, to be "just" as well as "reasonable".

The source legislation in section 505(1B) of ICTA, as inserted by section 56 of FA 2006, requires such apportionments to be "reasonable". All other apportionments under this Act are required to be "just and reasonable". There is no reason why an apportionment should not be on a just and reasonable basis. And it is desirable that all apportionments should be made on the same basis.

Accordingly, section 525(4) requires a just and reasonable apportionment to be made where the source legislation requires the apportionment to be made on a reasonable basis.

The same change was made in ITTOIA, to provide a uniform expression of the basis on which apportionments are to be made.

This change makes a minor amendment to the basis of apportionment for mixed trades, but is expected to have no practical effect as it is in line with current practice.

Change 94: Charitable trusts: limit on exemption for profits etc of small-scale trades and certain miscellaneous income: sections 526 and 528

This change rewrites the limit on the level of a charitable trust's income for the purposes of the exemption for profits etc of small-scale trades in section 526 and certain miscellaneous income in section 527 by reference to the charitable trust's incoming resources rather than in terms of its gross income. It also removes the requirement that the exemption for profits etc of a small-scale trade can apply only if the trade is carried on wholly or partly in the United Kingdom.

Section 46 of FA 2000 provides for an exemption from income tax for certain profits or other income or gains of a charitable trust which are chargeable to income tax. The exemption

applies in respect of a trade carried on wholly or partly in the United Kingdom or under or by virtue of any provision to which section 1016 of this Act (based on section 836B of ICTA) applies.

Section 46(3) of FA 2000 provides that one of the requirements for the exemption to apply is that the charitable trust's "gross income" must not exceed the "requisite limit". The "requisite limit" is defined in section 46(4) of that Act and depends on the charitable trust's incoming resources for the chargeable period.

Section 528 sets out the condition about the level of the trading and miscellaneous income that has to be met if the exemptions in sections 526 or 527 are to be available.

The condition operates by reference to the incoming resources associated with the trading activity and miscellaneous transactions whose profits are not exempt under other provisions. The expression "incoming resources" is used instead of "gross income" because this accounting term is a more direct and accessible way of capturing the meaning of "gross income" as defined in the source legislation.

The source legislation aimed to bring in turnover for trading activity and gross receipts for Schedule D Case VI transactions. But these terms are not used in charity accounting. "Incoming resources" is familiar to those involved in preparing or working with charity accounts. And since charity accounting does not allow offset between income and expenditure in determining disclosure (in contrast with the disclosure in the accounts of commercial organisations), it is relatively easy to check the limits.

It is not clear in section 46 of FA 2000 whether "gross income" includes incoming resources from an activity which gives rise to a loss, in cases where a profit would be taxable. But incoming resources from an activity are included irrespective of whether there is a profit or a loss.

Charitable trusts do not in practice include balancing charges in "gross income". And balancing charges do not come within the meaning of incoming resources.

The requirement in section 46(1)(a) of FA 2000 that the trade is carried on wholly or partly in the United Kingdom reflects the pre-ITTOIA requirement that the trade be subject to tax under Schedule D Case I (rather than Case V). In practice a charitable trust established in the United Kingdom will not carry on a trade wholly outside the United Kingdom, given the oversight exercised from its head office. And HMRC practice has been to accept that the profits of a small-scale trade are exempt, without considering where the trade is carried on. So the requirement has been dropped.

This change aligns the rewritten legislation with the way it is considered section 46 of FA 2000 is operated in practice.

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

Change 95: Charitable trusts: exemption for profits from fund-raising events: sections 529 and 539

This change gives statutory effect to ESC C4 (trading activities for charitable purposes).

The concession provides an exemption for the profits of various fund-raising activities which amount to a trade, but which are only undertaken to raise money for charity. The concession does not apply in circumstances where an attempt is made to use it for tax avoidance, and to reflect this the new statutory exemption is subject to the restrictions in section 539.

The fund-raising event has to be of a kind that falls within the exemption from VAT under Group 12 of Schedule 9 to the Value Added Tax Act 1994. This Schedule provides an exemption from VAT for the supply by a charity of goods and services in connection with an event that is organised primarily to raise money for itself or other charities. The Schedule defines "event" and places certain limits on the number of events that a charity can hold in the same location in any given year.

Section 529, in line with the extra-statutory concession, is linked to the VAT legislation to provide consistency in tax treatment.

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

Change 96: Charitable trusts: exemption for income from intellectual property etc: section 536

This change provides an exemption from income tax for certain royalties and other income from intellectual property and certain income derived from a relevant telecommunication right, whether or not the income is annual in nature.

Section 505(1)(c)(ii) of ICTA provides for an exemption from tax in respect of (among other things) income chargeable under section 579 of ITTOIA and income chargeable under Chapter 4 of Part 5 of ITTOIA. But only, in each case, to the extent that the income relates to annual payments.

Section 579 of ITTOIA charges royalties etc from intellectual property and Chapter 4 of Part 5 charges certain telecommunication rights. In each case the charge to tax is on income that does not arise from the carrying on of a trade. So the income chargeable under the provisions referred to can be annual in nature, but need not be so. Prior to ITTOIA, income of this sort was chargeable under Schedule D Case III if annual in nature, and under Schedule D Case VI if not. So the exemption applied only to Case III income.

But in practice HMRC allow an exemption for income chargeable under section 579 or under Chapter 4 of Part 5 whether or not it is annual in nature. This change is in line with that practice, and reflects the unity of the charging provisions post-ITTOIA.

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

Change 97: Charitable trusts: exemption for income from estates in administration: sections 537 and 539

This change provides an exemption to trustees of charitable trusts who are liable to income tax under section 659 of ITTOIA on estate income charged under section 649 of that Act, to the extent that the income is applied to the purposes of the charitable trust.

Estate income is income from property held by the personal representatives or administrators of the estate of a deceased person on behalf of the beneficiaries of the estate. The administrators are liable to income tax on the income.

Income of United Kingdom estates and United Kingdom source income of foreign estates is chargeable under section 649 of ITTOIA.

Foreign income of foreign estates (see section 651 of ITTOIA) is treated as arising from sources outside the United Kingdom (see section 658(2) of that Act) and is not chargeable under section 649 of that Act but falls to be dealt with in accordance with the rules applying to income from the particular source. And any relevant exemptions provided by Part 10 of this Act apply accordingly.

There is a long-standing HMRC practice of treating United Kingdom estate income received by charities as exempt, and of allowing repayment claims in such cases. This change puts this on an explicit statutory basis.

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

Change 98: Charitable trusts: meaning of non-charitable expenditure: sections 543, 544 and 545

This change clarifies the meaning of "non-charitable expenditure".

Section 506(1) of ICTA defines "charitable expenditure" as:

> (subject to subsections (3) to (5) below) expenditure which is exclusively for charitable purposes.

Section 506(3) to (5) treats certain payments, investments or loans as amounts of non-charitable expenditure.

Section 505(4) of ICTA restricts a charity's tax exemption by reference to non-charitable expenditure. "Non-charitable expenditure" is not defined but, by implication, it is expenditure which is not charitable expenditure.

Sections 543, 544 and 545 set out the definition of "non-charitable expenditure" in some detail, to reflect practice and HMRC guidance.

Section 543(1)(a) to (f), supported by section 544, provide in relation to trades, property businesses and miscellaneous transactions, that it is *losses* which may count as non-charitable expenditure, rather than those expenses which are required to be taken into account in calculating the profits or losses concerned.

Section 543(1)(a) to (f) also ensure that such losses do not count as non-charitable expenditure if corresponding profits would have been exempt under the provisions about small-scale trades, fund-raising events, lotteries or property income in sections 526, 529, 530 and 531. And section 543(1)(a)(i) makes it clear that losses made in a charitable trade do not count as non-charitable expenditure.

Section 545 supports section 543(1)(f), making it clear that expenditure (which is not itself defined in the source legislation) includes capital expenditure, but not the making of investments or loans or the repayment of loans made to the charitable trust. Section 543(1)(i)

and (j) then make specific provision about investments or loans that are not approved charitable investments or loans, reflecting section 506(4) of ICTA.

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

Change 99: Charitable trusts: tax year in which certain expenditure treated as incurred: section 546

This change makes it explicit that the time when expenditure is treated as incurred depends on UK generally accepted accounting practice (UK GAAP).

Section 506(2) of ICTA provides that, for the purposes of section 505 of ICTA:

> where expenditure which is not actually incurred in a particular chargeable period properly falls to be charged against the income of that chargeable period as being referable to commitments (whether or not of a contractual nature) which the charity has entered into before or during that period, it shall be treated as incurred in that period.

Section 506(2) was first enacted in FA 1986 and advanced the time that certain expenditure is recognised, on the basis that charitable trusts may have some flexibility in this regard. As a result of subsequent developments in accounting practice, the legislation now implicitly mirrors UK GAAP.

Section 546 is based on section 506(2) of ICTA, and makes the reference to UK GAAP explicit. Section 997(2) defines UK GAAP for the Income Tax Acts.

Section 546 is drafted in terms of the position if UK GAAP had applied because there is no legal or other obligation requiring all charitable trusts to prepare their accounts in accordance with UK GAAP. In particular "Accounting and Reporting for Charities: Statement of Recommended Practice (revised 2005)", which imposes a requirement to account in accordance with UK GAAP on charitable trusts (with certain exceptions), is not mandatory in Scotland and Northern Ireland. Neither does it apply to charitable trusts which are able to prepare accounts on a "receipts and payments" basis rather than an "accruals" basis.

This approach ensures parity of treatment as between charitable trusts operating in different parts of the United Kingdom or adopting different bases of accounting.

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

Change 100: Charitable trusts: approved charitable investments: sections 558, 559, 560 and 1021

This change modernises the list of investments qualifying as approved charitable investments for the purposes of the rules restricting exemptions.

Although the list is based on Part I of Schedule 20 to ICTA (qualifying investments), it does not replicate the approach taken in that Part.

Part I of Schedule 20 defines qualifying investments by specifying certain investments itself, and also by referring to investments falling within Part I, Part II (apart from paragraph 13) or Part III of Schedule 1 to the Trustee Investment Act 1961 (TIA 1961).

For trust law purposes TIA 1961 has been largely superseded by the Trustee Act 2000 (TA 2000). TA 2000 increased significantly the range of investments trustees can invest in, and it would be a significant change in the law to allow any investment in accordance with TA 2000 to be treated as an approved charitable investment. But it would be unhelpful to continue to refer for tax purposes to a Schedule to an Act (TIA 1961) that trustees no longer need to refer to for investment purposes.

So the detail of investments covered by Schedule 1 to TIA 1961 is incorporated in sections 558 and 559 in a more succinct and updated form.

This has been done by referring to the types of investment that a charitable trust can hold on "an approved basis". So investment in, for example, fixed or variable interest securities issued by any of Her Majesty's Government, the government of any overseas territory within the Commonwealth and the government of any state within (broadly) the European Union (EU) is reduced to securities issued by the government of any state in the EU and of any other state. This is wider, and so (strictly) is a taxpayer-favourable change. And rather than list the large number of individual entities in whose securities a charitable trust can hold an approved investment, reference is made to the international entities listed in the directive on the taxation of interest payments. Again, this is a taxpayer-favourable change.

This approach tends to broaden the scope of possible investments, but in a way that is in keeping with HMRC practice in relation to claims that an individual investment should be regarded as qualifying, as set out in paragraph 9(1) of Schedule 20.

When it comes to the ability to hold an approved investment in the securities of (broadly) a non-listed company, the anti-avoidance provisions in Part IV of Schedule 1 to TIA 1961 have been largely repeated.

A more detailed analysis of where the approved investments in the source legislation appear in the rewritten sections 558 and 559 is as follows:

Schedule 20 to ICTA	**Section 558**	**Section 559**
Paragraph 2	See details below relating to investments listed in TIA 1961	
Paragraph 3	Types 2 and 4	
Paragraph 3A	Types 3 and 4	
Paragraph 4	Type 5	
Paragraph 5 (note: the Unlisted Securities Market no longer exists)	Type 1	Subsection (1)(h)
Paragraph 6	Type 8	
Paragraph 6A	Type 1	Subsection (1)(g)
Paragraph 7	Type 9	
Paragraph 7A	Type 11	
Paragraph 8	Type 11	

Schedule 20 to ICTA	**Section 558**	**Section 559**
Paragraph 9	Type 12	

Part 1 of Schedule 1 to TIA 1961:	**Section 558**	**Section 559**
Paragraph 1: Savings Certificates	Type 6	
Paragraph 1: Other	Type 1	Subsection (1)(a)
Paragraph 2 (note: only deposits in the National Savings Bank are still relevant)	Type 10(a)	

Part 2 of Schedule 1 to TIA 1961	**Section 558**	**Section 559**
Paragraph 1: Treasury Bills and Tax Reserve Certificates	Type 6	
Paragraph 1: Northern Ireland Treasury Bills	Type 7	
Paragraph 1: Other	Type 1	Subsection (1)(a)
Paragraph 2 (but principal must be guaranteed as well as interest)	Type 1	Subsection (1)(a)
Paragraph 3 (but assumes nationalised industries are not an issue in the United Kingdom and are not likely to be an issue elsewhere)	Type 1	Subsection (1)(b)
Paragraph 4 (and extended to securities issued outside the United Kingdom)	Type 1	Subsection (1)(b)
Paragraph 4A (and extended to securities issued outside the United Kingdom and drops requirement about parameters for setting the interest rate)	Type 1	Subsection (1)(b)
Paragraph 5 (and extended to securities issued outside the United Kingdom)	Type 1	Subsection (1)(c) and (d)
Paragraph 5A (and extended to securities issued outside the United Kingdom and drops requirement about parameters for setting the interest rate)	Type 1	Subsection (1)(c) and (d)
Paragraph 5B	Type 1	Subsection (1)(b) and (c)
Paragraph 6	Type 1	Subsection (1)(h)

Part 2 of Schedule 1 to TIA 1961	**Section 558**	**Section 559**
Paragraph 7	Type 1	Subsection (1)(h)
Paragraph 9 (but some loans and deposits are not covered as this is considered unnecessary)	Type 1	Subsection (1)(b)
Paragraph 9A (but drops requirement about parameters for setting the interest rate)	Type 1	Subsection (1)(b)
Paragraph 10A	Type 8	
Paragraph 12	Type 10(b)	
Paragraph 13	Excluded by paragraph 2 of Schedule 20 to ICTA	
Paragraph 14	Type 5	
Paragraph 15	Type 6	
Paragraph 16	Type 1	Subsection (1)(b)
Paragraph 17 (but principal must be guaranteed as well as interest)	Type 1	Subsection (1)(b)
Paragraph 18 (but assumes nationalised industries are not an issue in the United Kingdom and are not likely to be an issue elsewhere)	Type 1	Subsection (1)(b)
Paragraph 19	Type 1	Subsection (1)(b)
Paragraph 20	Type 1	Subsection (1)(c) and (d)
Paragraph 21	Type 1	Subsection (1)(i)
Paragraph 22 (but some loans and deposits are not covered as this is considered unnecessary)	Type 1	Subsection (1)(b)
Paragraph 23 (and extended to similar societies outside the EU)	Type 10(c)	
Paragraph 24	Excluded (by extension) by paragraph 2 of Schedule 20 to ICTA	

Part 3 of Schedule 1 to TIA 1961	**Section 558**	**Section 559**
Paragraph 1 (and extended to securities issued outside the United Kingdom)	Type 1	Subsection (1)(i)
Paragraph 2	Type 1	Subsection (1)(e)
Paragraph 2A	Type 1	Subsection (1)(g)
Paragraph 3	Type 8	
Paragraph 4 (and extended to securities issued outside the EU and to securities of non-EU incorporated companies)	Type 1	Subsection (1)(i)
Paragraph 5 (and extended to similar societies outside the EU)	Type 1	Subsection (1)(f)
Paragraph 6	Type 8	

Part 4 of Schedule 1 to TIA 1961	**Section 560**
Paragraph 1	Not covered – this is taxpayer-favourable
Paragraph 2	Covered by Conditions A and B
Paragraph 2A	Covered by Conditions A and B
Paragraph 3	Covered by Condition C

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

Change 101: Accrued income profits: variable rate securities: transfers after the securities' last interest period: sections 579, 617, 630, 636, 639, 640, 641, 667, 669 and 747 and Schedule 1 (section 119 of TCGA and section 161 of FA 1998)

This change relates to the clarification of when accrued income scheme profits on transfers of variable rate securities arise where the settlement day for the transfer occurs after the end of the securities' last interest period and consequential changes.

(A) Accrued income charges (and reliefs) are normally computed by reference to transfers of securities of the same kind which are settled in the same interest period (see sections 713(1) and 714(1) and (2) of ICTA). Profits are treated as received on the last day of that period (see section 714(2) of ICTA).

Normally securities pay their last interest on their redemption day. So settlement on the transfer of securities will only occur outside an interest period in exceptional circumstances. There are two particular cases where the settlement day occurs after the end of the securities' last interest period. One is where securities with a variable rate of interest ("variable rate securities") are transferred, including securities which pay their last interest some time before redemption day. (The other is securities transferred with unrealised interest.)

Section 717 of ICTA deals with variable rate securities. The provisions about their transfer are not straightforward. Since section 717(7) of ICTA provides that the securities are treated as being transferred with accrued interest if they would not otherwise be so treated, it is clear how transfers which are settled in an interest period are dealt with: they fall within the main accrued income scheme regime and so the rule in section 714(2) of ICTA will apply. But it is not so clear what happens where the settlement day occurs after the end of the securities' last interest period.

In the case of a transfer that is treated as taking place at redemption under section 717(8) of ICTA, section 712(4) of ICTA provides that the settlement day is the day of the transfer (that is, the day of the redemption). Where the last interest period ends before redemption, so that the settlement day occurs after the end of the securities' last interest period, section 717(11) of ICTA, as applied by section 717(10) of ICTA, treats a further period lasting up to the settlement (redemption) day as an interest period of the security ("the artificial interest period"). Section 713(2)(a) of ICTA then operates so that the transferor is treated as entitled to a sum in the artificial interest period in which the settlement day falls. The rule in section 714(2) of ICTA then applies by reference to the artificial interest period. This has the result that the accrued income profits on redemption are taxed in the tax year in which the settlement (redemption) day falls.

However, section 717(10) of ICTA says nothing explicit about section 717(11) of ICTA applying to ordinary transfers (as distinct from transfers that are deemed to occur on redemptions) where the settlement day occurs after the end of the last interest period but before the date of redemption. Consequently, it is not clear how they should be dealt with. But in practice, HMRC interpret section 717(11) of ICTA as applying in all cases where the settlement day in fact falls after the end of the last interest period, so as to add an artificial interest period up to the settlement day for any transfer after the final interest period of a variable rate security. Then section 713(2)(a) of ICTA can again operate by reference to the artificial interest period, with the result that the accrued income profits are taxed in the tax year in which the settlement day falls.

Section 617(3) gives effect to that interpretation by providing that profits on all transfers of variable rate securities are treated as made in the tax year in which the settlement day falls where the settlement day is after the end of the last interest period.

Section 630 deals with transfers of variable rate securities where the settlement day falls outside an interest period. It deals with all such transfers, rather than restricting its application to transfers on redemption. Section 630 (1) and (2) therefore also gives effect to that interpretation in determining whether the transferor is treated as making accrued income profits without distinguishing a transfer to which section 717(11) of ICTA applied.

(B) Under section 721(2) of ICTA, if an individual dies, and the personal representatives transfer securities to a legatee *in the interest period in which the individual died*, section 713 of ICTA does not apply to that transfer.

As explained in part (A) of this note, in the case of the redemption of variable rate securities where the settlement day for the transfer occurs after the end of the securities' last interest period, section 717(10) and (11) of ICTA create a further artificial interest period and in practice this is taken to extend to all transfers and not just redemptions.

The settlement day for the purposes of section 721 of ICTA is the day on which the securities are transferred by the personal representatives to the legatee (see section 712(4) of ICTA). This is unlikely to coincide with the redemption day, but in practice it would be treated as falling within the artificial interest period.

As a consequence of the change explained in part (A), section 636, which rewrites the exemption for transfers to legatees in section 721 of ICTA, makes special provision at subsection (3) so that transfers to legatees of variable rate securities after the end of the only or last interest period of the securities are covered by the exemption, even though they will no longer occur in the artificial interest period and so will not fall within section 636(2).

(C) Section 715(1) of ICTA provides various exclusions from section 713(2)(a) of ICTA. The exclusions in section 715(1)(b), (c) and (e) of ICTA exclude transfers by individuals, personal representatives and the trustees of a disabled person's trusts unless, on any day in the year of assessment in which the interest period of the securities ends or the previous year, the nominal value of securities held by the transferor exceeds £5,000. Therefore these exclusions depend on the settlement day being in an interest period.

As a consequence of the change explained in part (A), sections 639, 640 and 641 which rewrite these exclusions make special provision so that transfers by these kinds of transferors, where the settlement day is after the end of the only or last interest period of the securities, are covered by the exclusions, even though they will no longer occur in the artificial interest period.

So, for example, for transfers by individuals section 639(3) provides that in the case of variable rate securities an individual is an excluded transferor if the nominal value of the securities does not exceed £5,000 in the relevant tax year or the previous tax year. Section 639(4)(a) provides that, if the settlement day falls in an interest period, the relevant tax year is the tax year in which the interest period ends. Section 639(4)(b) provides that, if the settlement day does not fall in an interest period, the relevant tax year is the tax year in which the settlement day falls.

(D) Under section 720(6) of ICTA, where trustees are treated as receiving income under section 714(2) of ICTA, that income is treated for the purposes of Chapter 5 of Part 5 of ITTOIA as income arising under the settlement. Section 720(6) of ICTA applies similarly in the case of trustees, who are resident or domiciled outside the United Kingdom throughout a tax year in which an interest period (or part of it) falls, if they would have been treated under section 714(2) of ICTA at the end of that interest period as receiving income (or a greater amount of income), had they been resident or domiciled in the United Kingdom during a part of such a tax year. The amount (or greater amount) that would have been so treated under section 714(2) of ICTA is also treated as income arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA.

(Trustees who are resident or domiciled outside the United Kingdom would normally fall with section 715(1)(f) of ICTA so that section 713 of ICTA does not apply to give amounts that would be taken into account under section 714(2) of ICTA. See section 643 which makes provision equivalent to section 715(1)(f) of ICTA, so that such trustees would normally be an "excluded transferor" or "excluded transferee" for the purposes of Part 12.)

Where an amount of accrued income profits is treated as arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA, the settlor will be charged to tax on the amount of the accrued income profits and not the trustees (had they otherwise been the person liable for tax on those profits).

By virtue of section 717(7) of ICTA, transfers of variable rate securities are treated for the purposes of sections 710 to 727A of ICTA as a transfer with accrued interest. Where the transfer occurs within an interest period, section 713 of ICTA applies (subject to the modification in section 717(9) of ICTA) to provide the amount that falls within section 714(2) of ICTA. As explained in part (A) of this note, in the case of the redemption of variable rate securities if the settlement day for the transfer occurs after the end of the securities' last interest period, section 717(10) and (11) of ICTA create a further artificial interest period. So, in that case section 713 of ICTA (as modified) applies again to provide an amount falling within section 714(2) of ICTA.

Section 667 treats "qualifying accrued income profits" which trustees are treated as making (or would be treated as making but for the fact that they are resident or domiciled outside the United Kingdom) as income arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA. "Qualifying accrued income profits" include profits treated as made under section 628(5) (profits treated as made in an interest period on a transfer of securities with or without accrued interest), and profits treated as made under section 630(2) (profits treated as made where the settlement day is outside an interest period) in respect of a transfer of variable rate securities. As a consequence of the change explained in part (A), profits treated as made under section 630(2) include profits on all transfers of variable rate securities where the settlement day is outside an interest period. And all such profits are therefore included in "qualifying accrued income profits" as that term is used in section 667.

Sections 579 (manufactured interest on UK securities: allowable deductions: matching) and 747 (amounts corresponding to accrued income scheme profits and related interest) rewrite provisions that use cross reference to profits falling within section 714(2) of ICTA (respectively, paragraph 3(2A)(b) of Schedule 23A to, and section 742(4) of ICTA) similarly to the use made in section 720(6) of ICTA. Those sections therefore use the term "qualifying accrued income profits", as defined in each of those sections, to refer to profits arising under Part 12. The definitions refer to profits treated as made under section 630(2) in respect of a transfer of variable rate securities. So the change explained in part (A) applies also for the purposes of those sections.

(E) Under section 723(1) of ICTA, relief is available where a person is treated under section 713(2)(a) of ICTA as entitled *in an interest period* to a sum or sums in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom and the proceeds are unremittable.

As explained in part (A) of this note, in the case of the redemption of variable rate securities if the settlement day for the transfer occurs after the end of the securities' last interest period, section 717(10) and (11) of ICTA create a further artificial interest period and in practice this is taken to extend to all transfers and not just redemptions.

As a consequence of the change explained in part (A), this Part makes special provision in section 669 so that unremittable proceeds of transfers of variable rate securities after the end

of the only or last interest period of the securities are covered by the relief, even though they will no longer occur in the artificial interest period and so will not fall within section 668(1).

(F) A number of provisions outside the accrued income scheme work by reference to section 713 or 714 of ICTA. To the extent that the special rules in section 717(10) and (11) of ICTA affect the application of those sections (as explained in part (A)), that effect carries through to the provision citing section 713 or 714 of ICTA. By virtue of the change explained in part (A), a provision which (as amended by Schedule 1 to this Act) works by reference to provisions in Part 12 of this Act that rewrite sections 713 or 714 of ICTA now incorporates that change in its effect. See, in particular, the amendments in that Schedule to section 119 of TCGA and section 161 of FA 1998. But more general references to the application of Part 12 of this Act or to Chapter 2 of Part 12 may similarly import the effect of this change.

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

Change 102: Accrued income profits: transfers of variable rate securities not treated as transfers with accrued interest: sections 626 and 630

This change alters the way that the accrued income scheme operates as respects transfers of variable rate securities by ceasing to treat them as transfers with accrued interest and applying the special rules relating to them directly.

Where securities are transferred with accrued interest, section 713(2)(a) and (b) of ICTA apply and there is an effect for both the transferor and the transferee. Under section 713(2)(a) of ICTA the transferor is treated as entitled to a sum and under section 713(2)(b) of ICTA the transferee is entitled to relief of the same amount. Section 713(4) and (6) of ICTA apply to determine the amount of the sum or relief ("the accrued amount") to be taken into account.

Under section 717(7) of ICTA, *all* transfers of variable rate securities are treated as transfers with accrued interest, even where they would otherwise be transfers without accrued interest. But then section 717(9) of ICTA makes two changes to section 713 of ICTA so that it does not apply in the way it normally does for transfers with accrued interest. First, section 713 of ICTA applies without subsection (2)(b), so that there is an effect only for the transferor and not for the transferee. (This means there can be a charge to tax under the accrued income scheme for the transferor but no corresponding relief for the transferee.) Secondly, section 713(4) to (6) of ICTA do not apply to determine the amount of the "sum" to be taken into account because section 713(3) to (6) of ICTA are replaced with a new subsection (3) that provides:

> In subsection (2) above "the accrued amount" means such amount (if any) as is just and reasonable.

So this approach applies a fiction, which is actually not very helpful because in fact the rules that are applied are not the same as those that apply to transfers with accrued income. Moreover, removing subsections (3) and (5) of section 713 of ICTA is unnecessary, since they apply only for transfers *without* accrued income.

Therefore, the fiction in section 717(7) of ICTA has not been rewritten. Instead, transfers of variable rate securities have been removed from the normal accrued income scheme regime, and then the special rules relating to them have been applied directly without first treating them as transfers with accrued interest, and without having to modify the normal rules.

Accordingly, sections 623 and 624, which set out the rules about when transfers are transfers with or without accrued interest, are disapplied for transfers of variable rate securities by section 623(5) and section 624(5). Sections 626 and 630 therefore apply without the intervention of any fiction. And section 635(2) and (3) sets out the special rules for transfers of variable rate securities that are the result of section 717(7) and (9) of ICTA in the terms of the rewritten accrued income scheme in this Part (i.e. that the transferee is not treated as making a payment on the transfer and the amount of the payment treated as made is such amount as is just and reasonable).

This change has no implications for the amount of tax paid, who pays it or when. It is a change in the law that makes the legislation clearer and easier to understand.

Change 103: Accrued income profits: relief for unremittable transfer proceeds: transfers with unrealised interest: sections 668 and 669

This change extends relief from tax on accrued income scheme profits if the proceeds of the transfer of foreign securities are unremittable to cases where securities are transferred with unrealised interest.

Section 723 of ICTA provides a relief if a person is treated under section 713(2)(a) of ICTA as entitled to a sum or sums in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom and the proceeds are unremittable. Section 723(1) of ICTA provides:

> This section applies where *in an interest period* a person is treated as entitled to a sum or sums under section 713(2)(a) in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom.

So the relief is only available if a person is treated as entitled to a sum or sums under section 713(2)(a) of ICTA and the person is so entitled in an interest period.

These conditions create problems if securities are transferred with the right to receive interest ("unrealised interest") payable on an interest payment day before the settlement day. Such transfers are dealt with under section 716 of ICTA.

If (as is normally the case) the settlement day for such a transfer falls within an interest period, section 716(2) of ICTA provides that section 714 of ICTA applies as if the transferor were entitled under section 713 of ICTA in the interest period to a sum equivalent to the unrealised interest. The effect is that section 714(2) of ICTA applies so that the person is treated as receiving profits, equal to that sum, that are chargeable to income tax.

But section 716(2) of ICTA only provides that section 714 of ICTA applies as if the transferor were entitled to a sum under section 713 of ICTA; it does not treat the transferor as being so entitled for all purposes. So the condition in section 723(1) of ICTA, that the transferor must be treated as entitled to a sum or sums under section 713(2)(a) of ICTA, is not satisfied. Moreover, if securities are transferred with unrealised interest and the settlement day falls outside an interest period, the second condition is not satisfied either.

In practice, however, relief is given under section 723 of ICTA if securities are transferred with unrealised interest and the proceeds of the transfer cannot be remitted to the United Kingdom, whether the settlement day falls inside or outside the interest period. So sections 668 and 669, which are based on section 723 of ICTA, cover all such transfers.

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

Change 104: Accrued income profits: relief for unremittable transfer proceeds: conditions for granting relief: section 668

This change broadens one condition and removes another condition for claims for relief in respect of unremittable income under section 723 of ICTA.

Chapter 4 of Part 8 of ITTOIA provides for relief for taxpayers taxed on income arising outside the United Kingdom, if the income cannot be remitted to the United Kingdom and certain conditions are met. This provision is the model for the relief provided by the accrued income scheme for unremittable transfer proceeds. Section 841 of that Act refers to income which cannot be remitted to the United Kingdom because of the laws of the overseas territory, any executive action of its government or the impossibility of the person obtaining transferable currency in the overseas territory.

Sections 835 to 837 of ITTOIA apply to taxpayers with income charged on the remittance basis (see section 832 of that Act). They provide that relief from tax on "relevant foreign income" (see section 830 of that Act) may be claimed if the conditions set out in section 835(2) and (3) of that Act are met.

- Subsection (2) requires that the income arose before the tax year for which relief is claimed.
- Subsection (3) requires the taxpayer to have been unable to transfer the income to the United Kingdom.
- Subsection (3)(a) to (c) requires the inability to transfer to have been due to one of three reasons:
  - the laws of the territory where the income arose;
  - executive action of its government; or
  - the impossibility of obtaining transferable currency in that territory.

Section 723 of ICTA provides a similar relief for accrued income scheme profits from transfers of securities situated outside the United Kingdom where the conditions set out in section 723(5)(a) to (c) of ICTA are met. Those conditions mirror the ones in section 835 of ITTOIA, but must be met in respect of the proceeds of the transfers.

Section 723(5)(c) of ICTA also requires that the inability to transfer is not due to any want of "reasonable endeavours" on the part of the taxpayer. (That condition was present in the source legislation for section 835 of ITTOIA, but was not reproduced in the rewritten legislation.)

(A) The condition contained in section 723(5)(b) of ICTA requires an inability to transfer "due to….the impossibility of obtaining foreign currency" in the territory where the income arose. It could be argued that there cannot be an inability to transfer due to the impossibility of obtaining foreign currency in that territory if foreign currency is in fact obtainable there (regardless of whether it may be transferred to the United Kingdom).

Section 668(5)(c) removes the possibility of that narrow interpretation being taken. It requires there to be an inability to transfer the proceeds due to the impossibility of obtaining in the territory currency "that could be transferred to the United Kingdom".

(B) The condition contained in section 723(5)(c) of ICTA has not been rewritten in this Act. It is regarded as adding little to the requirements of section 723(5)(a) and (b) of ICTA. If, by reasonable endeavours, the taxpayer could transfer the income to the United Kingdom, the test in section 723(5)(a) of ICTA of his being unable to transfer the income or remit the proceeds of transfer is not met, and there would then be no inability to transfer *due to* local law, government action or the impossibility of obtaining foreign currency as required under section 723(5)(b) of ICTA.

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

Change 105: Accrued income profits: relief for unremittable transfer proceeds: time limits: sections 668 and 669

This change alters the time limit for claiming relief from tax on accrued income scheme profits if the proceeds of the transfer of foreign securities are unremittable.

Section 723 of ICTA provides a relief if a person is treated under section 713(2)(a) of ICTA as entitled to a sum or sums in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom and the proceeds are unremittable. Under section 723(3) of ICTA the relief may only be given if a claim is made and section 723(6) of ICTA provides:

> No claim under this section shall be made in respect of a transfer more than six years after the end of the interest period in which the transfer occurred.

The usual time limit for making claims is set out in section 43 of TMA, which provides:

> Subject to any provision of the Taxes Acts prescribing a longer or shorter period, no claim for relief in respect of income tax or capital gains tax may be made more than five years after the 31st January next following the year of assessment to which it relates.

Moreover, the time limit under section 279 of TCGA (which provides similar relief from capital gains tax where capital gains from the disposal of assets situated outside the United Kingdom cannot be remitted to the United Kingdom) is also five years from 31 January next following the tax year in which the gains accrue. (See section 279(5)(a) of TCGA.)

There does not appear to be any justification for a different time limit applying for claims under section 723 of ICTA. So, in rewriting that section in sections 668 and 669, the time limit for making the claim for relief has been changed to bring it into line with the period that applies under section 43 of TMA. And sections 668(7) and 669(4) provide that the claim must be made on or before the fifth anniversary of the normal self-assessment filing date for the tax year in which the profits would be chargeable were it not for the relief (that is, 31 January in the following tax year).

The new time limit may be longer or shorter than the time limit in section 723(6) of ICTA, depending on when in the tax year the interest period of the securities in which the transfer or transfers were made ends. If the interest period ends before 31 January in a tax year, the change will be beneficial. If it ends later the change will be adverse, but those adversely

affected may make an election under Part 2 of Schedule 2 to this Act to disapply the change for the tax year to which the election applies.

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

Change 106: Accrued income profits: meaning of "interest period" where consolidation of strips into a gilt-edged security occurs: section 673

This change drops the reference to a day "specified" in a consolidated gilt-edged security in section 710(13B) of ICTA.

Strips of a gilt-edged security may be consolidated back into a gilt-edged security by exchanging the strips for a newly issued gilt-edged security. The disposal of the strips is dealt with under the deeply discounted securities regime in Chapter 8 of Part 4 of ITTOIA. But the acquisition of the gilt-edged security is treated as a transfer for the purposes of the accrued income scheme, with the person making the exchange treated as the transferee, but no one being treated as the transferor. (See section 722A(3) and (4) of ICTA.) Under section 711(6A) of ICTA the transfer may be either with accrued interest or without accrued interest.

Under the accrued income scheme, where securities are transferred with accrued interest the transferee is allowed tax relief for the accruing interest and the amount of the relief is equal to the "accrued amount". (See section 713(2) of ICTA.) Where securities are transferred without accrued interest the transferee is treated as entitled to a taxable sum and the amount of the sum is equal to the "rebate amount". (See section 713(3) of ICTA.)

If the gross interest accruing on a security is accounted for separately, the amount of the "accrued amount" or, as the case may be, the "rebate amount" under section 713(4)(a) or (5)(a) of ICTA is equal to the interest so accounted for. However, in any other case (except where the settlement day is an interest payment day), the amount of the "accrued amount" or, as the case may be, the "rebate amount" is ascertained under section 713(4)(b) or (5)(b) of ICTA by time apportioning the interest applicable to the security for the interest period in which the settlement day for the transfer falls. Formulae are provided in section 713(6) of ICTA.

Where strips are consolidated into a gilt-edged security, the settlement day is the day of the transfer. (See section 712(4) of ICTA.) So the interest period for which the gross interest has to be apportioned is the one in which the exchange takes place. But the consolidated security may be issued part of the way through an interest period for securities of that kind. As it is intended to be fully fungible with other securities of the same kind, the formulae in section 713(6) of ICTA need to be applied by reference to the same interest period as that of those other securities. Under the source legislation this is dealt with through section 710(13B) of ICTA which deems the interest period of the consolidated security in which the transfer is treated as taking place to have begun "on such day as shall for that purpose be specified in the security".

In practice, however, it appears that such a day is usually *not* specified in the security. So, as the consolidated security is intended to be fully fungible with other securities of the same kind, the specified day is in fact taken to be the day following the last interest payment day for such securities before the settlement day. Therefore, in defining "interest period" for Chapter 2 of Part 12, section 673 does not rewrite the special rule in section 710(13B) of

ICTA. Instead, the rule in section 673(1)(b) will apply. So the interest period of the consolidated security will begin with the day following the last interest payment day of the kind of gilt-edged securities concerned before the settlement day.

This change has no implications for the amount of tax paid, who pays it or when. It is a change in law but not in practice.

Change 107: Accrued income profits (exemptions): interest on securities involving accrued income losses: sections 679 and 680

This change alters the way that, in cases where accrued income scheme losses have been sustained on the transfer of securities, relief is given in respect of interest on the securities.

(A) Under section 714(3) and (4) of ICTA a person is entitled to an allowance if the person is treated as entitled to relief under section 713 of ICTA on securities of a particular kind in an interest period and either the person is not treated under that section as entitled to a sum or the person's reliefs exceed the total sum to which the person is treated as entitled. Under section 714(5) of ICTA any amount to which the person is entitled by way of interest on the securities that:

(a) falls due on the securities at the end of the interest period, and

(b) is taken into account in computing tax charged for the chargeable period in which the interest period ends

is reduced by the amount of the allowance.

In rewriting section 714(5) of ICTA, instead of providing that that interest is reduced, section 679 simply provides for an exemption in relation to the interest.

(B) In addition, section 679 deals differently with the restriction in section 714(5)(b) of ICTA which currently restricts the availability of this relief for accrued income losses so that relief is given once only, in the tax year in which the interest period ends.

This restriction was originally included because of the way interest was then assessed. In the first tax year that a source was acquired, interest was taxed on a current year basis but in later tax years the basis shifted to a previous year basis. The purpose of the restriction in section 714(5)(b) of ICTA was therefore to stop loss relief being given against the interest in a year when the interest was taxed on a previous year basis.

In 1994 interest began to be taxed on a current year basis. So in any tax year income tax will be charged on the income arising in that year only. The restriction is now generally unnecessary.

The one exceptional case where such a restriction is necessary is that of trading partnerships with untaxed income. Under sections 854 and 855 of ITTOIA a second deemed business is treated as set up and commenced when a new partner joins the partnership. This may lead to "overlap" profits when the same interest will be taxed twice. For example:

- P joins an existing trading partnership on 1 January 2007.
- The partnership draws up annual accounts to 31 December.
- Securities are purchased by the partnership cum dividend. The interest period of the securities ends on 31 March 2007.

- P's basis period for 2006-07 is 1 January 2007 to 5 April 2007.
- P's basis period for 2007-08 is 1 January 2007 to 31 December 2007.

In this case the interest received on 31 March 2007 forms part of profits for both 2006-07 and 2007-08, but the allowance under section 715(4) of ICTA should only be available in 2006-07, as that is the tax year in which the interest period ends.

But for existing partners of such a partnership, the restriction could result in partners not being entitled to the allowance on the acquisition of a security if the interest period ends after the end of an accounting period. In practice, HMRC allow the relief to be given in these circumstances.

In rewriting section 714(5) of ICTA, rather than including the existing restriction, which is unnecessary in the majority of cases, and then excluding such existing partners from the restriction in appropriate circumstances, section 679(3) prevents any person from being entitled to the exemption for interest in more than one tax year. And it restricts the year when the exemption is given to the tax year in which the interest period ends.

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

Change 108: Transactions in securities, transfer of assets abroad: power to obtain information: minimum time to respond: sections 703 and 748

This change provides that the recipient of a notice to provide information relevant to the legislation on transactions in securities or transfers of assets abroad must have at least 30 days to reply, rather than at least 28 days.

Sections 708 and 745 of ICTA enable HMRC to serve notices requiring the recipient to provide information relevant to the legislation on, respectively, transactions in securities and transfers of assets abroad.

Section 708 and 745 require that the recipient must be given at least 28 days in which to reply. In other similar provisions, such as section 778 of ICTA, which is rewritten in sections 771 and 788, the statutory minimum is 30 days.

Sections 703 and 748 rewrite sections 708 and 745 respectively. They harmonise the time limits by setting the statutory minimum at 30 days.

This change has no effect for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 109: Transactions in securities: statement of case by tribunal for opinion of court: section 707 and Schedule 2 Part 14 (transactions in securities: statement of case by tribunal for opinion of High Court or Court of Session)

This change affects the procedure on income tax appeals concerning transactions in securities by removing the requirement for the dissatisfied party to "declare his or their dissatisfaction" before requiring the tribunal to state a case for the opinion of the court.

Chapter 1 of Part 17 of ICTA (transactions in securities) has its own appeals procedure. This includes the option for the dissatisfied party to require an appeal which has been heard by the

Special Commissioners to be re-heard by the special tribunal constituted under section 706 of ICTA.

Section 705A(1) and (2) of ICTA provide:

> (1) Immediately after the determination by the tribunal of an appeal re-heard by them under section 705 of this Act, the appellant or the Board, if dissatisfied with the determination as being erroneous in point of law, may declare his or their dissatisfaction to the tribunal.
>
> (2) The appellant or the Board, as the case may be, having declared his or their dissatisfaction, may, within thirty days after the determination, by notice in writing require the tribunal to state and sign a case for the opinion of the High Court.

Under sections 705A(12) and 705B(1) of ICTA, in Scottish and Northern Irish appeals the case is stated for the opinion of the Court of Session sitting as the Court of Exchequer in Scotland and the Court of Appeal in Northern Ireland, respectively.

Section 705A thus obliges the dissatisfied party to declare his or their dissatisfaction before requiring the tribunal to state a case.

This obligation is considered to be superfluous.

Section 56 of TMA also deals with tax appeals to the courts by way of case stated. Section 56 of TMA (statement of case for opinion of High Court) was amended by SI 1994/1813, which (among other things) confined section 56 to appeals from the General Commissioners and substituted section 56A of TMA (appeals from the Special Commissioners). SI 1994/1813 repealed section 56(1) and (2) of TMA, the wording of which was identical in all material respects to section 705A(1) and (2). It is considered a historical accident that the obligation to declare dissatisfaction has been retained in section 705A of ICTA when it has been omitted from section 56 of TMA.

Section 707, which is based on section 705A of ICTA, therefore omits the requirement for the dissatisfied party to declare dissatisfaction before requiring the tribunal to state a case.

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

Change 110: Transfer of assets abroad: meaning of "associated operation": section 719

This change clarifies the meaning of "associated operation" for the purposes of the transfer of assets abroad legislation.

Section 742(1) of ICTA defines "an associated operation" in relation to a transfer as:

> an operation of any kind effected by any person in relation to any of the assets transferred or any assets representing, whether directly or indirectly, any of the assets transferred, or to the income arising from any such assets, or to any assets representing, whether directly or indirectly, the accumulations of income arising from any such assets.

This definition is ambiguous. It is unclear whether the references to "any such assets" are references only to the assets actually transferred, or to those assets plus any assets representing them.

The punctuation indicates that the latter is the better view, and section 719 of this Act reflects it.

This is a minor change in the law in that it will prevent the taxpayer arguing for the contrary view.

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

Change 111: Transfer of assets abroad: cessation of entitlement to receive capital sum: section 729

This change makes it clear that there is no liability under section 739(3) of ICTA (transfer of assets abroad: charge where capital sum receivable or received) if the taxpayer's entitlement to receive a capital sum has ceased.

Section 739 of ICTA prevents individuals who are ordinarily resident in the United Kingdom from avoiding liability to income tax by means of transfers of assets as a result of which income becomes payable to persons who are non-UK resident or non-UK domiciled. Section 739(3) deems income to become the taxable income of the individual if the individual receives or is entitled to receive a capital sum.

Broadly speaking, any sum paid or payable by way of loan or repayment of a loan is a "capital sum" for this purpose, as is any other sum paid or payable otherwise than as income, if it is not paid or payable for full consideration in money or money's worth. Section 739(3) does not deem the capital sum to be income; instead, it takes income which has become payable to persons abroad as a result of the transfer and deems that income to be the transferor's.

But the wording of section 739(3) of ICTA leaves the timing of the charge rather unclear. It reads:

> Where, whether before or after any such transfer, such an individual receives or is entitled to receive any capital sum …

Section 739(6) provides that income is not deemed to be the individual's under section 739(3) for any tax year "by reason only of his having received a sum by way of loan if that sum has been wholly repaid before the beginning of that year". Therefore income may be deemed to be the individual's in other cases where there has been an actual receipt of a capital sum in a previous tax year. But section 739 makes no provision about whether section 739(3) imposes a charge if the individual was merely entitled to receive a capital sum in a previous tax year.

In practice, where entitlement to a capital sum has ceased HMRC do not pursue further liability under section 739(3).

Section 729 gives effect to this practice by providing that the individual must either receive or be entitled to receive a capital sum in the tax year or have received a capital sum in an earlier tax year.

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

Change 112: Transfer of assets abroad: transferors not subject to charge where benefit received: section 732

This change clarifies the exclusion from liability to income tax under section 740 of ICTA (transfer of assets abroad: charge where benefit received) for those who are liable to income

tax under section 739 of ICTA (transfer of assets abroad: charge where power to enjoy income or where capital sum received) on deemed income in respect of the same transfer. The change makes it clear that this exclusion extends to those who would be liable under section 739 apart from falling within the exception in section 743(3) for non-domiciled individuals taxed on the remittance basis.

Section 739 of ICTA prevents individuals who are ordinarily resident in the United Kingdom from avoiding liability to income tax by means of transfers of assets as a result of which income becomes payable to persons who are non-UK resident or non-UK domiciled. Section 739 deems the income of the person abroad to be the taxable income of the individual if the individual has power to enjoy the income of the person abroad or receives a capital sum.

Under sections 831 and 832 of ITTOIA 2005, persons who are domiciled outside the United Kingdom can make a claim only to be subject to income tax in the United Kingdom on the relevant foreign income which is received in the United Kingdom (and not on their worldwide relevant foreign income).

Section 743(3) of ICTA makes a corresponding exception from section 739 of that Act for individuals who are domiciled outside the United Kingdom. An individual is not chargeable on deemed income under section 739 if that individual would not have been chargeable in respect of the actual income because of the individual's domicile.

Section 740 of ICTA deems individuals to receive taxable income if they receive benefits provided out of assets available as a result of transfers of the kind envisaged in section 739 and are not "liable to tax under section 739 by reference to the transfer". This raises the question whether, by preventing a non-UK domiciled individual transferor from being chargeable under section 739, section 743(3) of ICTA exposes that individual to potential liability under section 740.

It is HMRC's practice not to assess under section 740 a non-UK domiciled individual who transfers assets but is outside the charge to tax under section 739 by virtue of the provisions of section 743(3). But it is arguable that the wording of section 740 would permit a charge under section 740 on a non-UK domiciled transferor in these circumstances. Section 732 of this Act gives the current practice a clear statutory basis.

Where a non-UK domiciled individual transfers assets but is not chargeable to tax under section 739 owing to section 743(3), there is no bar in HMRC's view on the application of section 740 to others who did not themselves make the transfer but were beneficiaries of it. HMRC interpret section 732 in the same way.

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

Change 113: Transfer of assets abroad: calculation of liability of non-transferors receiving benefit: section 733

This change clarifies how liability for income tax of non-transferors who receive a benefit is calculated, in particular where the benefit is less than the "relevant income" in relation to the individual receiving the benefit.

Section 740 of ICTA deems individuals to receive taxable income if (broadly speaking) they receive benefits as a result of transfers of assets as a result of which income becomes payable

to persons resident or domiciled outside the United Kingdom and are not liable under section 739 of ICTA (liability of transferors) in respect of the transfers.

The general effect of section 740(1) to (3) of ICTA is:

- to tax non-transferors on the amount or value of any such benefit received by them;
- only to tax such a benefit where, on or after 10 March 1981 (see section 740(7) of ICTA), income has arisen by the use of which the benefit could be provided ("relevant income"); and
- to tax the benefit whether it is conferred before or after the relevant income is actually available.

Relevant income is defined in relation to an individual in section 740(3) of ICTA. Briefly, it is any income arising to a person abroad which, as a result of the transfer of assets, "can directly or indirectly be used for providing a benefit for the individual".

Under section 740(2)(a) of ICTA the amount to be charged in the tax year in which the benefit is received is found by comparing the amount or value of the benefit with "the relevant income of years of assessment up to and including the year of assessment in which the benefit is received". Under section 740(2)(b) if the benefit exceeds the relevant income, then an amount equal to the relevant income is chargeable to income tax in the individual's hands and the excess benefit is carried forward, compared with relevant income in the next and subsequent tax years and charged so far as it does not exceed that relevant income, until none is left to be carried forward.

Section 740 of ICTA leaves several questions unanswered.

It provides that if the relevant income exceeds the benefit, the amount or value of the benefit is chargeable to income tax in the individual's hands, but does not make provision about the treatment of the excess of the relevant income over that amount.

Taken literally and in isolation, section 740(2)(a) suggests that whenever a benefit is received the amount or value of the benefit must be compared with all the relevant income that has arisen on or after 10 March 1981, regardless of whether the receipt of previous benefits has involved charges by reference to that income before. But relevant income is defined as income that can directly or indirectly be used to provide a benefit in the tax year, and section 744(1) and (2)(b) of ICTA prevent the same relevant income being taken into account more than once.

It is therefore considered that the surplus relevant income (if it continues to be available) has not been taken into account and so must be carried forward year by year until extinguished by a benefit or benefits. Section 733 of this Act gives effect to this view by providing for surplus relevant income to be carried forward.

This change has consequential effects on the way that section 740(6) of ICTA is rewritten in section 734 of this Act. That section provides for a reduction in the amount carried forward in respect of a benefit to a tax year after the year of receipt where the whole or part of the benefit is a capital payment that causes a capital gains tax charge to arise.

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

Change 114: Transfer of assets abroad, transactions in land and sales of occupation income: power to obtain information: "reasonably require": sections 748, 771 and 788

This change expressly restricts the particulars that an officer of Revenue and Customs may require to be provided under section 745(1) or section 778(1) of ICTA to those particulars which the officer may reasonably require.

Section 745(1) of ICTA enables the Board to require a person to give them such particulars "as they think necessary" for the purposes of Chapter 3 of Part 17 of ICTA. Section 778(1) of ICTA similarly enables the Board or an inspector to require a person to give them such particulars "as the Board or the inspector think necessary" for the purposes of sections 775 and 776.

The opportunity has been taken in sections 748, 771 and 788 of this Act to modernise this language and expressly impose the criterion of reasonableness. This is consistent with the way in which HMRC exercise the power in practice.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 115: Transactions in land and sales of income from occupation: application to non-UK residents: sections 756, 759 and 778

This change is about the omission of provisions which might suggest that the normal rule that non-UK residents are not liable for income tax when the source of the income is outside the United Kingdom does not apply in the case of the charges under sections 775 and 776 of ICTA.

Section 775(9) of ICTA (sales of income from occupation: territorial scope) provides:

> This section shall apply to all persons, whether resident in the United Kingdom or not, if the occupation of the individual is carried on wholly or partly in the United Kingdom.

Section 776(14) of ICTA (transactions in land: territorial scope) similarly reads:

> This section shall apply to all persons, whether resident in the United Kingdom or not, if all or any part of the land in question is situated in the United Kingdom.

These provisions derive from paragraph 7(1) and (2) respectively of Schedule 16 to FA 1969.

It is unclear to what extent section 776 of ICTA applies to a non-UK resident who disposes of several areas of land, some within the United Kingdom and some outside the United Kingdom, under a single transaction if the statutory conditions for liability under section 776 are met. Similarly, it is unclear to what extent section 775 of ICTA applies to a non-UK resident who carries on an occupation partly within and partly outside the United Kingdom and enters into a transaction within section 775.

Section 827A(3) of ICTA provides that an amount arising to a non-UK resident is chargeable to income tax only if it is from a source in the United Kingdom. This would mean that the non-UK resident would only be chargeable on the gain attributable to the land situated, or on the capital amount attributable to the occupation carried on, in the United Kingdom.

But section 827A(5) of ICTA provides that section 827A is subject to any express or implied provision to the contrary in any provision of the Income Tax Acts. It could be argued that

sections 775(9) and 776(14) of ICTA each show a contrary intention to the general rule in section 827A(3) and that therefore in such a case the whole of the gain would be chargeable.

In practice, HMRC do not regard any such contrary intention as being shown. Sections 759 and 776 of this Act follow that interpretation and so do not rewrite the part of sections 775(9) and 776(14) about residence. This omission is considered to be a change in the law, as it will prevent HMRC from arguing for the other interpretation.

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

Change 116: Transactions in land: person liable: provider of opportunity to realise a gain: section 759

This change omits words from section 776(8) of ICTA indicating that where a gain on a transaction in land that is charged under that section is derived from an opportunity of realising a gain provided by another person and as a result that person is liable for the tax, it does not matter whether or not the opportunity was put at the disposal of the person to whom the gain actually accrues.

Section 776 of ICTA charges gains of a capital nature relating to the land to income tax where the gains are made by persons connected with land or the development of land and the statutory conditions are met.

In certain circumstances, people who are liable to pay income tax in the United Kingdom may enter into transactions in land as a result of which value, or an opportunity of realising a gain, is provided to another person (who may not be so liable). In such cases, section 776(8) of ICTA lays down that the provider of the value or, as the case may be, the opportunity is the person liable to income tax under section 776.

Section 776(8), so far as relevant, reads:

> If all or any part of the gain accruing to any person is derived from value, or an opportunity of realising a gain, provided directly or indirectly by some other person, whether or not put at the disposal of the first-mentioned person …

In Yuill v Wilson (1980), 52 TC 674[5] at page 706, Goff LJ criticised the drafting of what is now section 776(8):

> I find it very difficult to appreciate what [the words "whether or not put at the disposal of the first-mentioned person" in what is now section 776(8)] were intended to cover. In the case of *value* I can well see that a gain may be derived by one person from value provided by another, whether directly or indirectly, without that value being put at the disposal of the first-mentioned person; for example, if A pays money to B as consideration for the grant of an option to C. As at present advised, however, I find it very difficult to see how one can gain from an *opportunity* provided by another without that opportunity being put at the disposal of the first-mentioned person. (emphasis added)

As it is considered that no sensible meaning can be given to the words "whether or not put at the disposal of the first-mentioned person" so far as they relate to the earlier words "an opportunity of realising a gain", in rewriting the passage under review section 759(5)

[5] [1980] STC 460.

(transactions in land: person liable) refers only to the value provided by another person and not the opportunity of realising a gain.

If this view were incorrect, then the restriction of the scope of section 759(5) might in some circumstances exclude taxpayers from liability under the "transactions in land" Chapter.

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

Change 117: Transactions in land and sales of occupation income: income treated as the highest part of the taxpayer's income: sections 768 and 786

This change introduces a rule for determining in a case where a person has income chargeable under section 775 of ICTA (sales of occupation income) and income chargeable under section 776 of ICTA (transactions in land) how much of each of those kinds of income is treated as the highest part of the person's income.

Section 777 of ICTA supplements both section 775 and section 776 of ICTA.

Under both section 775 and section 776, a person (A) may be assessed to tax in respect of consideration receivable by another person (B). Under section 777(8)(a), in both cases A is entitled to recover from B the tax assessed and paid. To this end, section 777(8) entitles A to obtain from HMRC a certificate specifying the amount of income in respect of which tax has been paid.

The last sentence of section 777(8) provides:

> For the purposes of this subsection any income which a person is treated as having by virtue of sections 775 and 776 shall, subject to section 833(3), be treated as the highest part of his income.

Although the expression "the highest part of [the taxpayer's] income" in section 777(8) is not expressly defined, it is clear from the context that the expression means the part of the taxpayer's income which is subject to the taxpayer's highest marginal rate or rates of income tax.

But, if there is more than one amount of deemed income under section 775 or section 776 or both, and section 775 or section 776 or both take the taxpayer into the next tax bracket (e.g. over the higher rate threshold), section 777(8) does not specify the priority of the charges.

Such a case is unlikely to arise in practice, because section 777(8) certificates are rarely if ever requested. But, if it did, HMRC would resolve the problem by a just and reasonable apportionment under section 777(6)(a).

Sections 768 and 786 rewrite section 777(8). Splitting the last sentence of section 777(8) in this way has highlighted the absence of a tie-breaker in the source legislation. The sections therefore include one: they provide that if the individual is treated as having income under both Chapters, only a just and reasonable proportion of the land income, and only a just and reasonable proportion of the occupation income, is to be treated as the highest part of the individual's income.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 118: Transactions in land: clearance procedure: section 770

This change gives the Commissioners for Her Majesty's Revenue and Customs responsibility for granting or denying clearance concerning transactions in land.

Section 776 of ICTA is an anti-avoidance provision concerning transactions in land. Section 776(11) lays down a statutory clearance procedure. It provides that the taxpayer is to provide particulars of the transaction to "the inspector to whom he makes his return of income".

This could cause theoretical difficulties if the taxpayer:

- is not legally obliged to file a self-assessment return;
- does not file a self-assessment return; and
- wishes to obtain clearance under section 776(11) of ICTA.

In practice, if the taxpayer makes a clearance application to the HMRC office dealing with that taxpayer's affairs, that HMRC office will process the application.

Section 770, which is based on section 776(11) of ICTA, gives the responsibility for clearances concerning transactions in land to the Commissioners for Her Majesty's Revenue and Customs, rather than the officer to whom the taxpayer makes a return of income. This is consistent with section 707 of ICTA (transactions in securities: clearance procedure), which is rewritten in sections 701 and 702.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 119: Sales of occupation income: restriction on exemption for sales as going concerns: meaning of "income or receipts": section 785

This change clarifies the meaning of "income and receipts" for the purposes of the restriction under section 775(5) of ICTA on the exemption for sales of going concerns from the charge under section 775 of ICTA. The restriction on the exemption applies where the value of the going concern is attributable to a material extent to prospective income or profits for which full consideration will not be received.

Section 775 of ICTA (sale by individual of income derived from his personal activities) is directed against arrangements whereby individuals seek to sell their earnings in return for capital sums which escape income tax. If it applies, section 775 taxes the capital sum received for the sale as income.

Section 775(4) of ICTA gives an exemption for sales of going concerns. For example, it is common for existing partners in a professional firm to be paid a capital sum by a new partner in return for a share in the partnership. Section 775(4) provides that section 775 does not apply so far as the value of what is disposed of is attributable to its value as a going concern. So it ensures that section 775 does not catch normal commercial arrangements such as this.

Section 775(5) of ICTA is directed against attempts to abuse this exemption. If (for example) the taxpayer transfers into an existing business the copyright of a book which he or she has written, and obtains a capital sum for the disposal of the business as a going concern, the exemption is restricted. To the extent that the value of the business is attributable to the going concern, it falls within section 775(4). But to the extent that the value of the business is

attributable to the copyright, section 775(5) takes the capital sum out of section 775(4) and taxes it as income.

Section 775(5) of ICTA reads:

> If the value of the profession, vocation or business as a going concern is derived to a material extent from prospective income or receipts derived directly or indirectly from the individual's activities in the occupation, and for which, when all capital amounts are disregarded, the individual will not have received full consideration, whether as a partner in a partnership or as an employee or otherwise, subsection (4) above shall not exempt the part of a capital amount so derived.

Section 775(3)(b) of ICTA provides that the expression "income or receipts" includes "payments for any description of copyright or licence or franchise or other right deriving its value from the activities, including the past activities, of the individual."

But the scope of this inclusion section is uncertain. On the one hand, section 775(3) of ICTA begins "In this section …", implying that it extends to section 775(5). On the other, section 775(3)(b) begins "references in subsection (1) above", implying that it does not. It is unclear which takes priority.

It is considered that, as a matter of normal usage, the expression "income or receipts derived directly or indirectly from the individual's activities in the occupation" in section 775(5) of ICTA is apt to include "payments for any description of copyright or licence or franchise or other right deriving its value from the activities, including the past activities, of the individual." Therefore in so far as section 775(3)(b) applies to section 775(5) it is merely declaratory.

Section 785 rewrites section 775(5) of ICTA on the basis that section 775(3)(b) applies to it.

This is a change in the law, in that it will prevent taxpayers from maintaining the contrary view.

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

Change 120: Limit on liability to income tax of non-UK resident companies: omission of disregard of any relief to which a company is entitled by virtue of arrangements having effect under section 788 of ICTA: section 815

This change omits section 151(1)(a)(ii) of FA 2003.

Section 151(1) of FA 2003 provides that:

> The income tax chargeable for a year of assessment on the total income of a company that is not resident in the United Kingdom is limited to the sum of the following amounts—
>
> (a) the amount of tax that, apart from this section, would be chargeable on that total income if—
>
> (i) the amount of that income were reduced by the amount of any income to which this section applies, and
>
> (ii) there were disregarded any relief to which that company is entitled by virtue of arrangements having effect under section 788 of the Taxes Act 1988 (double taxation relief), and
>
> (b) the amount of tax deducted from so much of any income to which this section applies as is income the tax on which is deducted at source.

Section 151 of FA 2003 replaced section 129 of FA 1995. There was no disregard in section 129 of FA 1995 similar to that in section 151(1)(a)(ii) of FA 2003. The replacement of

section 129 of FA 1995 by section 151 of FA 2003 was not intended to make any change in the law except so far as a change was necessary following the change from "branch or agency" to "permanent establishment" introduced by section 148 of FA 2003.

It appears that section 151(1)(a)(ii) of FA 2003 was included by analogy with section 128(1)(a)(ii) of FA 1995. That sub-paragraph, however, only disregards reliefs under Chapter 1 of Part 7 of ICTA to which an individual is entitled, including any such reliefs to which an individual is entitled under that Chapter by virtue of a double taxation arrangement. The principal reliefs under that Chapter are personal allowance, blind person's allowance and married couple's allowance. The only other reliefs under that Chapter are life assurance premium relief and relief for payments securing annuities.

For an individual, only the personal and other reliefs mentioned above are disregarded in calculating the limit, not all reliefs to which the individual is entitled as a result of a double taxation arrangement.

For companies, the position should be the same. This means that there are no reliefs which should be disregarded, because a company is not entitled to any of those personal and other reliefs. If the reliefs to which the company was entitled as a result of a double taxation arrangement were disregarded, the limit on liability to income tax for the company could be higher, which could be to the company's disadvantage.

The provisions of sub-paragraph (ii) have, therefore, been omitted from the rewrite of section 151(1)(a) of FA 2003 in section 815(4), on the basis that they are inappropriate.

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

Change 121: Limit on liability to income tax of non-UK resident companies: substitution of references to income for references to chargeable profits in paragraph 4(3) and (5) of Schedule 26 to FA 2003: sections 821 and 823

This change substitutes references to a non-UK resident company's income in sections 821(3) and 823(2)(b) for the references to its chargeable profits in paragraph 4(3) and (5) of Schedule 26 to FA 2003. Paragraph 4 sets out the 20% rule applicable to investment managers.

The term "chargeable profits" is not defined for the purposes of Schedule 26 to FA 2003. Section 11(2) of ICTA defines the chargeable profits of a non-UK resident company as being the profits attributable to the company's permanent establishment in the United Kingdom and provides that such profits are chargeable to corporation tax. That definition, therefore, has no application in relation to the liability of a non-UK resident company to income tax in respect of income deriving from transactions carried out on behalf of the company by an investment manager who meets the independent investment manager conditions.

The basis on which the legislation in FA 2003 was prepared was that it was not to affect the law under FA 1995, except so far as required to adopt the concept of permanent establishment in place of branch or agency in relation to non-UK resident companies.

It is clear from the reference in the definition of "relevant excluded income" in section 127(5) of FA 1995 to "such of the profits and gains of the non-resident…as…for the purposes of section 128 below would fall (apart from the requirements of subsection (4) above) to be

treated as excluded income" that the defined term in that Act is limited to income and does not include gains. This has been reflected in sections 821(2) and 823(2)(a).

The references to "the aggregate of such of the chargeable profits of the company" in paragraph 4(3) of Schedule 26 to FA 2003 and to "so much of the chargeable profits of the non-resident company" in paragraph 4(5) of that Schedule are, therefore, in practice read as referring to income only.

Accordingly, section 821(3) refers to "the total of the non-UK resident company's income for the accounting periods" which derives from the relevant investment transactions, and section 823(2)(b) refers to "so much of the income of the non-UK resident company" deriving from the transaction.

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

Change 122: Limit on liability to income tax of non-UK residents: inclusion of stock dividends from UK resident companies as an additional category of disregarded savings and investment income: section 825

This change adds stock dividends chargeable to income tax under Chapter 5 of Part 4 of ITTOIA to the list of savings and investment income which is disregarded income under section 813 or disregarded company income under section 816.

As described in *Change 1,* section 1B of ICTA, as amended by paragraph 4 of Schedule 1 to ITTOIA, applies the dividend upper rate to an individual's income within Chapters 3 and 4 of Part 4 of ITTOIA (UK and foreign dividend income) that would otherwise have been taxed at the higher rate. It does not apply the dividend upper rate to income within Chapter 5 of Part 4 of ITTOIA (stock dividends from UK resident companies). But the established practice has been to treat such income as if it fell within section 1B of ICTA.

This established practice has been recognised in the rewrite of section 1B of ICTA. Section 13(2) of this Act applies the dividend upper rate instead of the higher rate to "dividend income". This term is defined in section 19 to include income under Chapter 5 of Part 4 of ITTOIA. Accordingly, stock dividends from UK resident companies will be taxed at the same rates as apply to ordinary dividends.

In the light of this change, it is not appropriate that any distinction should continue to be made between the status as disregarded income or disregarded company income of dividends from UK resident companies chargeable under Chapter 3 of Part 4 of ITTOIA and stock dividends from such companies chargeable under Chapter 5 of that Part. Such stock dividends have, accordingly, been added in section 825(1)(a).

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

Change 123: Occasional residence abroad: omission of limitation to Commonwealth citizens and citizens of the Republic of Ireland: section 829

This change extends the application of section 829 to all individuals who are UK resident and ordinarily UK resident and leave the United Kingdom for the purpose only of occasional residence abroad.

Section 829 is based on section 334 of ICTA, which applies only to Commonwealth citizens and citizens of the Republic of Ireland who are ordinarily UK resident.

The origin of the provisions in section 334 can be traced back to section X of the Statute of 1799 (39 George III c.13):

> And be it further enacted that any subject of His Majesty whose ordinary residence shall have been in Great Britain and who shall have departed from Great Britain and gone into any parts beyond the seas for the purpose only of occasional residence at the time of the execution of this Act, shall be deemed, notwithstanding such temporary absence, a person chargeable in respect of his or her income as a person actually residing in Great Britain and shall be assessed and charged accordingly (in the manner hereinafter directed) upon the whole amount of his or her income whether the same shall arise from property in Great Britain or elsewhere, or from any profession, office, pension, stipend, employment, trade or vocation, in Great Britain or elsewhere

through section 39 of the Income Tax Act 1842:

> And be it enacted that any subject of Her Majesty whose ordinary residence shall have been in Great Britain, and who shall have departed from Great Britain and gone into any Parts beyond the Seas, for the Purpose only of occasional Residence, at the Time of the Execution of this Act, shall be deemed, notwithstanding such temporary Absence, a Person chargeable to the Duties granted by this Act as a Person actually residing in Great Britain, and shall be assessed and charged accordingly (in manner hereinafter directed) upon the whole Amount of his Profits or Gains, whether the same shall arise from property in Great Britain or elsewhere, or from any allowance, annuity, or stipend, (save as herein is excepted,) or from any profession, employment, trade or vocation, in Great Britain or elsewhere

to its re-enactment, with no pre-consolidation amendments, in the first income tax consolidation Act, the Income Tax Act 1918, as rule 3 of the general rules applicable to Schedules A to E:

> Every British subject whose ordinary residence has been in the United Kingdom shall be assessed and charged to tax, notwithstanding that at the time the assessment or charge is made he may have left the United Kingdom, if he has so left the United Kingdom for the purpose only of occasional residence abroad, and shall be charged as a person actually residing in the United Kingdom upon the whole amount of his profits or gains, whether they arise from property in the United Kingdom or elsewhere, or from any allowance, annuity, or stipend (save as herein is excepted), or from any trade, profession, employment, or vocation in the United Kingdom or elsewhere.

The reference to British subject has subsequently been amended to reflect the establishment of the Republic of Ireland as an independent Sovereign State and the creation of the Commonwealth. But, otherwise, the language of the provision has not changed in any material respect.

In his judgment in Reed (HM Inspector of Taxes) v Clark, (1985), 58 TC 528 Ch D[6], Nicholls J reviews the history of this provision (then section 49 of ICTA 1970) and the cases in which it is considered. He observes (at page 550 B):

> Despite the long history of the statutory provision now reproduced as s 49, the researches of very experienced Counsel have not revealed any reported decision in which a claim to tax has succeeded only by virtue of that provision. But in several cases the provision has been commented upon…

Nicholls J refers to the judgments in Levene v CIR (1927), 13 TC 486 HL at all its stages. The judgment of Viscount Cave LC in that case in the House of Lords contains the following passage (at page 505):

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[6] [1985] STC 323

> My Lords, the word "reside" is a familiar English word and is defined in the Oxford English Dictionary as meaning "to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place". No doubt this definition must for present purposes be taken subject to any modification which may result from the terms of the Income Tax Act and Schedules; but, subject to that observation, it may be accepted as an accurate indication of the meaning of the word "reside". In most cases there is no difficulty in determining where a man has his settled or usual abode, and if that is ascertained he is not the less resident there because from time to time he leaves it for the purpose of business or pleasure.

The cases also make clear that residence in this context denotes, to paraphrase the words of Rowlatt J at first instance in Levene (at page 492), a quality attributable to the individual which makes the individual describable as resident with reference to a place.

In Reed v Clark the issue in relation to section 49 of ICTA 1970 was whether, it having been found by the Commissioners that Mr Clark was resident in the USA for the tax year 1978-79, his residence was only occasional. The decision of the Commissioners that it was not and that Mr Clark was both resident and ordinarily resident in the USA for that year was upheld by Nicholls J.

Although historically the provisions in section 334 of ICTA have been limited to British subjects and their current manifestations, Commonwealth citizens and citizens of the Republic of Ireland, the observations of Viscount Cave LC in Levene quoted above are applicable to any individual who has his or her settled or usual abode in the United Kingdom. Such a settled or usual abode will in virtually every case lead to the result that an individual is ordinarily UK resident for income tax purposes.

In accordance with the judgment of Viscount Cave LC, occasional residence abroad by such an individual who is not a Commonwealth citizen or a citizen of the Republic of Ireland equally will not displace the quality of the individual's residence as being in the United Kingdom. In practice, the same tests are applied in determining whether any individual, whether or not a Commonwealth citizen or a citizen of the republic of Ireland, has ceased to be UK resident upon leaving the United Kingdom. This change makes this explicit.

In rewriting this provision, it has also been made explicit that it only applies if the individual is UK resident, as well as ordinarily UK resident, at the time the individual leaves the United Kingdom. There has never been any doubt that the provision only applies if the individual is both UK resident and ordinarily UK resident at that time.

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

Change 124: Individuals in the United Kingdom for temporary purpose: substitution of 183 days for six months: sections 831 and 832

This change replaces references to six months with references to 183 days in sections 831(1) and 832(1) which deal with the residence status of individuals who are in the United Kingdom for some temporary purpose only.

Section 831(1) is based on section 336(1) of ICTA which provides that:

> A person shall not be charged to income tax under a charge to which subsection (1A) applies as a person residing in the United Kingdom, in respect of profits or gains received in respect of possessions or securities out of the United Kingdom, if—
>
> (a) he is in the United Kingdom for some temporary purpose only and not with any view or intent of establishing his residence there, and

> (b) he has not actually resided in the United Kingdom at one time or several times for a period equal in the whole to six months in any year of assessment, but if any such person resides in the United Kingdom for such a period he shall be so chargeable for that year.

Section 832(1) is based on section 336(2) of ICTA, which provides that:

> For the purposes of determining taxable earnings from an employment under Chapters 4 and 5 of Part 2 of the Income Tax (Earnings and Pensions) Act 2003 (employment income: charge to tax), a person who is in the United Kingdom for some temporary purpose only and not with the intention of establishing his residence there shall not be treated as resident in the United Kingdom if he has not in the aggregate spent at least six months in the United Kingdom in the year of assessment, but shall be treated as resident there if he has.

Section 336(1) and (2) of ICTA both depend upon the question whether the period or periods during which the person has been actually residing in the United Kingdom, or which the person has spent there, amount in total to six months. But the number of days in a consecutive period of six months may vary between 181 and 184. In the majority of cases, the period is of 183 days or less.

Accordingly, to ensure fairness between all persons affected by these provisions and to cater for broken periods, references to six months in these provisions are in practice treated as references to 183 days. This practice is published in HMRC booklet IR20: Residents and non-residents: Liability to tax in the UK.

Sections 831(1) and 832(1), therefore, refer to 183 days in place of six months.

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

Change 125: Jointly held property and earned income: section 836 and Schedule 1 (section 189 of FA 2004)

This change concerns the earned income exception from the rule which allocates income arising on property held jointly by a married couple, or members of a civil partnership, who live together, equally between the individuals concerned.

The change is that the joint property rule is rewritten in direct terms without reference to earned income, and the earned income exception is replaced with one for all partnership income, which has broadly the same effect. It also makes a related change to the definition of "relevant UK earnings" in section 189 of FA 2004.

Section 282A(1) of ICTA provides a rule that income arising to married couples and civil partners from jointly held property is allocated equally (the 50:50 rule). The rule is subject to a number of exceptions, including section 282A(4)(a). That subsection excludes all earned income from the rule. Earned income is defined by section 833(4) to (6) of ICTA.

This joint property rule is the only place in the Income Tax Acts where the concept of earned income is used directly. This note considers each type of earned income in turn and sets out whether it can arise on jointly held property.

The first case dealt with in section 833(4) of ICTA is employment, pension and social security income and property income attached to an employment. Such income cannot arise jointly.

The second case in section 833(4) is income arising from a trade, profession or vocation. Clearly, such income can arise jointly, ie where the business is carried on in partnership. Such

income is specifically excluded from the 50:50 rule by direct reference to partnerships – see *Exception C*. Because all income subject to the partnership rules in Part 9 of ITTOIA is excluded it is not necessary to reproduce the special rule in section 282A(4)(b) to ensure that the income of sleeping partners is also excluded.

Section 833(5) to (5E) of ICTA contains complex rules to determine whether income arising from patents and know-how is earned or unearned. Such income can arise jointly. The section does not reproduce any of these rules and all such income (unless it is partnership income) will as a result fall within the 50:50 rule.

So where income was previously classified as earned the 50:50 rule will apply in cases where it did not apply before. But, couples will have the option of electing for allocation to follow beneficial entitlement (provided their shares in the asset match their shares in the income), which gives couples an alternative basis on which to allocate income that may work to their advantage.

The other types of income to be considered are those that are treated as earned under specific provisions:

- Adjustment income within section 232 of ITTOIA. This income can arise jointly where it is partnership income. It is now excluded from the 50:50 rule through the exclusion for partnership income.
- Post-cessation receipts within section 256 of ITTOIA. The source of such receipts is considered to be the trade, profession or vocation, and that no longer exists. It follows that the income does not arise from jointly held property and so is not within section 282A of ICTA.
- Furnished holiday lettings businesses within Chapter 6 of Part 3 of ITTOIA. This is specifically excluded by *Exception D*.
- Sale of income derived from personal activities within section 775 of ICTA. This cannot arise jointly.
- Profits from a Lloyd's underwriting business. Section 171 FA 1993 provides that all income arising to a member from a Lloyd's underwriting business is treated as arising from a trade. This might include income from jointly held property, such as that held in an ancillary trust fund. Such income is treated as earned under section 180 FA 1993. In order to ensure that the 50:50 rule does not apply, section 180(1)(b) is amended by Schedule 1 to specifically disapply section 836.

In summary, the exclusion for income subject to the partnership rules corresponds closely to the exclusion in the source legislation for earned income. The only type of income that will become subject to the 50:50 rule is income from patents and know-how that was previously classified as earned under the rules in section 833(5) to (5E) of ICTA. And this should generally work to the taxpayers' advantage.

The repeal of section 833(5) to (5E) of ICTA also requires a change to the definition of "relevant UK earnings" in section 189(2)(c) of FA 2004. In essence, patent income arising to an individual who devised an invention counts as relevant UK earnings, but this is subject to exceptions in section 833(5C) and (5E) of ICTA. The amendment made to section 189 by

Schedule 1 to this Act does not incorporate those exceptions, so that a wider range of patent income now qualifies as "relevant UK earnings". This works to the taxpayer's advantage.

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

Change 126: Deduction of tax: deposit-takers and building societies: enactment of regulations: sections 852, 853, 871, 872, 946, 947, Schedule 1 (section 17 of TMA and Schedule 2 to FA 2005) and Schedule 2 Part 15 (deduction by deposit-takers: discretionary or accumulation settlements)

Introduction

This change enacts some provisions of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) and certain provisions in other regulations and orders. The main purpose of the change is to secure a common basis for the split between the primary and secondary legislation about the deduction of sums representing income tax by deposit-takers and by building societies.

Position under the source legislation

The main source provisions for the deposit-taker regime, such as the main definitions, details of the categories of payment from which a sum representing income tax is or is not to be deducted and provisions about declarations of non-UK residence, are set out in sections 480A to 482 of ICTA. These sections are supported by the Income Tax (Deposit-takers) (Interest Payments) Regulations 1990 (SI 1990/2232). This split between primary and secondary legislation is in keeping with the approach to the divide between primary and secondary legislation generally.

But, for historical reasons, not least in relation to the creation and later abolition of composite rate tax, all of the provisions for building societies are regulations - in particular the building society regulations made under section 477A of ICTA.

The following regulations and orders also apply in relation to the deduction regimes:

- The Income Tax (Building Societies) (Audit Powers) Regulations 1992 (SI 1992/10) and the Income Tax (Deposit-takers) (Audit Powers) Regulations 1992 (SI 1992/12) about audit powers for the two regimes;
- The Income Tax (Deposit-takers) (Non-residents) Regulations 1992 (SI 1992/14) about declarations and certificates for non-UK residents;
- The Income Tax (Interest Payments) (Information Powers) Regulations 1992 (SI 1992/15) about the provision of information by building societies and deposit-takers;
- The Income Tax (Prescribed Deposit-takers) Order 1992 (SI 1992/3234) which treats firms with EEA passport rights as deposit-takers;
- The Deposit-takers (Interest Payments) (Discretionary or Accumulation Trusts) Regulations 1995 (SI 1995/1370); and
- The Income Tax (Prescribed Deposit-takers) Order 2002 (SI 2002/1968), which treats certain dealers in financial instruments as deposit-takers.

Revised approach

The enactment of the following regulations ensures that the provisions relating to building societies will be divided between primary and secondary legislation in the same way as for deposit-takers. To achieve this:

- parts of regulations 2, 3, 4 and 11 of the building society regulations are included in Chapter 2 of Part 15 of this Act;
- regulation 10 of the building society regulations is included in Chapter 15 of Part 15 of this Act; and
- regulation 12(1) of the building society regulations is incorporated into section 17 of TMA (see Schedule 1 to this Act).

As a number of the building society regulations are enacted, the wide powers provided in section 477A(1) of ICTA are replaced with specific regulation and order making powers in line with the deposit-taker regime.

This makes it explicit that the two regimes run in parallel (differing only where necessary to reflect the particular status of building societies). It also facilitates the making of any future changes, because any such changes to those building society rules now in primary legislation will be made in a Finance Act (rather than by regulation) alongside parallel changes made to the rules for deposit-takers. Equally, it will no longer be possible to amend those rules by regulations.

This approach is also a prerequisite for *Change 127*, under which the main provisions of the two regimes are aligned and combined.

In addition the following provisions in regulations are also included in the Act:

- (in section 853) provisions about EEA firms (SI 1992/3234) and dealers in financial instruments (SI 2002/1968);
- (in section 849(4) and Schedule 1 Part 2 (new paragraph 11 of Schedule 2 to FA 2005)) the provisions about "relevant arrangements" in regulation 2(4) and (5) of the building society regulations (SI 1990/2231); and
- (in Schedule 2 Part 15 (deduction by deposit-takers: discretionary or accumulation settlements)) the provisions about deposits made by the trustees of discretionary or accumulation settlements before 6 April 1995 (SI 1995/1370).

Implications for material remaining in regulations

This Act contains powers to enable regulations to be made in relation to the matters for which regulations can presently be made (excluding those matters now included within the sections of this Act). These powers support the existing regulations, which will remain in force under the continuity of the law provisions in this Act (see Part 1 of Schedule 1 to this Act), and enable changes to them to be made in future.

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

Change 127: Deduction of tax: deposit-takers and building societies: definition of relevant investment: sections 851, 856, 858, 859 and 872

Introduction

This change builds on *Change 126* (enactment of regulations). It aligns the gross payment category rules for building societies with those for deposit-takers, resulting in a common basis for identifying the payments which are to be subject to deduction of sums representing income tax. This change enables the two regimes to be combined.

Under the source legislation, there is a significant difference in the way the deposit-taker rules and the building society rules identify the payments from which sums representing income tax are potentially to be deducted (subject to the various exceptions). The deposit-taker rules in section 481(4) of ICTA identify four categories (individuals, Scottish partnerships, personal representatives and trustees). But regulation 3 of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) imposes an obligation to deduct sums representing income tax in all cases unless the payment falls within the scope of a gross payment category set out in regulation 4 (or the payment is referred to in section 477A(1A) of ICTA).

The reasons for this are historical. The difference of approach no longer achieves anything of substance and makes the essential identity of the two regimes very difficult to discern. The regimes are aligned to the deposit-taker approach (already in primary legislation), this being the simpler of the two.

History

The history of these provisions starts in 1894, when extra-statutory arrangements were first introduced under which building societies accounted annually for income tax at a composite rate. These arrangements became statutory in 1951 and regulations included various exceptions (eg for pension funds).

In FA 1984 a similar composite rate tax (CRT) scheme with quarterly accounting was introduced for retail bank deposits. This triggered changes to the building society rules in 1985, to bring them onto a similar quarterly scheme and to widen the range of exceptions. But, whereas bank interest was either paid gross or net of CRT, any building society payments which were not within CRT, or specifically allowed to be paid gross, had to be paid net of basic rate tax.

From April 1991, CRT was abolished in favour of deduction of sums representing basic rate income tax. So far as the building society provisions were concerned, this was achieved simply by requiring deduction of sums representing basic rate tax from payments other than those which could be paid gross. The possibility of re-engineering the provisions more fundamentally, along the lines now proposed, was considered but did not prove possible at the time.

Since then, a number of further additions have been made to the categories of payment that can be made gross, in particular going beyond exempt bodies to embrace companies (in 1992). Differences of scope between the regimes are now very small.

Effects of alignment

There are a number of circumstances in which payments by building societies made after deduction under the source legislation will no longer need to have sums representing income tax deducted.

This is a taxpayer-favourable change in cash flow terms, but does not affect final liability to tax. It could also, in some circumstances, mean the taxpayer has to complete a self-assessment return. But these effects could arise under the source legislation if a taxpayer used a deposit-taker rather than a building society.

In tandem with this, the basis on which building societies may treat investments as relevant is aligned to that for deposit-takers. This:

- reduces the range of cases in which building societies will need to obtain declarations specifically for tax purposes; and
- means that many of the provisions in regulation 4(1) of the building society regulations, which identify specific gross payment categories, will no longer be needed (in particular, regulations 4(1)(d), (f), (g), (k), (p), (q) and (r)).

As a result of the alignment, the following remaining differences of scope between the two regimes are removed:

- The gross payment categories for non-UK residents are defined by reference to the beneficial owner. For building societies, this means that the payment will not need to be made directly to the non-UK resident beneficiary in order for it to be made gross.
- Payments made to non-UK resident individuals (or Scottish partnerships) under regulation 4(1)(a) of the building society regulations will only be made gross where *all* the persons (or, in the case of a Scottish partnership, the partners) entitled to the payment are not UK resident, in line with HMRC practice.
- Payments to overseas non-corporate bodies (eg a Delaware Limited Liability Partnership) not within regulation 4(1)(a) or 4(1)(g) of the building society regulations will be made gross if all of the partners are not ordinarily UK resident.
- Payments made by building societies to partnerships (including limited liability partnerships) which are either partnerships of companies or partnerships between individuals and companies are in practice subject to deduction of sums representing income tax. This is because there is no specific gross payment category for payments made to partnerships involving companies (although it is possible that regulation 4(1)(g) of the building society regulations might allow payments made to partners which are companies to be made gross). Following alignment to the deposit-taker regime (section 481(4) of ICTA), such payments will no longer be subject to deduction of sums representing income tax.
- Payments made by building societies to Scottish partnerships where one or more of the partners are companies will be made gross under the rewritten legislation. Under the source legislation, such payments are made after deduction of a sum representing income tax as there is no gross payment category in the building society regulations to allow for the payment to be made gross (and regulation 4(1)(g) of the building society

regulations will not apply as the payment cannot be described as being made *to* the company).

- Payments made by building societies to unapproved pension schemes (including funded unapproved retirement benefit schemes), are technically subject to deduction of sums representing tax simply because they are not listed in regulation 4. But HMRC practice is to allow such payments to be made gross, and the alignment will bring the legislation into line with this.
- Payments made by building societies to joint accounts where the holders are not all from one of the four categories of person to whom the deposit-taker regime applies will no longer be subject to deduction of sums representing income tax. (Such a case is theoretical as it is understood that building societies do not in practice permit joint accounts of such a kind.)
- Payments made by building societies to non-UK resident trustees of a discretionary or accumulation settlement will be made gross. Regulation 4(1)(bb) of the building society regulations refers to trustees of a discretionary or accumulation trust. This change in terminology brings the building society regime into line with the deposit-taker regime, which was amended by Schedule 13 to FA 2006.

This change is in taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small. It also affects administrative requirements, in particular in relation to building societies.

Change 128: Deduction of tax: deposit-takers and building societies: deduction by reference to beneficiary of payments: section 856

This change aligns the way the deposit-taker and building society regimes take account of the identity of the beneficiaries of the payments concerned. It ensures that payments made by building societies will be subject to deduction at source only if the person *beneficially* entitled to the payment is an individual or a Scottish partnership (where all the partners are individuals) or the person is a personal representative or a trustee of a discretionary or accumulation settlement.

This means that payments made through third parties will be subject to deduction of sums representing income tax where the beneficiary falls into one of those categories.

The source legislation for building societies requires deduction from *all* payments (without focusing on the beneficial owner), unless the recipient falls into a gross payment category set out in regulation 4 of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) (or the payment is referred to in section 477A(1A) of ICTA).

But, as part of the alignment of the gross payment category rules for building societies with deposit-takers (see *Change 127*), deduction will apply only to payments falling within the four categories of payee identified by section 481(4) of ICTA. In this context, regulation 4(1)(b) of the building society regulations (gross payments made to trustees where the beneficiary is an individual or Scottish partnership) has not been rewritten, as it makes no difference whether a payment is made to a trustee where the income of the trustee is payable

to an individual or a Scottish partnership, or the payment is itself one to which an individual or Scottish partnership is beneficially entitled.

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

Change 129*:* Deduction of tax: deposit-takers and building societies: investments to be treated as being or as not being relevant investments: section 857

This change is about the administrative effect of *Changes 126* (enactment of regulations) and *127* (definition of relevant investment) on how deposit-takers and building societies decide whether or not to treat investments as relevant investments.

As part of the alignment of the building society regime and deposit-takers regime, it is necessary to have one common basis for determining when an investment should be treated as being a relevant investment. This involves changes to the rules regarding the way that building societies check whether a particular payment should be made gross.

For example, regulations 11(1), (2), (2A) and (4) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) state that a building society cannot treat a payment as being within one of the gross payment categories found in regulation 4(1)(a) to (g), (k) or (r) unless it has a declaration to that effect. But once it has that declaration, it can continue to treat such payments as gross until it has information that regulation 4(1) of the building society regulations may not apply.

For deposit-takers, declarations are only required for persons falling in the equivalent of regulations 4(1)(a) to (c). As deposit-takers do not have to obtain declarations in respect of regulation 4(1)(d) to (g), (k) or (r), once the two regimes are aligned, building societies will no longer have to obtain declarations for payments previously caught under regulations 4(1)(d) to (g), (k) and (r). Building societies will have to check only that the payment is not caught in one of the four categories and, if it is not, no further checks or declarations will be required.

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

Change 130: Deduction of tax: deposit-takers and building societies: declarations of non-UK residence: sections 858, 859, 860 and 861

This change aligns the rules about declarations as between the deposit-taker and building society regimes, in line with practice, so that in all cases a declaration of non-UK residence in the prescribed or authorised format (which may or may not be in writing) will be required in order for a gross payment to be made.

Section 481(5)(k) of ICTA requires deposit-takers to have received a written declaration from an "appropriate person" confirming that the individual, deceased person or trustees are (or, in the case of a deceased person, was) non-UK resident before a gross payment can be made.

The declaration needs:

- to be in a prescribed or authorised format and contain an undertaking to notify the deposit-taker if circumstances change (see section 482(2) of ICTA); and

- to contain the names and addresses of the individuals or partners to whom the declaration applies (see section 482(2A) of ICTA).

These latter conditions are not prerequisites for the payment to be made gross. But a penalty can arise if they are not met (see section 98 of TMA).

But current practice is that the payment will only be made gross where a declaration is made in the prescribed or authorised format which contains all the above mentioned information.

For building societies the position is slightly different. Under the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) building societies cannot make gross payments unless they have received a non-UK resident declaration (which need not be in writing) from an "appropriate person" which must contain an undertaking to notify the building society if there is a change in circumstances (regulation 11(1) to (2AB)).

But it is not a prerequisite for gross payment that the declaration contains the names and addresses of the individuals or partners concerned (regulation 11(2AC) of the building society regulations). Nor is it necessary for the declaration to be in a prescribed or authorised format (regulation 11(3)). But a penalty can arise if these conditions are not met (see section 98 of TMA).

Again, current practice is that the payment will only be made gross where a non-UK resident declaration is made in the prescribed or authorised format and it contains all the above mentioned information.

In order to align both the deposit-taker and building society regimes with current practice a number of steps have been taken.

Firstly, the sections require in all cases a declaration of non-UK residence in the prescribed or authorised format (which may or may not be in writing) in order for a gross payment to be made.

The requirement that the declaration for deposit-takers be *in writing* (section 481(5)(k) of ICTA) has, therefore, not been reproduced, as it is unnecessary if the declaration is in a prescribed or authorised format. Further, the requirement, in section 482(2) of ICTA, that the declaration must contain such *information* as the Commissioners for Her Majesty's Revenue and Customs may *reasonably require* is in line with the deposit-taker rules, but goes beyond the explicit terms of regulation 11(3) of the building society regulations.

Second, declarations will need to include an undertaking (except in relation to deceased persons), and, in the case of the "individual interest condition" in section 856(3) or the "Scottish partnership condition" in section 856(4), it will require the names and addresses of the individuals concerned.

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

Change 131: Deduction of tax: deposit-takers and building societies: declarations of non-UK residence: Scottish partnerships: sections 859 and 861

This change clarifies the operation of provisions about Scottish partnerships.

Under Scottish law, a Scottish partnership is a separate legal entity and thus capable of being the beneficial owner of a deposit. Section 481(4)(b) of ICTA states that where a deposit is owned by a Scottish partnership, and all the partners are individuals, it will be treated as a relevant investment.

But under section 481(5)(k)(i) of ICTA, the deposit will not be treated as a relevant investment where, "the person who is beneficially entitled to the interest is not … ordinarily resident in the United Kingdom".

As the Scottish partnership is the person beneficially entitled to the deposit, this does not sit comfortably with the fact that it is the partners who each have a residence status, rather than the partnership itself. Further, existing practice (although declarations in favour of Scottish partnerships are rare) is to apply this provision by reference to whether all the partners are not ordinarily resident in the United Kingdom (rather than whether the Scottish partnership is not ordinarily resident).

Section 481(5)(k)(i) of ICTA and regulation 4(1)(a) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) have therefore been rewritten in section 859 in such a way as to ensure that a deposit will not be a relevant investment where a declaration has been made by the Scottish partnership that *all the partners* of the Scottish partnership are not ordinarily resident in the United Kingdom.

In the same way, section 481(5)(k)(iii) of ICTA treats a deposit as not being a relevant investment where the trustees are not UK resident and believe that no beneficiary is an individual ordinarily resident in the UK or a UK resident company. On a strict reading of section 481(5)(k)(iii) this means that a declaration may be made where the trustees are non-UK residents and a Scottish partnership, consisting in whole or part of UK resident partners, is a beneficiary. In order to rewrite section 481(5)(k)(iii) of ICTA in a way that is consistent with the rewrite of section 481(5)(k)(i) of ICTA, it is necessary to refer to the *partners* of the Scottish partnership rather than the *Scottish partnership* in section 861.

This aspect of section 861 follows the approach currently taken by regulation 4(1)(bb) of the building society regulations which allows a payment to be made gross where the trustees are not UK resident and the beneficiaries are non-UK resident or, in the case of a Scottish partnership, the partners are non-UK resident individuals. But regulation 11(2AA)(b) of the building society regulations requires the building society to obtain a declaration stating that the trustee does not have reasonable grounds for believing that the *beneficiaries* are UK resident. In order to rewrite regulation 11(2AA)(b) in a way that is consistent with regulation 4(1)(bb)(ii), it is necessary for the rewritten legislation to refer to the *partners* of the Scottish partnership rather than the *Scottish partnership*.

Section 861, therefore, provides that, where the beneficiary is a Scottish partnership, the declaration must confirm that all the partners are not ordinarily UK resident.

Further, section 482(2)(a) of ICTA and regulation 11(2AB)(b) of the building society regulations require an undertaking to be included in the declaration that, if the beneficiary becomes resident, a notification will be sent to the deposit-taker or building society. In order to rewrite these provisions in a way that is consistent with the rewrite of section 481(5)(k)(i) and (iii) of ICTA and regulation 4(1)(a) and (bb) of the building society regulations,

reference is made, in sections 859(3) and 861(3), to the *partners* of the Scottish partnership rather than the beneficiary.

Finally, for building societies, section 861(3)(b)(iii) departs from regulation 4(1)(bb)(ii) of the building society regulations, which in effect requires the declaration to state that no beneficiary of the trust is a Scottish partnership with a UK resident partner *or* a company partner *(whether UK resident or non-UK resident)*. It appears more appropriate for regulation 4(1)(bb)(ii) of the building society regulations to be consistent with the general approach taken in regulation 4(1)(bb)(iii) dealing with trusts. Consequently, section 861(3)(b)(iii) only refers to *UK resident company partners*.

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

Change 132: Deduction of tax: deposit-takers and building societies: inspection of declarations: section 862

This change aligns the rules about inspection of declarations as between deposit-takers and building societies.

Section 482(3) of ICTA allows an officer of Revenue and Customs to issue a notice to inspect "all" declarations made to deposit-takers. This section has been rewritten so the notice may allow the officer to inspect "any" declarations made. This change makes the position more flexible and brings the deposit-taker legislation into line with the building society legislation (regulation 11(5) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231)).

This change may, in some circumstances, make compliance more onerous for a deposit-taker. For example, where a notice specifies particular declarations and the deposit-taker has to select the appropriate declarations.

But it is likely, in general, that this change will reduce both the compliance burden for deposit-takers and administrative costs for HMRC as it will be possible for the notice only to require specific declarations.

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

Change 133: Deduction of tax: deposit-takers and building societies: qualifying deposit rights: sections 864 and 889

This change omits the provisions about deposit rights in sections 349(3A), 349(4), 477A(1A) and (10) and 481(5A) of ICTA, as these are obsolete.

These provisions were inserted by Schedule 8 to F(No 2)A 1992, alongside the insertion of section 56A of ICTA in order to pave the way for the introduction of dematerialised transactions.

Section 56A supplemented section 56 of ICTA, to ensure that the charge to tax on income from the disposal of deposits would embrace income from the disposal of such deposit rights. And the provisions inserted into sections 349, 477A and 481 extended the exceptions from the duty to deduct which applied to qualifying certificates of deposit to deposit rights satisfying the relevant qualifying conditions.

The legislation in F(No 2)A 1992 was timed to coincide with the intended introduction of TAURUS (Transfer and Automated Registration of Uncertificated Stock). But in 1993 TAURUS was abandoned and so this legislation was never used.

Instead a new electronic settlement system (CREST) was proposed and began operation in 1996, under the terms of the Uncertificated Securities Regulations 1995 (SI 1995/3272) (now replaced by the Uncertificated Securities Regulations 2001 (SI 2001/3755)). In 2003, specific regulations were made to cater for electronic settlement of dematerialised rights in deposits (the Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations (SI 2003/1633)).

The references to uncertificated eligible debt security units in SI 2003/1633 were incorporated directly into the relevant provisions of ICTA by ITTOIA. These references have been rewritten in this Act as "qualifying uncertificated eligible debt security units" (see sections 864, 889(3)(b) and 986).

The references to deposit rights in sections 349(3A), 349(4), 477A(1A) and (10) and section 481(5A) of ICTA are therefore obsolete and have been omitted. And, accordingly, regulation 4(1)(j) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) is not rewritten.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 134: Deduction of tax: interest paid by building societies: sections 874 and 875

This change removes a drafting defect in section 349(2) of ICTA, to make it clear that Chapter 3 of Part 15 of this Act (deduction from certain payments of yearly interest) does not apply to any interest paid by building societies. All duties to deduct sums representing income tax from payments made by building societies are dealt with in Chapters 2 and 4 of Part 15 of this Act (based on sections 349(3A) and (3B) and regulations made under 477A(1) of ICTA).

Subject to certain exceptions that are not relevant here, section 349(2) of ICTA imposes a duty to deduct sums representing income tax from yearly interest paid (whether by or through the payer):

(a) otherwise than in a fiduciary or representative capacity, by a company (other than a building society) or local authority; or

(b) by or on behalf of a partnership of which a company is a member; or

(c) by any person to another person whose usual place of abode is outside the United Kingdom.

Under the source legislation, payments by building societies of interest on shares in, deposits with or loans to them are dealt with by regulations under section 477A(1) of ICTA. The scope of this provision is wide. But yearly interest on freely transferable securities issued by building societies are excluded from those regulations by section 477A(1A) of ICTA, being dealt with separately in section 349(3A) and (3B) of ICTA.

A building society is a body corporate, within the definition of a company in section 832(1) of ICTA, so section 349(2)(b) of ICTA could be read as catching any payments of yearly interest by a partnership of which a building society is a member. Also, section 349(2)(c) of ICTA, with its reference to payments "by any person", could be read as imposing a duty on a

building society to deduct from payments of yearly interest it makes to persons abroad. But both these possibilities would duplicate duties imposed by regulations made under sections 349(3A) and 477A(1) of ICTA.

This was not always so. As originally enacted, section 476(5)(a) of ICTA excluded from sections 348 to 350 of ICTA any dividends or interest to which regulations applied, unless those regulations specifically provided for sections 348 to 350 to apply. (The current regulations make no such provision.) At that time building societies could not issue freely transferable securities.

On the abolition of the composite rate provisions by FA 1990, section 349(3) of ICTA, which provides for exceptions to the duty to deduct under section 349(2), was amended by inserting subsection (3)(e) to exclude from that duty:

> any dividend or interest paid or credited in a relevant year of assessment in respect of shares in, or deposits with or loans to, a building society.

But in FA 1991 amendments were made to ICTA by locating the duty to deduct from dividends and interest on freely transferable securities in new sections 349(3A) and (3B). To pave the way for this, section 477A(1A) was inserted, ensuring that such dividends and interest were outside the scope of the regulations under section 477A. Further, the words inserted as section 349(3)(e) of ICTA by FA 1990 were repealed and the words "(other than a building society)" inserted into section 349(2)(a) of ICTA, but with no adjustment to section 349(2)(b) or (c). This inadvertently opened up the possibility that parts, but not all, of section 349(2) could apply to payments of interest by a building society.

This change restores the position of building society interest payments by excluding them from Chapter 3 of Part 15 of this Act (the rewritten equivalent of sections 349(2) and (3) of ICTA). So all payments of dividends and interest now fall under either Chapter 2 or Chapter 4 of Part 15 of this Act.

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

Change 135: Enactment of the European Investment Bank (Designated International Organisation) Order 1996 (SI 1996/1179): sections 879, 991 and Schedule 1 (section 840A of ICTA)

This change enacts the provisions of the European Investment Bank (Designated International Organisation) Order 1996 (SI 1996/1179) (the Order).

Under section 840A(1)(d) of ICTA the Treasury has powers to designate a "relevant international organisation" as a bank. That provision is rewritten for income tax in section 991(4) of this Act.

To date the power has only been used in relation to the European Investment Bank (the EIB). The operative provisions of the Order are in Articles 3 and 4. Article 3 of the Order designates the EIB as a bank. This is enacted by this Act, so that:

- for income tax purposes, the EIB is now specifically included in the definition of "bank" in section 991(2)(d); and

- for corporation tax purposes, the definition of "bank" in section 840A of ICTA includes the EIB (see new subsection (1)(ca) of that section).

Article 4 modifies the normal rules about the deduction of a sum representing income tax from interest in the case of interest paid to the EIB.

Under section 874(1), certain persons paying yearly interest must deduct from the payment a sum representing income tax. Section 879(1) provides an exception to that duty if the person beneficially entitled to the interest is within the charge to corporation tax. Article 4 of the Order withdraws, in the case of the EIB, the condition that the person must be within the charge to corporation tax. This allows interest on advances from the EIB to be paid gross.

This is enacted in section 879(3). As a result of this Change, the Order is revoked by this Act.

The Treasury powers to designate further international organisations will remain as before, both for income tax and corporation tax purposes.

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

Change 136: Deduction of tax: statutory interest: section 888

This change makes specific provision that payments of "statutory interest" are not subject to deduction of tax under section 874.

The Late Payment of Commercial Debts (Interest) Act 1998 requires payment of "statutory interest" in certain circumstances. Tax Bulletin 42 (August 1999, interpretations) indicated that where such interest is paid, it would not be regarded as yearly and would not, therefore, be subject to deduction of tax under section 349(2) of ICTA.

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

Change 137: Deduction of tax: payments of UK public revenue dividends: application for deduction of tax: section 895

This change extends the definition of "registered" to include securities which are "recorded" in the books of the Registrar of Government Stock, in order to provide legislative support for deduction at source applications under section 895 in respect of UK public revenue dividends on securities held in CREST.

Section 50(2) of ICTA provides that holders of any *registered* securities may apply to have income tax deducted at source. Section 50(7) of ICTA defines "registered" as meaning entered in the register of the Registrar of Government Stock in accordance with the regulations under section 47(1)(b) of FA 1942 (see regulation 3 of the Government Stock Regulations 2004 (SI 2004/1611)).

Securities which are held in CREST are not entered in the register of the Registrar of Government Stock. The Registrar of Government Stock only maintains a *record* of entries made in CREST's register. This means that, strictly, UK public revenue dividends on securities held in CREST cannot be the subject of an application for deduction at source as the securities are not "*registered*" (ie they are not entered on the register of the Registrar of Government Stock).

But current practice is that UK public revenue dividends on securities held in CREST are paid net of tax on application. In order to legislate for this, the definition of "registered" has been extended to include securities entered in a register maintained in accordance with regulations made under section 207 of the Companies Act 1989. Regulation 21 of the Uncertificated Securities Regulations 2001 (SI 2001/3755) (as amended), introduced under that section, requires the Registrar of Government Stock to maintain a record of entries made in CREST's register.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 138: Charges on income: year in which payments taken into account: rates for deduction of tax: sections 900, 901, 902 and 903

This change requires a sum representing income tax to be deducted from certain annual payments and patent royalties at the basic rate (or, in some cases, the savings rate) in force in the tax year they are *made*. It also ensures the payments will always be taken into account in the payer's tax calculation for the tax year in which they are made.

Section 4 of ICTA requires any deduction made to be at the basic or savings rate in force for the relevant tax year. That year is defined in section 4(2) of ICTA and depends on whether the payment is paid wholly out of income brought into charge to income tax. If it is, the relevant year is the tax year in which the payment is due to be paid. If not, the relevant year is the tax year in which the payment is made.

In either case, the relevant year is also the year against the income of which the payment is treated as a charge by virtue of the rule in section 835(6)(b) of ICTA which links into section 4 of ICTA.

These rules give rise to two awkward points.

The first is that the payer may not know the level of his income for the tax year at the time of payment and so there may be uncertainty about whether it will be treated as being paid wholly out of income brought into charge to income tax. Not knowing which tax year is relevant at the time of payment means that the payer may not know the rate for deduction at that time. (This uncertainty is also referred to in connection with *Change 81*).

The second concerns the case where the payer has insufficient income in the year the payment was due but has ample income in the following year and (whether or not for that reason) makes the payment in that following year. Here, a sum representing income tax will be deductible at the rate for the year in which the payment was due. And section 835(6)(b) provides that the payment is treated as a charge against the payer's income of that year. That is potentially disadvantageous to a payer who has insufficient income in that year to cover the charge.

Under this change, the provisions of section 4 of ICTA are not rewritten so far as they address these issues, but instead the rule is that deduction is made at the applicable rate in force for the year of payment. And the sections providing for the collection of the tax (in later Chapters of Part 15) and for relief for the payments themselves in calculating net income (Chapter 4 of Part 8) follow suit. The self-assessment return and guidance material already

effectively adopt this approach, by simply asking for details of payments without considering whether a payment is late.

Moving to a deduction at the rate in force for the year of payment may benefit the taxpayer in the second case cited above. But the taxpayer is not disadvantaged in the reverse scenario, where a payment is made late and the payer had ample income in the year the payment was due, but has less total income than the amount of the payment in the year of payment. That is because the payer's income would not have been enough to cover the charge (before the change) and (after the change) it is only possible for some of the payment to be deducted in calculating net income.

Nothing in this new rule affects the year in which a payment subject to deduction of tax at source is assessable on the recipient. That is fixed by provisions such as sections 580(1) and 684(1) of ITTOIA.

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

Change 139: Charges on income: no deduction of tax from certain patent royalty payments: section 903

This change removes any requirement to deduct sums representing income tax from patent royalty payments that are exempt under section 347A of ICTA or section 727 of ITTOIA.

Those sections exempt certain annual payments (defined as "qualifying annual payments" by section 899) if they are paid by an individual other than in connection with that individual's trade. Because of those exemptions, the deduction at source provisions in section 348(1) and 349(1)(a) of ICTA do not apply to the annual payments covered by section 347A of ICTA and section 727 of ITTOIA.

Deduction at source might arguably still apply under sections 348(2) and 349(1)(b) of ICTA on the grounds that the payment is in respect of a patent, in the absence of a parallel proviso to that in sections 348(1A)(a) and 349(1A)(a) of ICTA. But it is not sensible for deduction at source to apply to a payment that is exempt regardless of who receives it. Moreover, sections 348(2) and 349(1) of ICTA require deduction of "a sum representing the amount of income tax" on the payment. It is doubtful whether this requirement could have any application in the case of payments that cannot be taxable income of the payee.

Accordingly, section 903, which is based on sections 348(2) and 349(1)(b) of ICTA, requires sums representing income tax to be deducted only from patent royalty payments that are not qualifying annual payments. If a qualifying annual payment (whether in respect of a patent or not) is paid by an individual in connection with the individual's trade, deduction is made under section 900. If paid by a person other than an individual, deduction is made under section 901. But none of the rewritten deduction at source provisions applies to a patent royalty payment that is an exempt annual payment.

This change will affect very few cases. Most patent royalty payments by individuals will be made in the course of the individual's trade. Furthermore, the exemption only applies to patent royalties that are also annual payments. Most patent royalties will not be pure income in the recipient's hands, but will instead be taxable trading receipts.

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

Change 140: Deduction of tax: scope of duty to deduct from certain royalties: sections 903 and 906

This change enacts a principle of case law that determines the scope of the duty to deduct in certain cases involving payments in respect of royalties, patents, copyrights, design rights and public lending rights.

Where such payments are annual payments, the scope of the duty to deduct from annual payments can be seen from Earl Howe v CIR, (1919) 7 TC 289, CA. In that case Scrutton LJ said:

> The result of these Sections [corresponding to section 348 of ICTA] seems to be that the "annuities, interest, and other annual payments" which can be deducted to obtain exemption are those from which the claimant can deduct tax on behalf of the recipient; being in effect the profits of the recipient who bears the tax they are not also to be treated as profits of the person paying them. If no tax can be deducted on behalf of the recipient, they cannot be treated as profits of the recipient, and must be treated as paid out of profits of the person paying, who is therefore to be taxed on them.

This principle was confirmed in the case of Bingham v CIR, (1955) 36 TC 254, ChD. In that case, a man resident in the United Kingdom made maintenance payments to his former wife who was resident in the Netherlands. The payments had been ordered by a Dutch court and so were not UK source income. He claimed to deduct those payments (which at that time were annual payments) from his income for surtax purposes. It was held that, since his former wife was not liable to UK taxation on the maintenance payments, sums representing income tax could not be deducted from the payments under what is now section 348 of ICTA, and they were not allowable as a deduction.

In the case of copyrights, design rights and public lending rights, sections 536, 537 and 537B of ICTA apply section 349(1) of ICTA as if the payments were annual payments. (The duty to deduct in such cases is rewritten in section 906.) So it follows that if the person whose income it is has no liability to UK income tax on the payments, the duty to deduct under section 349(1) of ICTA cannot apply.

There is nothing specific to apply the same principle to payments in respect of a patent (section 903). But Scrutton LJ's discussion of the principle is wide enough to encompass patent payments. And there would be no logic in a policy that demanded deduction at source if a patent payment was also an annual payment, but not otherwise.

This change enacts the relevant case law in both sections 903 and 906 and aligns the statute with practice.

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

Change 141: Deduction of tax: manufactured overseas dividends: periods for accounting for tax: section 925

This change brings the law into line with practice in relation to the periods by reference to which overseas dividend manufacturers may set off amounts of overseas tax against their United Kingdom tax liabilities.

Paragraph 4(7) of Schedule 23A to ICTA provides:

> Dividend manufacturing regulations may make provision for a person who, in any chargeable period, is an overseas dividend manufacturer to be entitled in prescribed circumstances to set off in accordance with the regulations and to the prescribed extent, amounts falling within paragraph (a) of sub-paragraph (7AA) below against the sums falling within paragraph (b) of that sub-paragraph, and to account to the Board for, or as the case may be, claim credit in respect of, the balance.

Section 832(1) of ICTA defines "chargeable period" as an accounting period of a company or a year of assessment. It defines "year of assessment", with reference to income tax, as a year for which such tax is granted by any Act granting income tax.

Section 925 rewrites paragraph 4(7) of Schedule 23A to ICTA in terms of a "prescribed period" rather than a "chargeable period". This will enable the Treasury to make regulations about set-off in relation to a period other than a tax year if that is thought desirable. This flexibility is potentially beneficial to taxpayers, as it enables regulations to prescribe periods (such as periods of account) which will be to their administrative convenience.

The change has no implications for the amount of tax paid, who pays it, or when. It affects (in principle but not in practice) only administrative matters.

Change 142: Deduction of tax: collection: deposit-takers, building societies and certain companies: building society return periods: section 947

This change removes any doubt about whether paragraph 2(2)(b) of Schedule 16 to ICTA and regulation 10(3)(d)(b) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) have the same meaning.

Under the source legislation regulation 10(3)(d) of the building society regulations modifies paragraph 2(2)(a) to (c) of Schedule 16 to ICTA in respect of building societies, so that complete payment quarters and any *part* of an accounting period will be treated as a return period. But where a *complete* accounting period is wholly contained within a return period, there is no return period. This means, for example, that a complete accounting period running from say 1 January to 31 January will not be caught by regulation 10.

So, in keeping with the alignment of the rules on deduction of tax at source for deposit-takers and building societies (see *Changes 126* and *127*), *subsections (2)* and *(3)* of section 947 have been drafted so that they also apply to building societies.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 143: Deduction of tax: collection: deposit-takers, building societies and certain companies: returns: sections 949, 952, 953, 957 and 958

This change makes it clear that a return need be submitted only where a section 946 payment was made in that particular return period. It also clarifies related points.

Paragraph 2 of Schedule 16 to ICTA leaves it unclear whether a return need be made only for a return period in which a section 946 payment has been made or whether returns need to be made for each return period in any accounting period in which at least one section 946 payment has been made. Section 949 makes the position clear, in line with current practice.

The related points which follow from this change affect sections 952, 953, 957 and 958.

Sections 952(2) and 953(4) (set-off) clarify that a payer may make a set-off claim even where no section 946 payment has been made in the return period concerned. Under the source legislation this point is unclear because paragraph 5 of Schedule 16 to ICTA requires the claim to be included in a paragraph 2 return. (As mentioned above, it is unclear when such a return needs to be submitted.)

Section 957 (assessment in other cases) clarifies that an assessment can be made in respect of *any* return (including a return made only in order to make a set-off claim). Under the source legislation, this point is unclear as paragraph 4(2) of Schedule 16 to ICTA refers to returns made under paragraph 2. (As mentioned above, it is unclear when such a return needs to be submitted.)

Section 958 (payer's duty to deliver amended return) clarifies that the payer is under a duty to correct not only returns which include a section 946 payment, but also returns where a claim for set-off has been made. Under the source legislation, this point is unclear as paragraph 7A of Schedule 16 to ICTA refers to returns made under paragraph 2. (As mentioned above, it is unclear when such a return needs to be submitted.)

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 144: Deduction of tax: collection: deposit-takers, building societies and certain companies: payments made otherwise than in an accounting period: section 950

This change brings into line the information which is required to be included on a return if a payment is made otherwise than in an accounting period with the information which is required if a payment is made in an accounting period.

Paragraph 9 of Schedule 16 to ICTA does not have a specific information requirement. But all payments must be accounted for on returns which, according to section 113(1) of TMA, "… shall be in such form as the Board prescribe…".

As the form prescribed already requires the information set out in section 950 this change will have no effect in practice.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 145: Deduction of tax: collection: deposit-takers, building societies and certain companies: payer's duty to deliver amended return: section 958

This change extends the taxpayer's duty to submit corrected returns to payments made otherwise than in an accounting period.

Under paragraph 4(2) of Schedule 16 to ICTA, where an incorrect return is submitted in respect of payments made in an accounting period (see section 949), there is a duty on the taxpayer to deliver an amended return.

But the source legislation does not provide for such a duty in respect of returns in respect of payments made otherwise than in an accounting period (see section 950).

Section 958 imposes a duty to submit a corrected return regardless of whether the return is for a payment made in an accounting period or otherwise.

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

Change 146: Deduction of tax: collection: deposit-takers, building societies and certain companies: power to make regulations modifying this Chapter: section 962

This change confirms that the powers to modify the provisions dealing with collection of income tax deducted at source by regulations apply to deposit-takers and building societies.

Section 350(4) of ICTA allows the Commissioners for Her Majesty's Revenue and Customs to make regulations which modify Schedule 16 to ICTA in its application to payments covered by section 349 of ICTA. These powers do not specifically mention the making of regulations which modify Schedule 16 in its application to payments made by building societies (covered by regulations under section 477A of ICTA), or payments by deposit-takers (covered by section 480A of ICTA).

But regulations made under the powers in section 350(4) of ICTA are capable of modifying Schedule 16 as it applies to deposit-taker and building society payments.

The aim of regulation 10 of the building society regulations (SI 1990/2231) and section 480A of ICTA is that, subject to some specific modifications, the collection regime applying to section 349 payments should apply to deposit-taker and building society payments. So regulation 10 and section 480A should be read as applying Schedule 16 to ICTA as modified from time to time by regulations made under section 350(4) of that Act.

It also possible to read the power in section 350(4) as a power to modify Schedule 16 as applied by regulations under section 477A and by section 480A. And, in the case of building societies, section 477A allows regulations to be made in respect of building society payments. And regulation 10 incorporates the provisions of Schedule 16 with modifications. So section 962 of this Act reflects the regulation making power in section 477A by permitting regulations to modify Chapter 15 of Part 15 of this Act in its application to building society payments.

Section 962 allows regulations to be made modifying that Chapter in relation to any kind of section 946 payment. This reflects the general way in which the various provisions about deduction of income tax at source are brought together and rationalised in this Act.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 147: Deduction of tax: removal of charge to tax: sections 939, 946, 963, 964 and 971

This change removes the charging provision in sections 42A(1), 350(1) and 582 of ICTA, to bring this legislation into line with the approach taken in other legislation about collection of income tax deducted at source. So a person will not be chargeable in relation to tax to be accounted for under Part 15 of this Act.

Section 42A(1) of ICTA allows the Commissioners for Her Majesty's Revenue and Customs to make regulations for the "charging, assessment, collection and recovery" of prescribed amounts which may become chargeable under Schedule A or as the profits of a UK property business.

Section 350(1) of ICTA provides that the person by or through whom certain payments are made (from which sums representing income tax are required to be deducted) shall be "assessable and chargeable" with income tax on the payment. And the idea of the payer being chargeable flows through into Schedule 16 to ICTA, as applied by section 350(4) of ICTA for certain payments caught by section 349 of that Act.

Section 582 of ICTA applies the section 350(1) charge to the special case of funding bonds, where instead of making a deduction the issuer of the bonds retains enough bonds to cover the sum representing income tax.

Other legislation concerned with deduction at source does not involve the payer being chargeable. Examples include PAYE legislation, and the rules for deposit-takers and building societies (sections 477A and 480A of ICTA) which apply Schedule 16 to ICTA directly rather than through section 350 of that Act.

This change aligns the sections rewriting sections 42A, 350(1) and 582 of ICTA with those rewriting other legislation which does not involve the idea of the payer being chargeable, rather than retaining that idea.

This, in particular, gives greater clarity to the distinction between:

- income tax charged on persons in their own right (on their own income); and
- income tax paid under deduction of tax at source provisions (where income tax is ultimately borne by the persons for whom the payments constitute income).

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 148: Deduction of tax: manufactured interest on UK securities: tax statements: section 975

This change brings the rules for tax statements about manufactured interest on UK securities into line with the rules for tax statements about actual interest on UK securities.

Paragraph 3(8) and (9) of Schedule 23A to ICTA deal with statements about manufactured interest on UK securities paid under deduction of tax. Section 352 of ICTA deals with statements about actual interest on UK securities paid under deduction of tax.

Paragraph 3(8) and (9) of Schedule 23A to ICTA and section 352 of ICTA are very similar. They differ in two respects.

First, under section 352, the statement is to be provided "if the recipient so requests in writing". By contrast, under paragraph 3(8), "the interest manufacturer shall, on paying the manufactured interest, provide" the statement. But since in both cases the recipient can enforce the duty to provide the statement, this does not appear to make any practical difference.

Second, paragraph 3(8)(d) requires the statement to include the date of the payment by the interest manufacturer, but section 352 imposes no such requirement. Neither does the rule about tax statements relating to manufactured overseas dividends in regulation 15 of the Income Tax (Manufactured Overseas Dividends) Regulations 1993 (SI 1993/2004).

These differences are believed to be due to historical accident. This Act therefore conforms the rewritten paragraph 3(8) and (9) to section 352.

Accordingly, section 975 of this Act, which is based on section 352 of ICTA, applies without modification to manufactured interest on UK securities paid under deduction of tax.

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

Change 149: Deduction of tax: meaning of "qualifying certificate of deposit" and "qualifying uncertificated eligible debt security unit": sections 985 and 986

This change aligns the terms of the repayment condition in the definitions of "qualifying certificate of deposit" and "qualifying uncertificated eligible debt security unit" with the terms of the repayment condition in the definition of "qualifying time deposit".

Under the source legislation (sections 349(4) and 482(6) of ICTA), the issuer of any of these two instruments must pay an amount of not less than £50,000 (or equivalent if in a foreign currency) "after a period of not more than five years beginning with the date on which the deposit is made".

The source legislation is not clear about whether this means that the amount must be repaid in one tranche at a specified time. But in practice, whenever these instruments are issued, they are issued on the basis that the amount is payable in one tranche at a specified time within five years of the date of the deposit being made, in line with the position for qualifying time deposits.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.

Change 150: Interpretation: definition of "personal representatives" for the purposes of the Income Tax Acts: section 989

This change applies the new defined term, "personal representatives" for the purposes of the Income Tax Acts. It completes the process started by ITEPA as a result of which definitions to the same effect were applied:

- by section 721(1) of ITEPA for the purposes of that Act;
- by section 279(1) of FA 2004 for the purposes of Part 4 of that Act (Pension schemes etc); and
- by section 878(1) of ITTOIA for the purposes of that Act.

The application of the defined term to ITEPA and ITTOIA is described in Change 159 in Annex 1 to the Explanatory Notes to ITEPA and in Change 151 in Annex 1 to the Explanatory Notes to ITTOIA. This note draws heavily on the contents of those notes.

With the exception of sections 111 and 151 of FA 1989, wherever the term "personal representatives" is used in the Income Tax Acts, other than ITEPA, Part 4 of FA 2004 and ITTOIA, the term is undefined.

Places where it is so used include the following provisions on which this Act is based:

- section 360A(2) of ICTA (meaning of "material interest" in section 360 of that Act (loan to buy interest in close company)) (see section 395(1)(d));
- section 364(1) of ICTA (loan to pay inheritance tax) (see section 403(1) and (2));
- section 417(3) of ICTA (meaning of "associate" for the purposes of Part 11 of that Act (Close companies)) (see section 253(1)(c)(i));
- sections 481(4)(c) and 482(6) of ICTA (meaning of "relevant deposit" for the purposes of section 480A of that Act (relevant deposits: deduction of tax from interest payments)) (see sections 856(5) and 860(4));
- section 686(6) of ICTA (accumulation and discretionary trusts: special rates of tax) (see section 483(1));
- section 703(11) of ICTA (cancellation of tax advantage) (see section 712(2));
- section 715 of ICTA (exceptions from sections 713 and 714 of that Act (accrued income scheme: deemed sums and reliefs)) (see section 640);
- section 721 of ICTA (accrued income scheme: death) (see section 636);
- section 777(7) of ICTA (provisions supplementary to sections 775 and 776 of that Act (sale by individual of income derived from his personal activities and transactions in land: taxation of capital gains)) (see sections 763(4) and 782(4)); and
- paragraph 50(1) of Schedule 16 to FA 2002 (meaning of "associate" for the purposes of that Schedule) (see section 381(1)(c)(i)).

Section 111 of FA 1989 (residence of personal representatives) has its own definition of "personal representatives". Section 111(1) and (2) of FA 1989 have been rewritten in section 834.

The definition in section 111(3) of FA 1989, which is also applied for the purposes of section 151 (assessment of trustees etc) of that Act by subsection (3) of that section, provides that:

> In this section "personal representatives" means—
>
> (a) in relation to England and Wales, the deceased person's personal representatives as defined by section 55 of the Administration of Estates Act 1925;
>
> (b) in relation to Scotland, his executor or the judicial factor on his estate;
>
> (c) in relation to Northern Ireland, his personal representatives as defined by section 45(1) of the Administration of Estates Act (Northern Ireland) 1955; and
>
> (d) in relation to another country or territory, the persons having in relation to him under its law any functions corresponding to the functions for administration purposes of personal representatives under the law of England and Wales.

Section 55(1)(xi) of the Administration of Estates Act 1925 provides that:

> "personal representative" means the executor, original or by representation, or administrator for the time being of a deceased person, and as regards any liability for the payment of death duties includes any person who takes possession of or intermeddles with the property of a deceased person without the authority of the personal representatives or the court, and "executor" includes a person deemed to be appointed executor as respects settled land.

Section 45(1) of the Administration of Estates Act (Northern Ireland) 1955 provides that:

> "personal representatives" means the executors or executor, original or by representation, or the administrators or administrator for the time being of a deceased person.

The definitions in section 55 of the Administration of Estates Act 1925 and section 45(1) of the Administration of Estates Act (Northern Ireland) 1955 refer to executors as well as administrators.

Under English law, executors are generally appointed by the will. Administrators are appointed by the court where no one is appointed as executor by the will or where the deceased dies without leaving a valid will.

English law recognises three other categories of executor. The first is executor according to the tenor, who on the terms of the will is appointed to perform the essential duties of an executor where the deceased person has failed to nominate a person to be his executor. Secondly there is executor de son tort, who is a person who takes upon himself the position of executor or intermeddles with the goods of the deceased person without having been appointed executor or administrator. Thirdly there is special executor, the term given to a person who is a trustee of settled land at the time of the death. The position is similar for Northern Ireland.

For the purposes of Scottish law, an executor is appointed either expressly or impliedly by the deceased, in which case the executor is known as an executor nominate, or by the court, in which case the executor is known as an executor dative. So the term "executor" under Scottish law is broadly equivalent to an "executor or administrator" under English law. Scottish law also recognises judicial factors and executor-creditors who may be appointed by the court to administer the deceased's estate or part of it. Although a judicial factor could not be described as an executor, such a factor might be regarded as an "administrator".

So, in relation to any part of the United Kingdom, a deceased person's personal representatives within the meaning of section 111(3) of FA 1989 are the persons responsible for administering the person's estate.

Accordingly, the first limb of the definition in section 989, that personal representatives are:

> in the United Kingdom, persons responsible for administering the estate of the deceased,

catches the same persons as does section 111(3) of FA 1989 in relation to each part of the United Kingdom, but does so more directly and succinctly.

It follows from what is said above, that the application of the first limb of the definition in section 989 in relation to the provisions in the Income Tax Acts which use the expression "personal representatives" without definition, including those rewritten in this Act, reflects the ordinary common sense meaning of those terms in each part of the United Kingdom.

The second limb of the definition in section 989 is in similar terms to section 111(3)(d) of FA 1989. It provides that personal representatives are:

> in a territory outside the United Kingdom, those persons having functions under its law equivalent to those of administering the estate of the deceased.

Section 111(3) of FA 1989 has, accordingly, not been rewritten and the definition in section 989 applies for the purposes of section 834 of this Act and section 151 of FA 1989.

That leaves the question of whether there is any change involved in applying the second limb to provisions in the Income Tax Acts which use the expressions "personal representatives"

without definition, as those provisions apply to countries and territories outside the United Kingdom.

The terms "executor" and "administrator" are not terms of art in relation to countries and territories outside the United Kingdom. But it seems likely that a court would hold that references to "personal representatives" in tax legislation would, in the absence of a definition, cover the people that most closely resemble executors or administrators in the United Kingdom. In view of what is said above, that means the people who have functions corresponding to those of personal representatives in the United Kingdom ie functions equivalent to those of administering the estate of the deceased.

References to "personal representatives" without definition in the Income Tax Acts, including in those provisions on which this Act is based, can be read as references to anyone with responsibility for administering a deceased person's estate, including those with equivalent responsibilities in other jurisdictions. These provisions can be divided into two categories.

In the first category are provisions which confirm that, on an individual's death, rights and liabilities which are or would otherwise have been conferred on the individual are conferred on the individual's personal representatives.

In this context it is clear that the references to "personal representatives" are to whoever in fact has the role of administering the property of the deceased person. These provisions are intended to confirm that such persons have the same ability and responsibility to deal with the deceased individual's tax affairs as the individual would have had if the individual were still alive, and are subject to the same tax liabilities.

Provisions in this category rewritten in this Act include sections 703(11) and 777(7) of ICTA. Such provisions which are not being rewritten include section 97(1) of TMA which provides that, if it comes to the notice of the personal representatives that the deceased made an incorrect return etc, they are under a duty to remedy the error without unreasonable delay.

The second category covers those provisions which apply only because a person has died, so that his or her property is being administered by his or her personal representatives.

In this category of cases, the fact that someone has died creates a gap in the law (or at least a doubt as to what the law is) or requires some special arrangement to be made. The provisions in question fill the gap or satisfy the requirement. So it is consistent with the aim of these provisions for them to be interpreted as applying in all cases in which a person has died and his property is being administered by others.

Provisions in this category rewritten in this Act include:

- section 364(1) of ICTA which extends tax relief to personal representatives in respect of interest paid on a loan to pay inheritance tax; and
- the meaning of "associate" given by section 360A(2) of ICTA and paragraph 50(1) of Schedule 16 to FA 2002 and by section 417(3) of ICTA as applied by section 312(1) of that Act, which provide that a person who has an interest in shares or obligations forming part of a deceased's estate is an associate of the personal representatives of the deceased.

Provisions in this category which are not being rewritten include section 179A(3) of FA 1993 which provides that the carrying on of the underwriting business of a deceased member of Lloyd's by the deceased member's personal representatives is not to be treated as a change in the persons engaged in carrying on that business.

As a consequence of the inclusion of this definition in section 989, the definitions to the same effect in section 721(1) of ITEPA, section 279(1) of FA 2004 and section 878(1) of ITTOIA are no longer necessary and are repealed by Schedule 3. Sections 111(3) and 151(3) of FA 1989 are also repealed.

This change has no implications for the amount of tax paid, who pays it or when.

Change 151: Interpretation: adopted children: section 989 and Schedule 1 (section 832 of ICTA)

This change omits section 832(5) of ICTA, so that the general law will apply, with the result that adopted children will be treated as if they were born as the children of their adopters.

The general law is set out in the Adoption and Children Act 2002 (as regards England and Wales), the Adoption (Scotland) Act 1978 (as regards Scotland) and the Adoption (Northern Ireland) Order 1987 (as regards Northern Ireland).

Section 67 of the Adoption and Children Act 2002 provides that "an adopted person is to be treated in law as if born as the child of the adopters or adopter" and that this applies for the interpretation of enactments passed before or since the adoption, subject to any contrary indication. Similar provision is made in the Scottish and Northern Irish legislation referred to above.

It is possible that this change might very slightly alter the scope of those adoptions which are covered. For example, under the general law some overseas adoptions are only covered if they are covered by an order made by the Secretary of State. (See sections 66(1)(d) and 87(1) of the Adoption and Children Act 2002). Depending on the tax provision in question, this could in principle be either taxpayer-adverse or taxpayer-favourable. But it will make no difference in practice.

The reference in section 832(5) of ICTA to paragraph 10 of Schedule 30 to ICTA 1988 is now otiose as that paragraph has been repealed.

Given the nature of the case, the change is extended to corporation tax, by repealing section 832(5) of ICTA.

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

Change 152: Interpretation: references to Scottish and Northern Ireland legislation: sections 66, 114, 532, 536, 558, 802, 990 and 1018

This change is about the extent to which references to "Act" are to be interpreted as including references to Scottish and Northern Irish primary legislation.

Section 990(1) defines "Act" to include Northern Ireland legislation for the purposes of the Income Tax Acts (unless the context otherwise requires: see section 988(1)). "Northern Ireland legislation" is defined in section 24(5) of the Interpretation Act 1978 (the 1978 Act)

and applies by virtue of Schedule 1 to the 1978 Act. It is the term commonly used in legislation when referring to Northern Irish primary legislation. The definition of "Northern Ireland legislation" has seven limbs, (a) to (g).

Section 832(1) of ICTA defines "Act" to include Acts of the Parliament of Northern Ireland and a Measure of the Northern Ireland Assembly. So it expressly covers limbs (b) and (d) of the definition of "Northern Ireland legislation" in the 1978 Act. And, as a consequence of various deeming provisions contained in Schedule 12 to the Northern Ireland Act 1998, it also covers limbs (c), (e) and (f) of the definition of "Northern Ireland legislation". Only limbs (a) and (g) of the definition of "Northern Ireland legislation" are not covered.

To simplify the definition of "Act" the current wording in section 832(1) of ICTA is replaced with a simple reference to "Northern Ireland legislation". The change in law is that limbs (a) and (g) of the definition of "Northern Ireland legislation" will now be covered. This will not have any practical consequences.

Section 1018(1) provides that in certain sections of this Act "Act" is to include Acts of the Scottish Parliament. "Act" on its own does not include Acts of the Scottish Parliament (see the definition of "Act" in Schedule 1 to the 1978 Act) and the definition of "Act" in section 990 does not extend its meaning to include Acts of the Scottish Parliament.

But it is appropriate that references to "Act" in sections 66, 532, 536 and 558 should include references to Acts of the Scottish Parliament. In each of these cases the extension of the meaning of "Act" can only be advantageous to taxpayers. A similar provision is contained in section 879 of ITTOIA.

Section 1018(2) overrides the definition of "Act" in section 990 for the purposes of this Act. This is to make it easier to identify the sections where Northern Ireland legislation is relevant and where it is not, and follows the approach taken in section 880 of ITTOIA. The references to sections 66, 114, 532, 536, 558 and 802 either reflect the current law or, if they change the current law, can only be advantageous to taxpayers.

Examples of where "Act" does not include Northern Ireland legislation are to be found in sections 4(1), 459(1) and 849(2).

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

Change 153: Tax calculation: highest part of income: priority between items specified in section 833(3) of ICTA: section 1012

This change introduces an order of priority between employment termination payments and gains from life assurance contracts in treating such amounts as the highest part of income.

There are a number of provisions in the Income Tax Acts which specify that items are to be treated as the highest part of income. They are subject to the rule in section 833(3) of ICTA which says that employment termination payments within Chapter 3 of Part 6 of ITEPA and gains from life assurance contracts within section 465 of ITTOIA outrank income under all other such provisions and form the topmost slice of income. But section 833(3) of ICTA gives no order of priority between those two types of income.

In practice, because life assurance gains carry a notional tax credit that might otherwise be lost, it will always be to the taxpayer's advantage to treat such gains as the highest slice. Accordingly, in rewriting section 833(3) of ICTA in section 1012 it has been made clear that, that life assurance gains outrank termination payments. See also new section 404A of ITEPA and new section 465A of ITTOIA inserted by Schedule 1 to this Act.

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

Change 154: Charges on income etc: calculation of modified net income: section 1025

This change specifies that certain adjustments are to be made to the amount of a person's net income in measuring income for particular purposes. The amount after these adjustments is the person's "modified net income".

The concept applies mainly to the deduction allowed for annual payments and patent royalties under Chapter 4 of Part 8 (see sections 448(4) and 449(5)).

But it also applies to:

- the similar rules that determine the deductibility or otherwise of the deemed payments to unit holders made by an unauthorised unit trust under Chapter 9 of Part 9 (see section 505(7)); and
- the rules that apply in respect of gift aid to certain non-resident donors and to donors who elect for a gift to be treated as made in the preceding tax year (see section 427(2)).

The link between the purposes concerned is that the issue in each case is whether there is sufficient income for a payment to be regarded (under the source legislation) as having been paid "out of" the income of the year.

In determining the amount of a person's net income for a tax year under section 23 (which rewrites the relevant parts of section 835 of ICTA), it is necessary to:

- take into account all claims and adjustments which affect the measure of income; and
- make a deduction for all reliefs that are deducted from or set against income.

But it is not appropriate for all claims that have their origins in a different year to be taken into account in measuring income of the year concerned. That is because the source legislation is concerned with establishing whether, in fact, the taxpayer had sufficient taxable income "out of" which the payment could have been made.

In these cases, this change provides that certain adjustments that have their origins in a different year are disregarded in calculating the income of the year concerned.

The change does not apply to reliefs that are carried forward from an earlier year – it is well established that these do reduce the pot of income "out of" which payments can be regarded as having being made. But the position in relation to a claim or adjustment that has its origin in a later year is not explicit.

The new rule in the calculation of charged income for the purposes of relief for charges and gift aid is to disregard all adjustments (whether an increase or a decrease) that have their origins in a later year and to which Schedule 1B to TMA applies.

These adjustments are:

- carry-back of losses under sections 64(2), 72(2), 89(2) and 132(1) (based on sections 380, 381, 388 and 574 of ICTA): see paragraph 2 of Schedule 1B to TMA;
- relief for fluctuating profits of farming etc and of creative artists under Chapter 16 of Part 2 of ITTOIA: see paragraph 3 of Schedule 1B to TMA;
- carry-back of post cessation receipts under section 257 of ITTOIA: see paragraph 5 of Schedule 1B to TMA; and
- any adjustment that would have been out of time but for the extension of the deadline for claiming other reliefs as a result of a claim for fluctuating profits of farmers or creative artists: see paragraph 4 of Schedule 1B to TMA.

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

Change 155: Double relief for interest payments: repeal of section 368 of ICTA in relation to relief remaining under section 353 of ICTA: Schedule 1 (section 368 of ICTA)

This change relates to the repeal of section 368 of ICTA which prevents interest qualifying for relief twice.

Section 368 of ICTA prevents relief being given for the same amount of interest more than once, for example under section 353 of ICTA and as a trading deduction. The rule in section 368 has been rewritten in section 387. But that provision only applies to relief under Chapter 1 of Part 8 of this Act and will not apply to relief under section 353 of ICTA by virtue of section 365 of ICTA. As that relief is obsolescent, it has been left in ICTA, rather than being rewritten in the Act. It relates to interest on loans taken out to purchase a life annuity and is given as a tax reduction.

As the rule in section 368 of ICTA is repealed without being rewritten in relation to section 365, there is the theoretical possibility for relief on the same interest under section 353 (life annuity loans) of ICTA and either under section 383 of this Act or as a trading deduction.

In practice, however, it is extremely unlikely that the circumstances which might allow double relief will exist. The loan would have to be taken out before 9 March 1999 by an individual aged over 65 with at least 90% of the loan proceeds being applied to purchase the annuity and the remaining portion applied on another qualifying purpose. It is then possible for interest on that remaining portion (a maximum of 10% of the loan) to give rise to both a tax reduction and an allowable deduction.

In view of the fact that this possibility is so remote, no special rule to prevent double relief has been introduced on the repeal of section 368 of ICTA.

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

Change 156: Deduction of tax: visiting performers: Schedule 1 (section 556 of ICTA and section 13 of ITTOIA)

This change makes it explicit that, when a payment or transfer of the type referred to in section 555 of ICTA is made, section 556 of ICTA and section 13 of ITTOIA will apply regardless of whether there is a duty to deduct tax at source under section 555. This gives statutory effect to the majority decision of the House of Lords in Agassi v Robinson [2006 UKHL 23] [7].

In that case, the House of Lords held that a visiting performer is liable to income tax on payments made in respect of a UK performance regardless of whether the payment is made directly to the performer or to a person connected with the performer. They held that the liability to income tax on a visiting performer under section 18(1)(a)(iii) of ICTA is not determined by whether there is a duty to deduct income tax from the payment. So the operation of section 556 of ICTA does not depend on the payer having an obligation to deduct tax at source under section 555 of ICTA.

As Lord Scott said at paragraph 17(2) of the judgment:

> In order to know whether for section 556(5) purposes the payment is one to which section 555(2) applies, two, and in my opinion only two, questions need to be asked. First, has a payment been made (to whatever person), not being a payment "of such a kind as [has been] prescribed" (section 555(6))? If the answer is "yes", then, second, has the payment "a connection of a prescribed kind with the relevant activity"? If the answer to this question, too, is "yes" then, in my opinion, for section 556(5) purposes, the payment is one to which section 555(2) applies. The identity of the payer is, in my opinion, as a matter of construction of section 555(2), irrelevant to the question.

The amendments to section 556 of ICTA make it explicit that, when a payment or transfer of the type referred to in section 555 of ICTA is made, no liability to corporation tax will arise. This is regardless of whether there is a duty to deduct under section 966 of this Act.

The amendments to section 13 of ITTOIA make it explicit that when a payment or transfer of the type referred to in section 555 of ICTA is made, it is not necessary for there to be a duty to deduct under section 966 of this Act in order for the performer to be liable to income tax on the payment or transfer under Chapter 2 of Part 2 of ITTOIA (income taxed as trade profits).

As part of this amendment, section 555(5) of ICTA has been incorporated into section 13 of ITTOIA to make clear that there is no link between the primary liability to income tax under Chapter 2 of Part 2 of ITTOIA (income taxed as trade profits) and the duty to deduct tax under section 966 of this Act.

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

[7] [2006] STC 1056

Change 157: Old double taxation relief arrangements: references to surtax: Schedule 1 (section 789 of ICTA)

This change amends how provisions for exemption from surtax in old double taxation relief arrangements are to be interpreted in relation to dividend income.

Section 789(2)(a) of ICTA provides that any provision in double taxation arrangements made before 30 March 1971 for income to be exempt from surtax is to be applied on the basis that:

- in relation to income to which section 1A of ICTA applies, the lower rate is applied instead of the higher rate; and
- for all other income, the basic rate is applied instead of the higher rate.

That provision was not amended in 1997 when the dividend ordinary rate was introduced (with effect from April 1999). Since dividend income is income to which section 1A applies it follows that, in strictness, dividend income subject to these old double taxation arrangements is to be charged at the lower rate (instead of at the dividend upper rate). That is not the intention. The amendment ensures that the rate at which this income is charged in place of the dividend upper rate will be the dividend ordinary rate (instead of the dividend upper rate).

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

Change 158: Tax calculation: recovery of excess double taxation relief: Schedule 1 (section 804 of ICTA and paragraph 11 of Schedule 20 to FA 1994)

This change alters the way that excess double taxation relief is clawed back under section 804(5B) of ICTA and paragraph 11(3) of Schedule 20 to FA 1994.

As a result of the rules for allowing credit for overseas tax against an overlap profit, section 804(5B) of ICTA provides that in certain circumstances an excess amount of credit relief has to be identified. The taxpayer is then "treated as having received in that year a payment chargeable to income tax of an amount such that income tax on it at the basic rate is equal to the excess". So having identified an amount of tax, it is then converted to an amount of income. Section 804(6) of ICTA provides that the amount of income is not treated as income for any other purpose.

This provision is about the recovery of excess tax credit relief. It would work much more naturally if it simply provided for an amount of income tax to be charged. And it would then be no longer necessary to have the special rule in section 804(6). Accordingly, section 804(5B) of ICTA is amended to provide for an amount of income tax to be brought into charge and section 804(6) is omitted.

Paragraph 11 of Schedule 20 to FA 1994 provides corresponding rules for businesses affected by the transitional provisions for facilitating self-assessment. Paragraph 11(3) is amended in the same way and paragraph 11(7) is omitted.

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

Change 159: Inclusion of civil partners in section 37A of TMA: Schedule 1 (section 37A of TMA)

This change extends to civil partners the treatment given to spouses in certain cases where personal reliefs have been transferred and the transferor's income tax liability is subsequently increased. It corrects an omission in the changes made by the Tax and Civil Partnership Regulations 2005 (SI 2005/3229).

Under section 257BB of ICTA (as amended by those Regulations) the unused part of a married couple's tax reduction may be transferred to the claimant's spouse or civil partner. The same applies to unused blind person's allowance under section 265 of ICTA. Where there has been such a transfer and the transferor's income tax liability is subsequently increased due to an assessment to make good a loss of tax wholly or partly attributable to fraudulent or negligent conduct, section 37A of TMA provides that a transfer to a spouse is unaffected. Section 37A was not amended by the Regulations to apply in cases where the transfer of relief was to a civil partner.

In making consequential amendments to section 37A to update the references to the personal relief provisions, the opportunity has been taken to provide that civil partners are treated in the same way as spouses.

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

Change 160: Loss relief: claims for set-off of trading losses, employment losses and post-cessation expenditure against capital gains: Schedule 1 (sections 261B to 261E of TCGA)

This change removes the requirement that a claim to set trading or other losses against other income must be made before it is possible for a claim to be made to set trading or other losses etc against capital gains, thus ensuring that such claims can be made in cases where there is no other income against which they could be set.

Section 72 of FA 1991 requires a person to make a loss relief claim under section 380 of ICTA before it is possible for the person to make a claim for capital gains tax relief in respect any unutilised part of that loss. And section 90 of FA 1995 requires a person to make a claim for loss relief under section 109A of ICTA before allowing the person to make a claim for capital gains tax relief in respect any unutilised part of that loss.

It is possible that the person will have no income, and so will simply make a claim under section 72 or section 90 as appropriate.

In practice, HMRC accept such claims under either or both of those sections, even though no income tax claim has been made. This change puts this practice on a statutory footing.

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

Change 161: Deduction of tax: visiting performers: Schedule 1 (section 48 of ITEPA)

This change makes it explicit that a "transfer" which is subject to deduction under the rules about visiting performers in Chapter 18 of Part 15 of this Act is not subject to the rules about the provision of services through intermediaries in Chapter 8 of Part 2 of ITEPA.

Section 48(2)(b) of ITEPA provides that “payments” which are subject to deduction under section 555 of ICTA are not also subject to the operation of Chapter 8 of Part 2 of ITEPA. But it says nothing about “transfers”.

In practice “transfers” are also regarded as excluded from the operation of Chapter 8. The insertion of a reference to “transfer” into section 48(2)(b) of ITEPA makes it explicit that transfers caught by Chapter 18 of Part 15 of this Act are not also subject to the rules set out in Chapter 8 of Part 2 of ITEPA.

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

Change 162: Estate income: treatment of payments to beneficiaries: Schedule 1 (section 680A of ITTOIA)

This change clarifies for income tax purposes the nature of sums paid out of income by personal representatives to beneficiaries.

The aim of section 698A of ICTA is to preserve the underlying character of income received by personal representatives when that income is paid out to beneficiaries for the purpose of determining what rate of tax is to be applied to the income.

The income tax charge on estate income in the hands of the beneficiary is contained in Chapter 6 of Part 5 of ITTOIA. The rules in that Chapter gross up the amount of the actual payment to the beneficiary by reference to the tax charged on the personal representatives on the income concerned. That income may have the character of dividend income, savings income or other income and will have been charged respectively at the dividend ordinary rate, the lower rate or the basic rate.

Section 698A(2) of ICTA is clear in providing that where Chapter 6 of Part 5 of ITTOIA has grossed up a payment at the dividend ordinary rate then the payment to the beneficiary is deemed to be a dividend. The beneficiary is then potentially liable at the dividend ordinary rate or the dividend upper rate on that income.

Section 698A(1) of ICTA is less clear in achieving its objective in relation to a payment that has been grossed up at the lower rate. It treats such a payment as income to which section 1A of ICTA applies otherwise than by virtue of the income being income chargeable under Chapter 3 of Part 4 of ITTOIA (dividends). But it does not necessarily follow that it is treating the payment as income to which the lower rate applies. This is because not all the “non-Chapter 3 of Part 4 of ITTOIA” income to which section 1A of ICTA applies is income chargeable at the lower rate. Some of that income is chargeable at the dividend ordinary rate.

The same point arises in relation to income paid through a trustee where section 698A(3)(b) of ICTA applies.

Section 698A of ICTA is rewritten by new section 680A in ITTOIA. By deeming income which has been treated as bearing tax at the savings rate as savings income, any doubt about the rates of tax that apply is removed.

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

ANNEX 2: EXTRA-STATUTORY CONCESSIONS, CASE LAW, AND LIST OF REDUNDANT MATERIAL NOT REWRITTEN

This Annex is in three parts:

- Table 1: a list of ESCs (and one Statement of Practice) that are rewritten in this Act;
- Table 2: a list of Changes which involve enacting case law principles; and
- Table 3: a list of provisions that are redundant in whole or in part and are omitted by this Act.

TABLE 1

The following ESCs and Statement of Practice are rewritten in this Act.

ESC etc	Description	See Annex 1
A43	Interest relief: partnership changes	Change 75
A86	Blind person's allowance	Change 6
C4	Fund raising events for charitable purposes	Change 95
SP A33	Loan to invest in partnership	Change 70

TABLE 2

The following table sets out those changes in the law which involve giving statutory effect to principles derived, wholly or mainly, from case law.

Topic	Change number	Section
Charges - "out of profits or gains"	82	450
Interest in possession trusts: trustees' expenses	91	500
Individuals temporarily abroad	123	829
Visiting performers	156	Schedule 1 (section 556 of ICTA and section 13 of ITTOIA)

TABLE 3

The omission of provisions which are redundant in whole or in part is an integral part of the rewrite process.

But, for ease of reference, those omissions worthy of specific explanation are listed in the table below. The table also sets out where those explanations can be found.

Redundant provision	Topic	See commentary on section etc
TMA s.55(1)(c)	Deduction of tax	Schedule 1
ICTA s.2(1)	Rates of tax	4

Redundant provision	**Topic**	**See commentary on section etc**
ICTA s.266(6) and (6A)	Relief for certain life insurance payments	Chapter 6 of Part 8
ICTA s.277	Jointly owned property	Chapter 3 of Part 14
ICTA s.292	EIS	Overview to Part 5
ICTA s.294	EIS	Overview to Part 5
ICTA s.295	EIS	Overview to Part 5
ICTA s.296	EIS	Overview to Part 5
ICTA s.299(3)	EIS	209
ICTA s.305	EIS	Overview to Part 5
ICTA s.306(9) and s.307(6)(a), (aa), (7) and (8)	EIS	239
ICTA s.310(3)	EIS	241
ICTA s.350(2)	Charges on income etc	963
ICTA s.350A(2)(b)	UK public revenue dividends	897
ICTA s.360A(3)	Relief for interest paid	395
ICTA s.368(2)	Relief for interest paid	387
ICTA s.382(4)	Losses: double counting	63
ICTA s.459 to 466	Friendly societies	Schedule 1
ICTA s.467	Trade unions	Schedule 1
ICTA s.481(5A)	Qualifying deposit rights	864
ICTA s.482(11)(ab)	Deduction at source: trusts	Schedule 2
ICTA s.515	Inmarsat	Schedule 1
ICTA s.575(1)(a)	Share loss relief	131
ICTA s.691(4)	Maintenance trusts: elections	508
ICTA s.704 A(f)	Transactions in securities	686
ICTA s.742(9)(c)	Transfer of assets abroad	Schedule 1
ICTA s.746	Transfer of assets abroad	Schedule 1
ICTA s.775(9)	Sales of occupation income	778
ICTA s.776(13)	Transactions in land: land	772
ICTA s.777(13)	Transactions in land: receivable	772

These notes refer to the Income Tax Act 2007 (c.3) which received Royal Assent on 20 March 2007. These notes are published in three volumes.

Redundant provision	Topic	See commentary on section etc
ICTA s.777(4)	Transactions in land	772
ICTA s.777(4)	Sales of occupation income	789
ICTA s.777(8)	Transactions in land	769
ICTA s.777(8)	Sales of occupation income	787
ICTA s.778	Transactions in land	771
ICTA s.778	Sales of occupation income	788
ICTA s.823	Income tax calculation	Schedule 1
ICTA s.832(1)(part)	Definition: interest	989
ICTA s.832(5)	Definition: adoption	989
ICTA s.835(2),(7)(b),(8)	Income tax calculation	Schedule 1
ICTA s.836	Income tax calculation	Schedule 1
ICTA Sch 16 p. 8	Deduction of tax	Schedule 1
ICTA Sch 23A p.3(2)(c)(i)	Manufactured payments and repos	579
FA 1991 s.53	Deduction of tax	Schedule 1
F (No2) A 1992 Sch 8 ps 2-4	Qualifying deposit rights	864
FA 2002 Sch.16 p.29(4)(a)	CITR	361
FA 2003 s.151(1)(a)(ii)	Limits on liability of non-UK residents to income tax	815
FA 2006 Sch 17 p.19(2)	Real Estate Investment Trust	974

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