ANNEX 1

MINOR CHANGES IN THE LAW MADE BY THE ACT

Change 1 Mining concerns etc. dealt with in section 55 of ICTA and plant and machinery allowances: sections 15(1)(f) and 252

Section 15(1)(f) treats any concern listed in section 55(2) of ICTA as a qualifying activity. (The concerns include, to give a selection from a fairly long list, mines, gasworks, docks, markets and railways.) Treating these concerns as qualifying activities ensures that the persons carrying them on can obtain plant and machinery allowances even if they are not trading. Nothing in CAA 1990 caters for section 55 concerns that are not trades.

Section 55(1) of ICTA charges the profits of these concerns to tax under Case I of Schedule D. The implication of section 55(1) is that the concerns are not necessarily trades (but it does not follow that none of them are trades).

Section 55 concerns cannot be regarded as Schedule A businesses and so entitled to plant and machinery allowances under section 28A of CAA 1990. Under section 832(1) of ICTA, "Schedule A business" means any business "the profits or gains of which are chargeable to tax under Schedule A . . ." Paragraph 2(2)(a) of Schedule A (see section 15(1) of ICTA) provides that Schedule A does not apply to profits charged to tax under Case I of Schedule D under section 55.

Section 252 provides for giving effect to plant and machinery allowances in the case of section 55 concerns. It is consequential on section 15(1)(f).

Change 2 Expenditure on buildings and structures, etc., which is unaffected by exclusions from what can be plant or machinery: section 23(3)

Sections 21 to 23 are based on Schedule AA1 to CAA 1990. But they differ from the Schedule in that they simplify and extend the provisions about what items are treated as unaffected by the express exclusions from what can be plant or machinery.

Schedule AA1 was inserted in CAA 1990 by section 117 of FA 1994 against the background of burgeoning case law extending the meaning of "plant". The Schedule was intended, so far as practicable, to call a halt to this process. In general terms, it contains provisions excluding things from being machinery or plant and other provisions about things that are unaffected by the exclusions.

The effect, as a matter of strict law, of leaving "unaffected" the question of whether expenditure is expenditure on plant or machinery is to leave the question to the courts. In theory a decision reached before FA 1994 by a lower court that something was "plant" might, after FA 1994, be overruled by a higher court. In theory, too, a court might decide that a general category whose status is under Schedule AA1 treated as "unaffected" contains not only a sub-category which is plant or machinery but also another sub-category which is not plant or machinery—the court might distinguish the earlier case. For practical purposes, however, items whose status is treated under the Schedule as "unaffected" are accepted by the Inland Revenue as capable of being plant and so litigation on the things that are "unaffected" is likely to be rare.

An extension of the provisions treating items as "unaffected" by the express exclusions therefore means that more items can be treated as plant or machinery. This in turn favours the taxpayer, by potentially extending the range of circumstances in which the taxpayer may obtain plant and machinery allowances.

In more detail, list C in section 23 merges column 2 of Table 1, column 2 of Table 2 and paragraphs 1(3)(b) to (e) and 5(2) of Schedule AA1 into a single list of items that are unaffected by the express exclusions in sections 21 and 22.

This changes the literal effect of paragraphs 1(3) and 2(3) of Schedule AA1. Paragraph 1(3) treats the question whether expenditure on the items in paragraphs (b) to (e) is expenditure on plant or machinery as unaffected by paragraph 1(1) only. Paragraph 2(3) treats the items in column 2 of Table 2 as unaffected by paragraph 2(1) only.

Superficially, section 23 might also seem to restrict the effect of paragraph 5(2) of Schedule AA1, since that provides for nothing in the Schedule to affect the question whether expenditure on the type of glasshouses described there is expenditure on machinery or plant. This appears to suggest that nothing in paragraph 3 or 4 affects that question (as well as nothing in paragraphs 1 and 2). But it is not thought that there is anything in paragraph 3 or 4 that would affect that question. The location of paragraph 5(2) could be attributable to the fact that it left unaffected a situation that at the time when Schedule AA1 was being drafted was the subject of active litigation. When the Schedule was being drafted it would have been uncertain which, if any, of the provisions of the Schedule the ultimate decision would need to be protected against.

Change 3 Meaning of "caravan": section 23(5)

Section 23(5) defines "caravan" (used in item 19 of List C) by reference to the Caravan Sites and Control of Development Act 1960 (for England, Wales and Scotland) and the Caravans Act (Northern Ireland) 1963 (for Northern Ireland). In contrast, in Schedule AA1 to CAA 1990, "caravan" (used in paragraph 1(3)(c)) is not defined.

In making this change, section 23(5) reflects ESC B50. ESC B50 states—

> "The word "caravan" is not defined for the purposes of CAA 1990 Sch AA1 para 1(3)(c), which confirms that capital allowances may be due on caravans provided mainly for holiday lettings, and therefore takes its everyday meaning. This is narrower than the definition of "caravan" in the Caravan Sites and Control of Development Act 1960 s 29(1). By concession, this wider definition will be used for capital allowance purposes. Expenditure on the provision of a caravan (as defined in CSCDA 1960 s 29(1)) on a holiday caravan site mainly for holiday lettings will be treated for capital allowance purposes as expenditure on the provision of plant."

ESC B50 is concessionary on the basis that if expenditure on an item falls into the "unaffected" category under Schedule AA1 the item is capable of being treated as expenditure on "plant".

The definition in the 1960 Act is—

> "caravan" means any structure designed or adapted for human habitation which is capable of being moved from one place to another (whether by being towed, or by being transported on a motor vehicle or trailer) and any motor vehicle so designed or adapted, but does not include—
>
> (a) any railway rolling stock which is for the time being on rails forming part of a railway system, or
>
> (b) any tent;".

The main significance of the extended definition in the present context is that it includes structures that can be moved only by being put on trailers.

The definition in section 29(1) of the 1960 Act is further extended, in relation to England and Wales, by section 13(1) and (2) of the Caravan Sites Act 1968. The effect of the extension, broadly speaking, is to include what are sometimes described as "double unit" caravans, as long as they are not too big. The 1960 Act does not extend to Northern Ireland. The relevant legislation for Northern Ireland is the Caravans Act (Northern Ireland) 1963, referred to in section 23(5)(b).

Change 4 Demolition costs: section 26(1)(b)

Section 26 is based on section 62 of CAA 1990. Both section 26and section 62 treat a person who demolishes plant or machinery as incurring expenditure equal to the net cost of demolition. But section 26 is more generous than section 62.

Section 62(1) of CAA 1990 applies where any plant or machinery "which is in use for the purposes of the trade" is demolished. On its literal reading this would appear to exclude the beneficial treatment of demolition costs where the person has ceased to use the plant or machinery before the demolition occurs.

In contrast, section 26 applies where "the last use of the plant or machinery was for the purposes of the trade". So there is no risk of taxpayers being excluded from the beneficial treatment of demolition under this section because the plant or machinery has ceased to be in use at the time when the demolition occurs.

Change 5 Expenditure on thermal insulation, safety measures and double relief: section 27(1)(b)

Section 27(1) deals with the application of sections 28 to 33. Sections 28 to 33 enable plant and machinery allowances to be made in respect of expenditure on thermal insulation of industrial buildings, fire safety, safety at sports grounds and personal security. Section 27(1)(b) limits the application of sections 28 to 33 to cases where an allowance under Part 2 or a deduction could not otherwise be made in respect of the expenditure.

The significance of obtaining an allowance under Part 2 by way of sections 28 to 33, rather than a Part 2 allowance under the ordinary rules, is that the disposal value is treated as nil.

The general proposition in section 27(1)(b) simplifies the drafting of sections 28 to 33 but in doing so makes minor changes in the law, the effect of which is to bring sections 67, 69, 70 and 71 of CAA 1990 into line.

A test that is very closely equivalent to that given in section 27(1)(b) is to be found in respect of expenditure on personal security in section 71(1)(c) and (d) of CAA 1990. This limits the application of section 71 to cases where—

> "(c) no sum in respect of the expenditure could be deducted in computing the profits of the trade, profession or vocation for the purposes of Case I or Case II of Schedule D, and
>
> (d) apart from this section, paragraph (a) or paragraph (b) of section 24(1) would not apply."

Although section 71(1)(c) refers to "the purposes of Case I or Case II of Schedule D" the effect of section 161(3) of CAA 1990 is to extend this reference so as to include trades, professions and vocations dealt with under section 65(3) of ICTA.

In relation to sections 69 and 70 of CAA 1990 (which deal with fire safety and safety at sports grounds) there is a similar test but it goes wider. The test in those sections is that "an allowance or deduction in respect of the expenditure could not, apart from this section, be made . . .". So section 27(1)(b), in referring more narrowly to an "allowance <u>under this Part</u>", changes the law in favour of the taxpayer. In particular, the taxpayer is not prevented from obtaining an allowance under Part 2 (with the advantage of the nil disposal value given by section 63(5)) merely because an industrial buildings allowance could be made in respect of the expenditure.

In relation to section 67 of CAA 1990 (which deals with thermal insulation), there is no test at all. So introducing the test is potentially adverse to the taxpayer, because it prevents the taxpayer from obtaining an allowance in respect of expenditure on thermal insulation (with its potential nil disposal value) if an allowance could already be obtained under Part 2 or the expenditure could be relieved as a revenue expense.

There used to be rules (under section 14 of CAA 1968, as amended by paragraph 16(2) of Schedule 8 to FA 1971, and section 74(6) of FA 1980) which ensured that, if an allowance was available in respect of expenditure on an industrial building, no allowance would be available under what has become section 67 of CAA 1990. (The pre-consolidation version of section 67 was section 14 of FA 1975.) But section 14 of

CAA 1968 and section 74(6) of FA 1980 were repealed by paragraph 28(5)(a) and (d) of Schedule 13 to FA 1989 as a perceived consequential on the new, simpler rules on preventing double allowances.

At the time it was overlooked that to produce a consistent approach the provisions that have now become sections 67, 69, 70 and 71 of CAA 1990 needed to say the same thing.

This oversight is perhaps understandable, because the provisions from which sections 67, 69, 70 and 71 derived were scattered about. (See: section 14 of FA 1975 (thermal insulation); section 17 of FA 1974 (fire safety); section 49 of F(No.2)A 1975, section 40 of FA 1978 and section 119 of FA 1989 (sports safety); and section 117 of FA 1989 (personal security).) The fact that the legislation had not at that stage been consolidated would have made it more difficult to see the whole picture.

Change 6 Fire safety (Northern Ireland): section 29(5) and (6)

Section 29(5) and (6) extends provisions enabling plant and machinery allowances to be made in respect of expenditure on certain fire safety measures to Northern Ireland. Section 69 of CAA 1990, from which section 29 derives, contains no provision enabling plant and machinery allowances to be made for such expenditure. But section 29 reflects the general effect of the first part of ESC B16, which states that in practice tax relief is given in respect of such expenditure on the same basis as in Great Britain.

Change 7 Legislation used to determine whether a business is small or medium-sized for purposes of entitlement to first-year allowances: section 48

Subsections (8) and (9) of section 48 correct small anomalies in the way that legislation relating to companies is referred to in connection with first-year allowances for small or medium-sized enterprises. The legislation in question is the Companies Act 1985 and the Companies (Northern Ireland) Order 1986. Section 48 provides for the 1985 Act to be used, except where the qualifying activity is carried on wholly or mainly in Northern Ireland, and for the 1986 Order to be used where the qualifying activity is carried on wholly or mainly in Northern Ireland.

The sections of CAA 1990 on which section 48 is based, sections 22A and 22AA, deal both with small or medium-sized companies and with small or medium-sized "businesses". In this context "business" means individuals, partnerships consisting of individuals and so on—people or entities which are not companies.

For companies, sections 22A and 22AA invoke the 1985 Act except for Northern Irish purposes, for which the 1986 Order is invoked. This is achieved by identifying the 1985 Act as the relevant legislation except in relation to "a company formed and registered" in Northern Ireland; in relation to such a company, the 1986 Order is identified instead. But this does not work satisfactorily for businesses.

Sections 22A(2) and 22AA(2) provide for a business to be treated as small or medium-sized if (broadly speaking) it would be so treated if it were a company. Under sections 22A(7) and 22AA(7), the relevant legislation for this purpose is, as just indicated, the 1985 Act unless the company has been formed and registered in Northern Ireland. The hypothetical company referred to in sections 22A(2) and 22AA(2) has not actually been formed and registered in Northern Ireland and nothing has told the reader in what circumstances it should be presumed to be so. But common sense suggests that Northern Irish legislation ought to be used for determining the size of Northern Irish businesses in the same way that it is used for determining the size of Northern Irish companies.

Very much the same point arises in relation to the meaning of "financial year" given under sections 22A(6) and 22AA(6) and the reference to the drawing up of accounts that is contained in sections 22A(3)(c) and 22AA(3)(c).

There is no logic in providing for the 1986 Order to be used for Northern Ireland companies, but for the 1985 Act to be used for businesses, including Northern Irish ones, that are not companies. Section 48 corrects this anomaly by providing, in the case of businesses, for the 1986 Order to be used where the qualifying activity is carried on wholly or mainly in Northern Ireland. As the law is similar in both jurisdictions, the change has no practical effect.

Change 8 Allocation of expenditure to pools: section 58

Section 58 is based on section 25 of CAA 1990 but is expressed in very different language. The general objective is to restate section 25 in simpler, less tortuous language. Doing so involves both clarifying some ambiguities which emerge on a close reading of section 25 and making some minor changes. But the clarifications and changes are all part of the same package.

Leaving aside a case where a first-year allowance is made for a chargeable period and a disposal event occurs in respect of the plant or machinery in that period, nothing in section 58 requires a person who would like to claim allowances to allocate the expenditure to a pool for the chargeable period in which the expenditure is incurred. The taxpayer is allowed to allocate expenditure to the pool for a later period. Most taxpayers are likely to want to allocate expenditure to the pool as soon as possible. But providing this flexibility could for example help a taxpayer who has inadvertently failed to include expenditure for the earliest possible period.

Whether CAA 1990 provides the same flexibility turns on the interpretation of section 25(1) of CAA 1990, which uses different concepts from those used in the Act.

Section 25(1) identifies a person's "qualifying expenditure". Section 25(1)(a) identifies the expenditure which is to be qualifying expenditure for the first time and section 25(1)(b) identifies expenditure that is qualifying expenditure because it is carried forward.

Section 25(1)(a) states (leaving out some words that are not relevant to the present discussion)—

> "a person's qualifying expenditure for a chargeable period is the aggregate of . . .
>
> (a) the balance remaining after deducting any first-year allowances . . . of any capital expenditure . . . being expenditure incurred in the chargeable period in question or at any previous time, and not being—
>
> (i) expenditure which, or any part of which, has formed part of his qualifying expenditure for any previous chargeable period, or
>
> (ii) expenditure in respect of which a first-year allowance is or could . . . be made for the chargeable period in question; . . ."

The words "or at any previous time" in the third line suggest that expenditure incurred in a previous chargeable period can become qualifying expenditure for the current period. But the word "is", in the first line, makes it sound as if the old expenditure should already have automatically become qualifying expenditure in the chargeable period in which it was incurred.

In order to reconcile the automatic nature by which expenditure becomes "qualifying expenditure" (which follows from the word "is") with the possibility of expenditure from a previous chargeable period becoming "qualifying expenditure" (which follows from the words "or at any previous time"), it is necessary to look at when expenditure incurred in a previous period could not have been qualifying expenditure in that period.

There are two cases, the first more obvious than the second. First, where a first-year allowance has been made for the previous chargeable period. None of the expenditure could have been qualifying expenditure in that period. The words "at any previous time" mean that the balance is qualifying expenditure in the next period. Secondly, a person could also have been entitled to a first-year allowance, not claimed it and decided not to give notice under section 25(3) that subsection (1) should apply to him.

But if these two cases were the only targets of the words "or at any previous time", the words seem unnecessarily wide. It would have been quite adequate to say "or in the previous chargeable period".

There are two possible reasons for the width of the words "or at any previous time".

First, this wording would have been needed to handle a transitional case when the provision that became section 25(1) came into being. The pre-consolidation version of section 25(1) was section 44(4) of FA 1971. Section 44(4) was amended by paragraph 3(2) of Schedule 14 to FA 1985 as a consequential upon removing the "brought into use" requirement for writing-down allowances. At the time when FA 1985 was making these amendments, there would have been taxpayers who had incurred expenditure which was not yet qualifying expenditure because the plant or machinery had not yet been brought into use. The amended version of section 44(4) would have ensured that their expenditure would become qualifying expenditure as soon as the "brought into use" requirement was removed. In hitting this target, the potential for confusion in the future in relation to non-transitional cases may have been missed.

The second reason for the words "or at any previous time" turns on drafting considerations. Section 25(1)(a) refers merely to "the chargeable period in question or at any previous time". But before its amendment by FA 1994, it used to refer to "the chargeable period in question or its basis period". The words "at any previous time" may have originally been used to avoid the problems of saying something along the lines of "the chargeable period or its basis period or the previous chargeable period or its basis period" (which would have created a confusion of "its").

So there are good reasons why section 25(1)(a) refers to "any previous time", and there are, on close inspection, no reasons why "is" in the first line of section 25(1) needs to be read as meaning that the taxpayer has a choice as to whether expenditure is qualifying expenditure.

However, the Inland Revenue has in the past received legal advice that section 25(1) gives the taxpayer the option of adding expenditure to a pool in a later chargeable period. This view was made known in 1994 when section 118(2) of the FA 1994 imposed a rule (now repealed) that expenditure must be notified before it could be added to a pool. Section 58 reflects the view just mentioned, but it probably represents a change in the law (on the basis of the interpretation offered in the previous paragraphs).

Nothing in section 58 requires the taxpayer who has incurred expenditure and wishes to claim allowances to allocate the whole of the expenditure to the pool all at once. The wording of the rules as to when the taxpayer may allocate expenditure to the pool (see, in particular, the references to "amount" in subsection (2)) recognises that a part of the expenditure may be allocated to the pool for one chargeable period and a part for another.

This almost certainly represents a relaxation in the law. This is because section 25(1)(a)(i) of CAA 1990 prevents expenditure from being "qualifying expenditure" (in the Act's terminology, in the pool) if "any part" of it has formed part of the taxpayer's qualifying expenditure (i.e., pool) for a previous chargeable period. This change is in favour of the taxpayer. For example, a taxpayer who inadvertently allocates less than the full amount of the expenditure to the pool will not lose entitlement to allowances on the remainder.

Nothing in section 58 requires the taxpayer who does not wish to claim a first-year allowance, but who wishes to claim a writing-down allowance for the period in which the first-year qualifying expenditure was incurred, to elect to do so by notice to the Inland Revenue. This is in contrast to section 25(3) of CAA 1990, which only permits this to be done by giving notice.

Section 58(6) provides that the balance of expenditure after deducting a first-year allowance must be allocated to a pool in an exceptional case. The case is where a disposal event occurs and none of the balance has previously been allocated to the pool.

This is based on section 25(5) of CAA 1990, which provides that where a first-year allowance is made, and a disposal value falls to be brought into account in the chargeable period in which the expenditure was incurred—

> "that expenditure shall not by virtue of subsection (1)(a)(ii) above be excluded from the capital expenditure referred to in subsection (1)(a) above."

Section 25(5) ensures that a taxpayer who has claimed a first-year allowance for a chargeable period can claim writing-down allowances on any outstanding balance of expenditure for the same chargeable period even though the plant or machinery has already been disposed of. (This was given as its purpose when the provision was introduced in 1985 and is the result however section 25(1) is read.)

There is, however, another case to consider. This is where the taxpayer has claimed a first-year allowance, disposed of the plant or machinery and has disposal receipts greater than any balance remaining after deducting the first-year allowance. One would expect the taxpayer to have to allocate the expenditure to a pool. Section 25(5) produces this result if, as suggested above, the correct reading of section 25(1) is that expenditure automatically becomes "qualifying expenditure" or (to use the Act's terminology) has to be added to the pool. (It does not necessarily do so on the alternative reading of section 25(1).)

Section 58(6) therefore contains changes that are consequential on ensuring that the taxpayer who wishes to claim allowances at some stage is not obliged to allocate expenditure to a pool at the earliest opportunity. The simplest consequential change is to require at least some of the balance to be allocated to the pool.

Change 9 More than one disposal event: section 60(3)

Section 60(3) contains a rule that, if qualifying expenditure has been allocated to a pool, and more than one disposal event occurs in respect of the plant or machinery, a disposal value is required to be brought into account in the pool in connection with the first event only. This rule is based on part of section 24(6) of CAA 1990 but goes further in making clear that a person is not required to bring a disposal value into account more than once in the same pool in respect of the same expenditure on plant or machinery.

Section 24(6)(c) deals with the situation where "in a chargeable period" one of a list of events occurs and "that is the first such event to occur".

It is thought that the words "in a chargeable period" in the opening line of section 24(6)(c) are probably intended to qualify the words "and that is the first such event to occur". If they do not do so, section 24(6)(b) is otiose.

Section 24(6)(b) ensures that the person cannot be required to bring a disposal value into account unless he or she owns the plant or machinery on which the expenditure was incurred in the chargeable period in which the disposal event occurs.

It is thought that the combination of paragraphs (b) and (c) of section 24(6) was meant to achieve the practical result that section 60(3) is intended to achieve.

But on the above reading section 24(6) could produce an unjust result in the following example.

Assume machinery is stolen in one chargeable period so that a disposal event within section 24(6)(c)(ii) has occurred. At this stage, it may not be possible to say that the person has ceased to own the machinery, because it may be possible to recover it.

Now assume that in the next chargeable period the stolen machinery is recovered in a state where it can be described as having "ceased to exist as such" (a disposal event within section 24(6)(c)(iii)) but it is clear that the machinery was reduced to this state after the start of the later chargeable period and before a third party has obtained good title to the machinery.

In the above example, a disposal event has occurred in the earlier chargeable period, the person stills owns the plant or machinery in a later chargeable period, and then a further disposal event occurs. On the reading of section 24(6)(c) offered above, the person appears to be obliged to bring a disposal value into account twice over.

This is perhaps a rather fanciful example and it would take some ingenuity to think of further examples. But it would be bizarre if a person were liable to bring a second disposal value into account in the above example.

Change 10 Disposal value and relevant receipts where plant or machinery used for mineral exploration and access is abandoned: sections 61, Table, item 5 and 402(5)

Sections 61, Table, item 5 and 402(5) contain a change as regards the disposal value (for plant and machinery allowances) or the relevant receipts (for mineral extraction allowances) where plant or machinery used for mineral exploration and access is abandoned.

The disposal value given in section 61 applies only if the plant or machinery is abandoned on or after the first day on which a mineral extraction trade is carried on (see section 161(5)). The relevant receipts given in section 402(5) need to be taken into account only if the plant or machinery is abandoned before the first day of trading.

In both cases, the substance of the new provision is the same. The amount of the disposal value or the relevant receipts is any insurance money received in respect of the abandonment, and any other compensation of any description so received, so far as that compensation consists of capital sums.

In the case of plant or machinery allowances, section 26(1) of CAA 1990 does not provide a disposal value specifically for the case where plant or machinery is abandoned in this way. In the absence of specific provision, section 26(1)(f) provides for the disposal value to be the price that the plant or machinery would have fetched if sold in the open market.

The change made in item 5 of the Table in section 61 brings the treatment of plant or machinery abandoned at a site used for mineral exploration and access into line with the treatment of plant or machinery lost in circumstances where it is reasonable to assume that the loss is permanent.

Whether or not this change works in favour of, or against, the taxpayer who is required to bring the disposal value into account, or is neutral in its effect, depends on the circumstances at the time of the abandonment.

There are, in theory, three possibilities.

The market value of the abandoned plant or machinery may be greater than any insurance money or other compensation received by the taxpayer. For example, the taxpayer may not have any insurance which covers the abandoned plant or machinery. (The events which have led to the abandonment may not have been an insurable risk.) In this case the change would be favourable to the taxpayer.

Another possibility is that the market value and the disposal value given in item 5 of the Table are the same. For example, the market value of the plant or machinery and the sums received in respect of it could both be nil. In this case the change would have no effect on the taxpayer.

Finally, the change could be adverse to the taxpayer if the market value of the plant or machinery at the time of the abandonment is less than any sums received.

It is thought that in practice the last possibility is very unlikely to occur.

A similar point arises in connection with mineral extraction allowances, but whether section 402(5) represents a genuine change in the law is more marginal. Section 106 of CAA 1990 applies where the plant or machinery is "sold, demolished, destroyed or abandoned" before the person begins to carry on the mineral extraction trade. (See section 106(1)(d).) Subsections (3) and (4) of section 106 provide for the person who incurred the expenditure on the plant or machinery to be treated as having incurred qualifying expenditure equal to the amount by which that expenditure exceeds any—

> "sale, insurance, salvage or compensation moneys resulting from the event in mentioned in subsection (1)(d)".

At first sight this appears to provide for the deduction of "insurance, salvage or compensation moneys" in a case where the plant or machinery is abandoned.

But in fact "sale, insurance, salvage or compensation moneys" is a phrase which is defined by section 156 of CAA 1990 in relation to specified events. The specified events do not in terms include abandonment of plant or machinery. But section 156(d) refers to the case where "machinery or plant is put out of use". In this case, "sale, insurance, salvage or compensation moneys" means "any compensation of any description so far as it consists of capital sums".

It is not clear whether section 156(d) of CAA 1990 would necessarily apply in every case where plant or machinery is abandoned. There might in theory be cases where it would be possible to argue that plant or machinery had been abandoned without its being "put out of use". If so, section 402(5) would be unfavourable to the taxpayer.

Section 402(5) differs from section 156(d) of CAA 1990 in referring specifically to "insurance money" as well as to compensation. Again, the effect of section 156(d) is not entirely clear. This is because of the contrast between section 156(d), which refers merely to "any compensation of any description", and section 156(c), which refers specifically to "insurance moneys" as well as to "any other compensation of any description". Read literally, this contrasting wording implies that "insurance moneys" are not necessarily to be regarded as a form of compensation. If the phrase "any compensation of any description" in section 156(d) does not include insurance money, section 402(5) could be unfavourable to the taxpayer. But there would be no logic in making the change in item 5 of the Table in section 61 and not adopting the same wording in section 402(5).

Change 11 General limit on amount of disposal value: section 62

Section 62 is based on section 26(2) and (3) of CAA 1990, but differs in that it bases the limit on the disposal value on "qualifying expenditure" rather than "capital expenditure".

This change could be favourable to the taxpayer in a case involving connected persons.

Section 26(2) of CAA 1990 provides that the disposal value shall in no case exceed the capital expenditure incurred by the person in question on the provision of the plant or machinery. Section 26(3) of CAA 1990 provides that where the person has acquired the plant or machinery as a result of a transaction which was, or a series of transactions each of which was, between connected parties, the limit is the greatest capital expenditure incurred by any of the connected parties. Section 62 is in similar terms except that it refers to "qualifying expenditure" rather than "capital expenditure".

In the main case dealt with in section 26(2) of CAA 1990 and section 62(1), this change will not have any practical effect, because "qualifying expenditure" under Part 2 is essentially a sub-category of capital expenditure: capital expenditure incurred in circumstances entitling the person incurring it to an allowance.

But the change could be favourable to the taxpayer in a case involving connected persons, because "qualifying expenditure" is a narrower concept than "capital expenditure". The range of persons whose expenditure could raise the limit on the disposal value is narrower.

For example, suppose a person who is not carrying on a qualifying activity buys machinery for £100 and sells it for £60 to a connected person ("C") who is carrying on a qualifying activity and who in turn sells it to a third party for £70 (its market value). The disposal value that C would be required to bring into account (apart from the limit) is £70. C's qualifying expenditure is £60. The greatest capital expenditure incurred in the transaction as a result of which C acquired the machinery is £100. The greatest qualifying expenditure incurred in the transaction is £60. So C is better off under the new rule, because the disposal value is cut back from £70 to £60.

This change, though favourable to C in the above example, could be adverse to the third party if the anti-avoidance provisions in Chapter 17 of Part 2 (based on sections 75 to 76A of CAA 1990) apply. This is because the third party's qualifying expenditure would be limited to C's disposal value.

Change 12 Nil disposal value for certain gifts: section 63(1) and (2)

Subsections (1) and (2) of section 63 are based on the closing words of section 24(6) of CAA 1990 and on sections 83A and 84 of ICTA. They deal with disposal values in the case of certain gifts. But they differ from section 24(6) of CAA 1990 and sections 83A and 84 of ICTA in that they provide for a nil disposal value rather than providing that no disposal value is required to be brought into account.

Normally, a gift of plant or machinery requires a disposal value to be brought into account because a gift involves cessation of ownership (see section 24(6)(c)(i) of CAA 1990 and section 61(1)(a)).

The closing words of section 24(6) of CAA 1990 provide that the subsection does not require a disposal value to be brought into account if the circumstances of the gift are such that there is a charge to tax under Schedule E. There will be a Schedule E charge as a result of the gift if, broadly, it is made to an employee of, or person holding an office under, the giver.

Section 84(3)(b) of ICTA provides that section 24(6) of CAA 1990 does not require a disposal value to be brought into account if the gift is made to a designated educational establishment and the donor has claimed allowances in respect of the machinery or plant. Section 83A(3)(b) of ICTA (added by section 55 of FA 1999) makes corresponding provision for a gift made to a charity or one of the heritage bodies and museums listed in section 507(1) of ICTA.

The change made in section 63 has the potential to affect any provision that applies only if a disposal value is, or is required to be, brought into account.

One case where the change could benefit the taxpayer is where the taxpayer incurs expenditure on plant or machinery in a chargeable period, claims a first-year allowance on it (at less than 100%) and gives it to charity in the same chargeable period.

Section 25(1)(a)(ii) of CAA 1990 excludes expenditure from being qualifying expenditure if a first-year allowance is or could be made in respect of it. Section 25(5) of CAA 1990 ensures that expenditure in respect of which a first-year allowance is made is capable of being qualifying expenditure if the disposal value of the machinery or plant "falls to be brought into account" in accordance with section 24(6) of CAA 1990 in the same chargeable period as that in which the expenditure is incurred.

In this example, it would appear that under CAA 1990 the taxpayer's expenditure cannot be qualifying expenditure as a result of section 25(5) because no disposal value "falls to be brought into account". So the taxpayer is apparently prevented from obtaining writing-down allowances on the balance of the expenditure after the deduction of the first-year allowance. However, it is thought that in practice the taxpayer has been treated as able to obtain writing-down allowances in this situation. The change in section 63 reflects this.

There could in theory be a disadvantage to taxpayers resulting from the change. This could happen if the donee is not only able to claim capital allowances but is also subject to the anti-avoidance provisions in sections 75 to 76A of CAA 1990 (rewritten in Chapter 17 of Part 2).

Such cases are likely to be infrequent. The following is an illustration. A person carrying on a trade gives a computer to an employee and the employee brings the computer into use for the purposes of the employee's trade. Section 81 of CAA 1990 then treats the employee as having incurred expenditure equal to the market value of the computer at the time when the computer is brought into use and as having done so by way of purchase. If the employee is also connected to the donor, the employee's qualifying expenditure is limited to the disposal value "to be brought into account" (under section 75(1) of CAA 1990) or if "no disposal value falls to be brought into account", to the smallest of a number of values (under section 76(2) of CAA 1990). The effect of section 63 in this illustration is to limit the employee's qualifying expenditure to nil (which is in fact what his actual expenditure amounts to).

Change 13 Relief for gifts to educational establishments: section 63(2)

Section 63(2) (another aspect of which has been discussed in Change 12) does not reproduce two requirements contained in section 84 of ICTA.

Section 84(1) limits the relief to cases where the donor has claimed an allowance under Part II of CAA 1990. Section 84(3) provides that the subsection does not apply unless, within a specified period, the donor makes a claim for the relief, specifying the article given and the name of the educational establishment in question.

Section 63(2), in dropping these requirements, brings the rule deriving from section 84 of ICTA into line with the rule deriving from section 83A of ICTA.

Dropping the requirement that a donor has claimed an allowance in respect of plant or machinery given to an educational establishment means that the relief is, in theory, more widely available. For example, the effect of bringing expenditure on particular plant or machinery into account can be to reduce the amount of a balancing charge rather than to result in an allowance being made. There are provisions in CAA 1990 which expand the notion of claiming allowances to include this situation (see sections 38F(4), 51(5A), 76B(2)(e) and 154(2) of CAA 1990). This change is therefore in theory in favour of the taxpayer. But, in practice, the condition in section 84(1)(b)(ii) of ICTA has been taken to be met in a case such as this.

Dropping the claims procedure in section 84(3) of ICTA carries through the logic of an amendment made when section 83A was added to ICTA by section 55 of FA 1999. When the Bill which became FA 1999 was introduced, the new section 83A included a claims procedure corresponding to that contained in section 84(3). This was removed as a result of an Opposition amendment agreed to in Standing Committee. It was thought that, under self-assessment, the requirement for a claim was no longer appropriate. The same argument is equally applicable to the claims procedure under section 84.

Change 14 Case where no disposal value need be brought into account: section 64

Section 64(1) provides that no disposal value need be brought into account if the expenditure has not been taken into account in a claim in determining the person's available qualifying expenditure. This change follows on from Change 8.

Section 24(6) of CAA 1990 requires a person to bring a disposal value into account in a chargeable period in respect of machinery or plant if (abbreviating it somewhat): (a) the person has incurred capital expenditure on the machinery or plant for the purposes of the trade, (b) the machinery or plant belongs to the person at some time in the chargeable period, and (c) a disposal event occurs in the chargeable period.

But there is nothing in section 24(6) of CAA 1990 that limits the requirement on the person to bring a disposal value into account to the case where the person has used the expenditure in a tax claim.

To what extent does section 64(1) effect a real change in the law?

When considering the effect, under CAA 1990, of the lack of any requirement that the person has used the expenditure in a tax claim, it is worth bearing three points in mind.

The first is that the person who has not made use of the expenditure in a tax claim should nevertheless be regarded as having qualifying expenditure under CAA 1990. (This point has been discussed in Change 8.)

The second is that the requirement to bring a disposal value into account is not meaningful on its own. It is given meaning by section 24 of CAA 1990 which ensures that an allowance is made in respect of the excess of qualifying expenditure over disposal value and a charge is made on the excess of disposal value over qualifying expenditure. See section 24(2) and (5). The references in section 24(2) and (5) to "qualifying expenditure" are not limited so as to refer only to qualifying expenditure that has been used in a tax claim.

The third is that section 26(2) and (3) of CAA 1990 limits the disposal value by reference to capital expenditure incurred. (Under the Act, the limits are based on qualifying expenditure rather than capital expenditure (see Change 11).)

So, what, under Part II of CAA 1990, is the position of a person who has not made use of expenditure on plant or machinery in a tax claim if a disposal event occurs in respect of the plant or machinery?

Under section 24(2) and (5), the disposal value has to be set against the person's actual qualifying expenditure, not the qualifying expenditure included in a tax claim. But under section 26(2) the disposal value that the person is required to bring into account cannot exceed the capital expenditure that the person has incurred. It is thought that this is the effect of CAA 1990.

If, contrary to the view expressed in Change 8, section 25(1) of CAA 1990 were to be interpreted as giving the taxpayer a choice as to whether expenditure is qualifying expenditure, section 24(6) would appear to give rise to potential unfairness. If a taxpayer chose not to treat expenditure in respect of plant or machinery as qualifying expenditure and then disposed of the plant or machinery, it would seem to require him or her to bring a disposal value into account even though he or she did not have qualifying expenditure to set it against.

Because the Act changes the law so as to give the taxpayer flexibility in allocating expenditure to the pool (see Change 8), it is necessary to remove this potential unfairness. This is what section 64(1) does.

Section 64(2) to (4) addresses a complication involving connected persons. These provisions are required because of subsection (1) of section 64.

To explain this point it is necessary to consider how section 24(6) of CAA 1990 works if a person has not used the expenditure in a tax claim but the situation is one regulated by section 26(3) of CAA 1990 (connected persons).

For example, suppose a person who is carrying on a qualifying activity buys machinery for £100, obtains allowances on it and then sells it to a connected person ("C") for £50. C is entitled to claim allowances but sells the machinery (at market value) for £60 without having done so. Under section 24(6) of CAA 1990, C is required to bring a disposal value into account of £60 (the limit under section 26(3) is £100, not £50). C has qualifying expenditure under section 25 whether or not C claims allowances or includes the expenditure in a tax claim. So C is subject to a balancing charge of £10 (£60 - £50).

If the change in subsection (1) of section 64 were made and subsections (2) to (4) were not included, the result would be that C would not be subject to this balancing charge (because C would not have made use of the expenditure in a tax claim).

There is no reason why taxpayers should gain a windfall as a result of the change in section 64(1). Subsections (2) to (4) of section 64 are designed to prevent this.

Change 15 Final chargeable periods (and, in particular, final chargeable period for special leasing): section 65 (and section 19)

Section 65 identifies "the final chargeable period". The significance of "the final chargeable period" is that an entitlement to a balancing allowance cannot arise except for this period.

The notion of "the final chargeable period" corresponds to the notion in CAA 1990 of the chargeable period in which the trade is permanently discontinued (see section 24(2)(b) of CAA 1990).

Part II of CAA 1990 treats various activities that are not trades as trades. In this discussion they are referred to as "notional trades".

The question of when a notional trade is to be regarded as permanently discontinued for the purposes of section 24(2)(b) turns on some rather tortuous provisions; and the application of section 24(2)(b) in relation to a notional trade under section 61(1) of CAA 1990 is particularly puzzling.

For many of the notional trades, there are provisions in CAA 1990 that are almost in common form. Sections 31(2)(b), 34(2)(b), 37(3)(b), 79(4) and 80(5)(a)(iii) all provide for a situation in which "without prejudice to section 24(6)(c)(i) to (iii)", the notional trade is to be treated as permanently discontinued. The situation in which the notional trade is treated as permanent discontinued is usually that the plant or machinery begins to be used wholly or partly for purposes other than those of the actual trade.

It is thought (though the point is not wholly free from difficulty) that the words "without prejudice to section 24(6)(c)(i) to (iii)" are meant to imply that, where expenditure in respect of plant or machinery is treated as incurred for the purposes of a notional trade, and an event mentioned in section 24(6)(c)(i), (ii) or (iii) occurs, the notional trade has to be regarded as permanently discontinued.

Section 65(2) reflects this construction of sections 31(2)(b), 34(2)(b), 37(3)(b), 79(4) and 80(5)(a)(iii) of CAA 1990. In so far as there is any doubt over whether the notional trades under these sections are to be treated as permanently discontinued on the happening of an event listed in section 24(6)(c)(i), (ii) or (iii), section 65 clarifies the law in favour of the taxpayer.

Section 61(1) of CAA 1990 is very different from sections 31(2)(b), 34(2)(b), 37(3)(b), 79(4) and 80(5)(a)(iii). Unlike those sections, it does not contain any indication at all as to when the notional trade is to be regarded as "permanently discontinued". Section 61(1)(b) merely provides—

> "at the time when the lessor permanently ceases to let the machinery or plant otherwise than in the course of a trade, the machinery or plant shall be treated for the purposes of this Part as being used wholly for purposes other than those of [the notional trade]".

Since section 24(6)(c)(iv) of CAA 1990 treats the use of machinery or plant wholly or partly for purposes which are other than those of the trade as an event distinct from the permanent discontinuance of the trade, section 61(1)(b) of CAA 1990 might be taken to mean that permanently ceasing to let the machinery or plant otherwise than in the course of the trade is not meant to be capable of giving rise to a balancing allowance. But this would be very odd indeed, because this is the very situation in which one might expect a balancing allowance to be capable of arising.

Section 19(3) therefore expressly provides for the qualifying activity of special leasing to be treated as permanently discontinued in this situation. Under the Act expenditure incurred on the provision of plant or machinery for special leasing has to be allocated to the main pool. This is because there has to be a separate pool for each qualifying activity. So section 19(3), when read with section 65(1), produces the result that there is a final chargeable period (which may give rise to a balancing allowance) if the chargeable period is one in which the taxpayer permanently ceases to hire out the plant or machinery otherwise than in the course of the qualifying activity.

This change is in favour of the taxpayer in that it makes clear that a balancing allowance can arise in the situation where the taxpayer would expect it to be capable of arising.

Change 16 Hire-purchase contracts, etc.: section 68(3)

Section 68, which is based on part of section 60 of CAA 1990, deals with disposal values where a person has been acquiring plant or machinery "under a contract providing that the person shall or may become the owner of the plant or machinery on the performance of the contract". Hire-purchase contracts come within this description. But other contracts can also do so, in particular, those under which plant or machinery is paid for by instalments.

Section 68(3) contains a change in the law to provide a disposal value consisting of "relevant capital sums" where the plant or machinery being acquired under the contract has not been brought into use.

The following paragraphs explain this change in more detail.

Hire-purchase and related contracts receive special treatment for capital allowances purposes. The person acquiring the plant or machinery is treated as owning the plant or machinery straightaway and, as soon as the plant or machinery is brought into use, expenditure due under the contract is accelerated. The fictional ownership is brought to an end if the person ceases to be entitled to the benefit of the contract and this triggers the requirement (under section 24(6)(c)(i) of CAA 1990 and section 61(1)(a)) to bring a disposal value into account.

Section 60(2)(b) of CAA 1990, which is reflected in section 68(2), provides for the disposal value where the plant or machinery has been brought into use to be any accelerated expenditure, together with what the Act calls "relevant capital sums" (capital sums which the person is entitled to receive by way of consideration, compensation, damages or insurance money in respect of his rights under the contract.)

But section 60 of CAA 1990 does not provide for a disposal value where the plant or machinery has not been brought into use. Therefore the disposal value is given by section 26(1)(f) of CAA 1990 and is the market value of the plant or machinery. In contrast, section 68(3) provides for the disposal value to be "relevant capital sums". This means that the disposal value matches the disposal value where the plant or machinery has been brought into use (except that there is no accelerated expenditure to be clawed back through the disposal value).

Providing for the disposal value where the plant or machinery has not been brought into use to be "relevant capital sums" is likely to be favourable to taxpayers, since such sums are unlikely to exceed the market value of the plant or machinery, and may be less or nil.

The change could be adverse to a taxpayer whose "relevant capital sums" exceed the market value of the plant or machinery. But it is thought that this is unlikely to occur in practice.

The disposal value of plant or machinery being acquired under hire-purchase or related contracts gives rise to special considerations if the circumstances fall within the anti-avoidance provisions rewritten as Chapter 17 of Part 2. These are dealt with in section 229, which is discussed in Change 27.

Change 17 Plant or machinery required to be provided under terms of lease: section 70(2) to (5)

Subsections (2) to (5) of section 70 are based on part of section 61(4) of CAA 1990 but contain changes designed to resolve some uncertainties about how section 61(4) is meant to be operated.

Section 61(4) of CAA 1990 provides—

> "(4) Where-
>
> (a) a lessee incurs capital expenditure on the provision for the purposes of a trade carried on by him of machinery or plant which he is required to provide under the terms of the lease, and
>
> (b) the machinery or plant is not so installed or otherwise fixed in or to a building or any other description of land as to become, in law, part of that building or other land,
>
> then, if the machinery or plant would not otherwise belong to him, the machinery or plant shall be treated for the purposes of this Part as belonging to him for so long as it continues to be used for the purposes of the trade; *but, as from the determination of the lease, section 24(6) shall have effect as if the capital expenditure on providing the machinery or plant had been incurred by the lessor and not by the lessee*."

The words in issue are those from "but" to the end of the subsection (italicised in the above extract).

Section 61(4) of CAA 1990 is seldom invoked in practice nowadays. But the concluding words have been assumed to have two effects. First, the lessee can continue to claim allowances on the expenditure after the determination of the lease and is not required to bring a disposal value into account merely because the lease comes to an end. Secondly, the lessor is required to bring a disposal value into account if a disposal event occurs in respect of the plant or machinery after the ending of the lease, but is not able to claim allowances in respect of the expenditure.

Treating the lessor as liable to bring a disposal value into account relies on the fact that the words quoted above refer specifically to section 24(6) of CAA 1990, rather than to section 24 as a whole. Section 70(4) reflects this interpretation.

The basis for section 70(3)(b) and (c) is that section 61(4) of CAA 1990 provides that section 24(6) shall have effect as if the capital expenditure had been incurred by the lessee and not by the lessor.

Section 24(6)(a) and (b) of CAA 1990 ensures that a person is required to bring a disposal value into account only if the person has incurred capital expenditure for the purposes of a trade (in the Act's terminology, a qualifying activity) and the plant or machinery belongs to the person at some time in the chargeable period.

Section 61(4) of CAA 1990 does not treat the requirements of section 24(6)(a) and (b) as being met. So the lessor cannot be intended to bring a disposal value into account unless he has a qualifying activity and owns the plant or machinery at some point in the chargeable period in which the disposal event occurs. The artifice in section 61(4) of deeming the lessor to have incurred the lessee's expenditure leaves it unclear what the link between the plant or machinery provided by the lessee and the lessor's qualifying activity is meant to be. But there must be meant to be a link, because otherwise section 24(6) could not apply and the tail end of section 61(4) would become meaningless. Section 70(3)(b) spells out the nature of the link in a way that accords with common sense.

Under section 61(4) of CAA 1990 the lessee is likely to be treated as ceasing to own the plant or machinery on the ending of the lease. (This is because section 61(4) treats the lessee as owning the plant or machinery only "for so long as it continues to be used for the purposes of the trade".) Under section 24(6)(c)(i) of CAA 1990, cessation of ownership normally requires the former owner to bring a disposal value into account. But it cannot be the intention that the lessee is required to bring a disposal value into account as well as the lessor. Section 70(2)(b) reflects this interpretation.

The next question is whether section 61(4) of CAA 1990 produces the result that the lessee can continue to be regarded, after the ending of the lease, as having incurred the expenditure (so that he can continue to claim allowances) and that the lessor is not endowed with any notional expenditure against which the disposal value can be set.

The fact that section 61(4) of CAA 1990 says that "section 24(6) shall have effect as if the capital expenditure . . . had been incurred by the lessor and not by the lessee" might lead some to conclude that the lessee was not meant to claim allowances in respect of the expenditure after the determination of the lease and that the lessor was being given some notional expenditure against which the disposal value could be set.

However, section 61(4) of CAA 1990 treats the capital expenditure as if it <u>had been</u> incurred by the lessor. The correct inference to draw from this probably is that the lessor's notional expenditure is being treated as expenditure that was qualifying expenditure in the past, which was automatically allocated to a pool and which therefore cannot now inflate current qualifying expenditure. This is the interpretation that has been applied in practice. But subsections (4) and (5) of section 70 are meant to bring this out more clearly.

Section 70(5) is needed to overcome the rule in section 64 (discussed in Change 14) that a person need not bring a disposal value into account if no expenditure has been allocated to a pool.

Change 18 Vehicles provided for purposes of employment or office: section 80(2)

Section 80 is based on section 27(2A) to (2E) of CAA 1990, which deals with the entitlement of employees and office holders to allowances for mechanically propelled vehicles and cycles. But section 80(2) differs from section 27(2B). It extends the availability of allowances so as to come into line with the availability of deductions for travelling expenses under section 198 of ICTA.

For simplicity's sake the following explains the change in relation to employees and cars, but the reasoning is similar for office holders (and for cycles).

Under section 27(2) of CAA 1990 employees are entitled to allowances in respect of machinery or plant only if it is "necessarily provided" for use in the performance of the employee's duties. But cars provided for use in employment are very unlikely to pass this "necessarily provided" test. Section 27(2A) and (2B) of CAA 1990 relaxes the rule in section 27(2) so that allowances can be obtained in respect of a car if it is provided (rather than "necessarily provided") for use in the performance of the employee's duties.

But under section 198 of ICTA deductions for travelling expenses are no longer limited to travelling in the performance of duties, as a result of amendments made by section 61 of FA 1998 (replacing earlier amendments made by section 62 of FA 1997). The effect of the change in section 80(2)(b) is to align the capital allowances treatment of the cost of travel with deductions under section 198 of ICTA.

In practice employees who are entitled to expenses and capital allowances in respect of cars are often dealt with under an administrative scheme known as the "Fixed Profit Car Scheme". The employee receives an allowance from the employer which more than covers running costs and wear and tear. The scheme offers standard rates for the taxable component in the allowance (the part that goes beyond running costs and wear and tear). The standard rates are based on car engine sizes. The scheme is intended to produce, in a simpler and administratively more convenient way, essentially the same result as would be achieved by making both deductions under section 198 of ICTA and allowances under Part II of CAA 1990. For the administrative scheme to be workable, the conditions governing availability of allowances for capital expenditure need to be, and are in fact treated as being, the same as the conditions governing availability of deductions for running costs.

An employee is entitled to have his or her entitlement to allowances assessed on the statutory basis. So it is possible for an employee to be taxed for some periods by reference to the simpler administrative scheme and for other periods by reference to statutory entitlements to deductions and allowances. Section 27(2C) to (2E) of CAA 1990 ensures that, if an employee has received recognition of the capital depreciation on a car for any period under the administrative scheme, any balancing allowance is reduced to reflect that fact.

The corollary of extending entitlement to allowances for the costs of travelling to additional cases is that the provisions for reducing the balancing allowance need to be extended to the additional cases. So section 80(3) (which is based on section 27(2C) to (2E) of CAA 1990) applies to expenditure of the kind described in section 80(2)(b) in the same way that it applies to the kind of expenditure described in section 80(2)(a).

Change 19 Long-life assets: monetary limit relief applied to all qualifying activities: section 98(1) and (2)

Section 98(1) and (2) refers to a "qualifying activity". This is based on, but goes wider than, section 38C(3)(a) and (4)(a) of CAA 1990, which refers to a "trade or profession".

"Qualifying activity" is wider than "trade or profession" because the former brings in employees, office holders, those carrying on vocations and section 55 concerns, whereas the latter does not.

Section 38C is part of a Chapter in CAA 1990 (Chapter IVA of Part II) that deals with long-life assets. To be a long-life asset, the plant or machinery must have a useful economic life of at least 25 years. (A typical example of a long-life asset is an aeroplane.)

Under section 38F(1) of CAA 1990, the rate of writing-down allowances for expenditure incurred on long-life assets is 6% instead of 25%. This applies <u>irrespective</u> of the nature of the activity carried on by the person incurring the expenditure.

Under section 38C of CAA 1990, the reduced rate of writing-down allowances does not apply to expenditure incurred by an individual, or a partnership of individuals, if the expenditure is below a monetary limit (normally, £100,000) and (among other things) is incurred for the purposes of a "<u>trade or profession</u>" carried on by the individual or partnership.

Section 27(1) of CAA 1990 applies the provisions of Part II to "professions, employments, vocations and offices" as they apply to trades. The necessary implication of section 38C in picking out one item in this list, professions, is that the others (employees, office holders and those carrying on vocations) are excluded. But it may well have been thought that such persons would not be incurring long-life asset expenditure and so there was no practical need to count them in.

Although it seems very unlikely that employees etc. would have long life asset expenditure, it also seems wrong to leave them out; and it makes the drafting simpler to include them. The change is favourable to taxpayers.

The extension of the monetary limit provisions to section 55 concerns is a straightforward consequential on Change 1.

For completeness, it may be worth explaining why "trade or profession" in section 38C(3)(a) and (4)(a) already includes the management of an investment company, carrying on a property business and special leasing of plant or machinery.

As far as the management of an investment company is concerned, section 28(1) of CAA 1990 applies the provisions of Part II in relation to machinery or plant provided for use or used for management purposes as they apply in relation to machinery or plant provided for use or used for a trade. As far as property businesses are concerned, sections 28A(1), 29(1) and 161(2A) of CAA 1990 apply the provisions of Part II to such businesses as they apply to trades. As far as special leasing is concerned, section 61(1) of CAA 1990 treats the lessor as having incurred the expenditure for the purposes of a trade.

Change 20 Application of 10% rate to pool for expenditure on plant or machinery used partly for purposes other than those of the qualifying activity: section 109(3)

Section 109(3) provides for the 10% rate for writing-down allowances to apply to expenditure even if it is in a single asset pool.

Under the Act, the single asset pools include a pool for expenditure on plant and machinery used partly for purposes other than those of the qualifying activity. This pool is based on section 79 of CAA 1990.

In contrast, section 42(2) of CAA 1990 (which provides for the 10% rate to apply to expenditure dealt with under sections 41, 80, 34, 35(1) and 61), does not mention section 79.

Records suggest that the section 79 pool was not mentioned in section 42(2) because it was considered to be not relevant in practice. If that is the case, the drafting of this provision can be simplified, without any real practical effect, by referring to single asset pools without any exclusion for a single asset pool for expenditure where the plant or machinery is used partly for purposes other than those of the qualifying activity.

Change 21 Election to use appropriate non-ship pool: section 129

Section 129 is based on section 33 of CAA 1990.

Section 33 of CAA 1990 enables the shipowner to give notice disapplying the rules in section 31 of CAA 1990 that require expenditure on the provision of a ship to be treated as incurred for the purposes of a separate notional trade.

Section 129(1) enables the shipowner to achieve the same result by making an election. The election is expressed in terms of the appropriate non-ship pool as the Act uses the concept of pools for expenditure rather than separate notional trades.

Expressing the shipowner's choice as an election means that section 42 of TMA 1970 and Part VII of Schedule 18 to FA 1998 apply to it. (Section 42(10) of TMA 1970 provides for section 42 to apply to elections as it applies to claims.)

The main effect of that is that the election must be made in a tax return if a return has been required and there is still time to make or amend the return. But this has no effect on the time limit which is the same as it is under CAA 1990 (see section 33(5A) of CAA 1990 and section 129(2)).

The change also means the shipowner will benefit from section 42(9) of TMA 1970 or paragraph 56 of Schedule 18 to FA 1998. These provisions enable the shipowner to make a supplementary election if he discovers an error or mistake in the original election. (There is no equivalent way to rectify errors and mistakes in notices given outside tax returns.)

Change 22 Deferral of balancing charge on ship—limit on amount deferred: section 138(1)(a)

Section 138(1) lists the amounts which limit the amount of a balancing charge that can be deferred on a claim under section 135. The amount deferred cannot exceed the smallest of those amounts. Section 138 is based on section 33A(3) of CAA 1990.

Section 138(1)(a) describes one of those amounts as the amount of the balancing charge which, if the deferment claim had not been made, would have been made in the chargeable period in question in the appropriate non-ship pool. This is the pool to which expenditure on the provision of the ship would have been allocated in the absence of the ships rules (section 127(3)). But section 33A(3)(c) of CAA 1990 is in terms of the amount of the balancing charge which, if there had been no deferment claim, would have been made in respect of the shipowner's actual trade.

This change means that the amount under section 138(1)(a) could be less than it is under section 33A(3)(c) of CAA 1990. The change is adverse to taxpayers, in that it could reduce the amount that may be the subject of a deferment claim.

The balancing charge for the "actual trade" is capable of being made up of the balancing charge arising under section 24(5) of CAA 1990 (in what the Act calls the "main pool") and also balancing charges arising in what the Act calls "class pools" or "single asset pools". The provisions of CAA 1990 establishing these "class pools" and "single asset pools" operate by creating separate notional trades for them and then attributing any allowance or charge that would be made for the notional trade to the actual trade.

But not all the charges arising in respect of separate notional trades are included for the purposes of section 33A(3)(c) of CAA 1990. Section 33A(6) excludes balancing charges arising in the case of the notional trades created by sections 41, 79 and 80 of

CAA 1990. These apply where plant or machinery is used for overseas leasing, where plant or machinery is provided or used partly for non-trade purposes and where a payment is made in respect of the depreciation of plant or machinery.

It appears that, when section 33A was added to CAA 1990 by FA 1995, subsection (6) was intended to exclude balancing charges arising in any notional trades capable of existing at that time. But the notional trades created for expenditure on expensive cars and short-life assets by sections 34 and 37 of CAA 1990 were not included in the list in section 33A(6). The notional trade for long-life assets was created by section 38E of CAA 1990. Section 38E was inserted in CAA 1990 by FA 1997. But FA 1997 did not add section 38E to the list in section 33A(6).

Section 138(1)(a) catches only the balancing charge that would have been made, if the deferment claim had not been made, in the pool to which the expenditure on the ship would otherwise have been allocated. So balancing charges arising in all other pools in respect of the shipowner's qualifying activity are excluded.

To the extent that the other pools include balancing charges in respect of expensive cars and short-life assets, section 138(1)(a) reflects what was intended when section 33A was added to CAA 1990. Section 138(1)(a) also excludes balancing charges in respect of long-life assets, unless the long-life asset pool is itself the appropriate non-ship pool. This will not in fact be possible until after 31st December 2010 (see section 38B(3) of CAA 1990 and section 94(1)).

Change 23 Amounts deferred as a result of disposal events occurring at the same time as relevant disposal event: section 141(2)

Section 141 is based on section 33D(6) of CAA 1990. Section 33D(6) restricts the circumstances in which a balancing charge deferred under section 33A of CAA 1990 can be attributed to new expenditure. Section 141(2)(b) enables deferred amounts to be attributed to new expenditure in a slightly wider range of circumstances.

Under section 33D(6) of CAA 1990, a deferred balancing charge cannot be attributed to new expenditure unless all the shipowner's other shipping expenditure incurred earlier in the relevant six year period has been used up by having deferred amounts attributed to it. This six year period begins when the "relevant disposal event" occurs. This is the disposal event which gives rise to the deferred balancing charge in question. The deferred amounts attributed to the earlier expenditure must have arisen as a result of disposal events which occurred before the relevant disposal event.

Section 141(2)(b) relaxes this restriction in that the deferred amounts attributed to the earlier expenditure may have arisen as a result of disposal events occurring at the same time as, as well as before, the relevant disposal event.

This might be relevant if, for example, two ships (A and B) are sold at the same time. A balancing charge might arise in both single ship pools. If both charges are deferred, and the shipowner subsequently buys a new ship (C), he may want to attribute part of the amount deferred on ship A to the expenditure on ship C. If the shipowner bought another new ship (D) earlier in the 6 year period beginning with the sale of ships A and B and attributed any of the amount deferred in respect of ship B to expenditure on ship D, section 33D(6) of CAA 1990 would not permit him to attribute any of the amount deferred in respect of ship A to expenditure on ship C. Section 141(2)(b) would enable him to do so.

The change therefore extends the circumstances in which it is possible to attribute deferred amounts to new expenditure.

The effect of attributing amounts to expenditure is to require a disposal value equal to the attributed amount to be brought into account in the single ship pool to which the new expenditure is allocated. If a deferred amount is not attributed to new expenditure, the deferral is treated as not having taken place once it becomes impossible to attribute the amount. This puts the taxpayer in the position he or she would have been in had the amount not been deferred.

So, from the taxpayer's point of view, it is preferable to have the ability to attribute a deferred amount to new expenditure.

Change 24 Notices given by successors to shipowner's qualifying activity: section 155(2)(b)

Section 155(2)(b) is based on section 33F(7) of CAA 1990. Section 155(2) is expressed to apply for the purposes of the "deferment rules", that is, the rules about deferring a balancing charge rewritten in sections 135 to 156. The deferment rules come from sections 33A to 33F of CAA 1990. But section 33F(7) applies only for the purposes of section 33F. So, in applying section 155(2) to all the deferment rules, the Act goes wider than CAA 1990.

Section 33F(7) of CAA 1990 provides that, where the shipowner's trade has changed hands but is not deemed to have been discontinued, references in section 33F to the shipowner, in the context of giving a notice, have effect as references to the person carrying on the trade at the time the notice is given or is required to be given.

This catches the power to give notice under section 33F(4) varying an attribution of expenditure and the requirement to give notice under section 33F(5) when circumstances arise which mean that the shipowner was not entitled to claim deferment.

But section 155(2)(b) also catches the power to give notice attributing a deferred amount to new expenditure. In CAA 1990, this power is in section 33A(5) and so is not caught by section 33F(7). So, under the Act, notice attributing a deferred amount to new expenditure can be given by a successor to the shipowner's trade as well as by the shipowner himself.

The effect of section 33D(7) of CAA 1990 is that the new expenditure may have been incurred by the successor. And the effect of section 33F(4) and (7) is already to enable the successor to give notice varying the attribution of expenditure. So it is a logical extension of this to enable the successor to give notice attributing the expenditure in the first place.

Change 25 Pre-trading expenditure on mineral exploration and access: section 161(4)(a)

Section 161 is based on section 63 of CAA 1990. Section 161 enables a person to obtain plant and machinery allowances where pre-trading expenditure has been incurred on the provision of plant or machinery for mineral exploration and access and the person still owns the plant or machinery on the first day of trading. Section 161 is of fairly limited application, because it is in practice needed only for cases where research and development allowances are not available.

Section 161(4)(a) defines "pre-trading expenditure" as <u>capital</u> expenditure incurred before the day on which a person begins to carry on a mineral extraction trade.

This is a change compared with section 63(1)(a) of CAA 1990, which refers merely to "expenditure". So the literal, though surprising, effect of section 63(1) is to enable allowances to be obtained in respect of revenue expenditure on the provision of plant or machinery for mineral exploration and access.

Revenue expenditure incurred by a person before carrying on trading can be relieved under section 401 of ICTA. Under this section the taxpayer is able to deduct all the expenditure in one go. But the relief is limited to cases where the expenditure was incurred not more than 7 years before the start of trading. So the practical significance of the lack of the word "capital" in section 63(1)(a) of CAA 1990 is in relation to expenditure incurred more than 7 years before trading started.

The purpose of capital allowances is to provide relief in respect of capital expenditure. Section 106(1)(a) of CAA 1990 (the comparable relief where the plant or machinery is no longer owned when trading begins) refers to <u>capital</u> expenditure. The inclusion of the word "capital" in section 161(4)(a) corrects an oversight in section 63(1)(a) of CAA 1990. It ensures that, in the context of pre-trading expenditure on plant or machinery for mineral exploration and access, capital allowances cannot be obtained for revenue expenditure.

Change 26 Adjustment of second part of section 51(1) of CAA 1990: section 172

Subsection (2) of section 172 relaxes the effect of the second part of section 51(1) of CAA 1990.

Section 51(1) of CAA 1990 provides—

> "(1) This Chapter applies to determine entitlement to allowances under this Part in respect of expenditure on machinery or plant that is or becomes a fixture; and at any time when, by virtue of this Chapter, any machinery or plant is treated as belonging to a person, no other person shall be entitled to an allowance in respect of it."

The effect of the words after the semi-colon were the subject of conflicting judicial dicta in *Melluish (HM Inspector of Taxes)* v *BMI (No. 3) Ltd and Others* (HL) [1994] 3 WLR 630; [1995] STC 964; (1995) 68 TC 1. The House of Lords was considering the pre-consolidation version of Chapter VI of Part II of CAA 1990 (section 59 of, and Schedule 17 to, FA 1985) but the point is the same.

Lord Browne-Wilkinson (with whose speech the rest of their Lordships concurred) suggested at one point that—

> "The words are introduced to ensure that claims relating to expenditure incurred between 11 July 1984 and the passing of the 1985 Act cannot be established on the grounds that, under the general law as it stood during the intervening period, the fixture 'belonged' to the person incurring the expenditure."

But at a later point he also said—

> "For example if, under Sch 17, the fixture is to be treated as belonging to a local authority, no other person is entitled to an allowance even though the local authority itself is not entitled to an allowance (see s 59(1), second sentence)."

The first statement assumes that what became the second part of section 51(1) of CAA 1990 is for transitional purposes; the second statement treats what became the second part of section 51(1) as having a non-transitional purpose.

The first statement was *obiter*: it was made in the context of considering the question whether section 59 and Schedule 17 formed an exhaustive code on fixtures, and his Lordship recognised that the question "does not strictly require to be decided in the present case".

The second statement was made in the context of deciding whether the taxpayer companies were prevented from obtaining allowances under Schedule 17 as equipment lessors because the equipment lessees were exempt from tax. It is doubtful that it is *obiter*.

Records suggest that the words that now form the second part of section 51(1) were in fact originally introduced with a view to ensuring that, at any given time, only one set of allowances should be made for one fixture.

However, on a literal reading, as suggested by Lord Browne-Wilkinson's second remark, the second part of section 59(1) of FA 1985 went further than this. It apparently produced the draconian result that if under Schedule 17 (subsequently Chapter VI of Part II of CAA 1990) there is more than one owner of a fixture, none of them is entitled to an allowance.

The differently worded provision in section 172(2) is designed to remove this draconian effect of the second part of section 51(1) of CAA 1990.

Change 27 Section 25(6) of CAA 1990: section 229

Section 229 is based on sections 25(6) and 60(2A) of CAA 1990, but contains changes which are consequential on Change 16.

Section 25(6) of CAA 1990 applies in limited circumstances only.

Section 25(6) applies only if a disposal value is due to be brought into account because of an assignment of the benefit of a contract. The only situation in which a person can be required to bring a disposal value into account because of an assignment of the benefit of a contract is where section 60 of CAA 1990 (hire-purchase and related contracts) applies.

Section 25(6) also applies only if section 25(5) or (5B) applies. In other words, it applies only if—

> *A.* a person is required to bring a disposal value into account for a chargeable period for which a first-year allowance is made, or
>
> *B.* capital expenditure has been incurred on the provision of plant or machinery for leasing under a finance lease and a person is required to bring a disposal value into account for the chargeable period in which the expenditure is incurred.

Where section 25(6) applies, its effect is to treat the person, for the purposes of section 25(1), as having incurred the total capital expenditure he would have incurred if he had wholly performed the contract.

This effect can be needed in relation to situation A only if the person concerned has not brought the plant or machinery into use. (If the person has brought the plant or machinery into use, section 60(2)(b) already accelerates the person's expenditure. This has been explained in Change 16.)

In situation B, the would-be finance lessor does not have accelerated expenditure because section 60(2A) prevents acceleration of expenditure irrespective of whether or not the plant or machinery has been brought into use. Section 25(6) then allows acceleration of expenditure if the person has to bring a disposal value into account because of an assignment.

Section 25(6) does not provide for the amount of the disposal value in the situations in which it applies. So the disposal value is the market value under section 26(1)(f) of CAA 1990.

So the purpose of section 25(6) might perhaps be thought to be, putting it crudely, to increase a person's expenditure so as to mop up an unduly large disposal value arising through the market value rule. But it is possible that, on a literal reading, section 25(6) could go further than this and give a taxpayer an unexpected windfall—i.e., if the deemed expenditure is greater than the disposal value required to be brought into account. It seems unlikely that such an effect was intended, since it does not fit with the general principles on which capital allowances are given.

Under Change 16, the disposal value provided for cases where the plant or machinery has not been brought into use will no longer be "market value". It will be "relevant capital sums". So it is necessary to decide what, if anything, should be put in place of section 25(6) of CAA 1990.

The Tax Law Rewrite Project's first proposal was to put nothing in place of section 25(6) of CAA 1990. At that stage it was thought that if the law were changed to give the new disposal value of "relevant capital sums" for cases where the plant or machinery has not been brought into use, section 25(6) would become redundant.

However, it was then thought that this could be too harsh on assignees in the anti-avoidance cases dealt with in Chapter 17 of Part 2. In anti-avoidance cases, the assignee's qualifying expenditure may (depending on the circumstances) be limited to the disposal value brought into account by the assignor. (See sections 218 and 224.)

Section 229 is designed to protect the assignee in an anti-avoidance context from an unduly depressed disposal value, by including the expenditure that will be incurred under the contract if it is wholly performed in the disposal value.

For cases where a finance lease is not involved (i.e., in situation *A* described above), section 229 is of wider scope than section 25(6). Section 229 applies in any case where a person who has not brought plant or machinery into use assigns the benefit of a contract, whereas, as explained above, section 25(6) applies only if the person has assigned the benefit of the contract in the chargeable period in which a first-year allowance is claimed.

For cases where a finance lease is involved (i.e., in situation *B* described above), section 229 is also wider than section 25(6). Section 229 applies in any case where the finance lessor, or would be finance lessor, assigns the benefit of the contract, whereas, as explained above, section 25(6) applies only if the assignment takes place in the chargeable period in which the expenditure is incurred.

The change in section 229 leaves the assignor in the same position he would be in if section 68 applied to him. This is because, although his disposal value is increased, his expenditure is increased by the same amount. It is, perhaps, rather artificial to treat him as incurring expenditure for the purpose only of bringing the disposal value into account, and then to take the expenditure away again by adding it to the disposal value. But this is thought to be the simplest way of protecting the assignee against a depressed disposal value.

Change 28 Additional VAT liabilities, first-year allowances and change of circumstances: section 237

Section 237 deals with situations where the circumstances which have given the taxpayer a first-year allowance in respect of original expenditure have changed by the time the taxpayer incurs an additional VAT liability.

Section 22 of CAA 1990 does not address directly the question of change of circumstances between incurring the original expenditure and incurring an additional VAT liability. But the answers can generally be deduced indirectly from the wording of section 22.

The following paragraphs do not attempt to deal with all possible changes in circumstances exhaustively. They discuss, first, the two cases which section 237 clarifies and, secondly, a case where CAA 1990 prevents first-year allowances from being made in respect of additional VAT liabilities but where section 237 does not.

Section 22(6B)(d) of CAA 1990 prevents first-year allowances being made in respect of expenditure if it is incurred on the provision of plant or machinery “for leasing”. A person who has incurred expenditure otherwise than “for leasing” may, by the time the additional VAT liability is incurred, be leasing the plant or machinery, or even leasing it in circumstances where section 42 of CAA 1990 would normally apply.

The mere fact that the plant or machinery is leased by the time the additional VAT liability is incurred may not prevent a person from obtaining a first-year allowance. This is because section 22(1B) treats the additional VAT liability as expenditure incurred on the provision of the plant or machinery for the purposes of the trade. But it does not expressly ascribe any specific purpose (such as leasing) to the incurring of the imaginary expenditure. So it is not clear whether section 22(6B)(d) prevents a first-year allowance being made where the plant or machinery is leased by the time the additional VAT liability is incurred.

Section 237(1) therefore represents a compromise between two possibilities: first that no first-year allowance is available if the plant or machinery is leased when the additional VAT liability is incurred; and, secondly, that a first-year allowance is available even if, by the time the additional VAT liability is incurred, the plant or machinery is leased in circumstances where section 42 applies to the original expenditure. It ensures that no first-year allowance is available in respect of an additional VAT liability if at the time when the liability is incurred the plant or machinery is used for “overseas leasing which is not protected leasing” (i.e., the equivalent of leasing which is within section 42(1) of CAA 1990).

A person may have incurred expenditure on the provision of plant or machinery for use primarily in Northern Ireland and then be subject to an additional VAT liability when the plant or machinery is no longer primarily used in Northern Ireland. The wording of section 22(3CA) appears to establish that the change in circumstances does not affect a person’s entitlement to a first-year allowance in respect of the additional VAT liability. But there cannot be any entitlement under section 22(3CA)(b) if by the time the additional VAT liability arises, section 22 is deemed never to have applied to the original expenditure under section 22B(1) of CAA 1990. It is simpler and more direct to prevent a first-year allowance being made in respect of the additional VAT liability in the first place, rather than to allow it to be made and then claw it back. This is what section 237(2) achieves. It produces a similar effect to CAA 1990, but by a different route.

The case where CAA 1990 prevents first-year allowances from being made in respect of additional VAT liabilities but where section 237 does not concerns permanent discontinuance of the trade.

Section 22(6B)(a) of CAA 1990 provides that no first-year allowance is to be made in respect of “any expenditure to which this section applies by virtue only of one or more of subsections (3C), (3CA), (3D) or (3E)” if the chargeable period in which the expenditure is incurred is also the chargeable period in which the trade is permanently discontinued. This appears to prevent a first-year allowance being made in respect of an additional VAT liability incurred in the chargeable period in which the trade is permanently discontinued. But section 237 does not prevent first-year allowances in this case.

However this change is not thought to result in any difference to the taxpayer’s overall entitlement to allowances. Even if he were not entitled to a first-year allowance in respect of the additional VAT liability, he would still be entitled to a balancing allowance in respect of that liability—see sections 55(4), 56(7) and 65.

Change 29 Limit on disposal value where additional VAT rebate made: section 239

Section 239 contains a taxpayer favourable change in the law. It is favourable because it means that a lower disposal value could be required to be brought into account where more than one additional VAT rebate is made and one of them "accrues" after an ordinary disposal event has occurred in respect of the plant or machinery.

In order to understand the problem that the change addresses, it is necessary to know two points about CAA 1990.

First, section 24(7) of CAA 1990 (which is reproduced in section 238) provides for an additional VAT rebate to be brought into account either as a separate disposal value (if there is no other disposal event in the chargeable period) or as an addition to a disposal value (if an ordinary disposal event also occurs in the chargeable period).

Secondly, the effect of section 159A(3) of CAA 1990 can be to require a disposal value to be brought into account for a chargeable period not only after that in which the additional VAT rebate is made but also after that in which the plant or machinery has been disposed of in the ordinary sense (for example, sold). The Act describes the chargeable period for which a disposal value is required to be brought into account as the chargeable period in which the additional VAT rebate "accrues". (This is a different approach from CAA 1990, which uses the idea of the rebate being "made" in two very different senses.)

An example of the problem that the change addresses is this.

If—

> a person incurs expenditure in one chargeable period of £1,000,000,
>
> an additional VAT rebate of £10,000 accrues in the next chargeable period,
>
> an "ordinary" disposal value is required to be brought into account in the next chargeable period of £995,000, and
>
> an additional VAT rebate of £7,500 accrues in the next chargeable period,

the effect of CAA 1990 is apparently to require the person to bring into account disposal values of £1,007,500 (£10,000, £990,000 and £7,500) in the three chargeable periods.

The limit in section 26(2A) of CAA 1990 applies in relation to the first disposal value, but beats the air (the limit is £1,000,000). The limit in section 26(2) applies to the second disposal value and cuts it back to £990,000 (the limit is £1,000,000 - £10,000). The limit in section 26(2A) applies to the third disposal value, but beats the air (the limit is £1,000,000 - £990,000).

It seems possible to produce a more appropriate limit in this situation by omitting "(other than the making of an additional VAT rebate)" in section 26(2A), and making some other small adjustments in the wording. This is the approach taken in section 239(3) and (4).

Change 30 Property treated as sold to person succeeding to qualifying activity: section 265(3)

Section 265 comes from section 78(1) of CAA 1990. Section 78(1) applies in a case where a person succeeds to a qualifying activity. It provides for the treatment of property used or available for use for the purposes of the activity immediately before and immediately after the succession takes place. Section 265(3) requires the property to have been owned by the predecessor immediately before the succession. Section 78(1) does not include this requirement.

Where section 78(1) applies, the property is treated as sold to the successor at market value when the succession takes place. Section 78(1) does not apply if the property has actually been sold to the successor. So the successor will not actually have incurred capital expenditure on acquiring it. This means that, if section 78(1) did not apply, the successor would not be able to claim allowances in respect of the property. The effect of section 78(1) is that he is treated as having incurred expenditure equal to the market value of the property.

It has generally been assumed that it is implicit in section 78(1) that it applies only where there is a change in ownership. But in fact section 78(1), read literally, could apply even if the predecessor did not own the property before the succession took place. For example, plant or machinery could be on loan to and used by a trader who then dies and the plant or machinery could be treated as loaned to the successor who continues to use it. In these circumstances it would be wrong to treat the person succeeding to the trade as having bought the plant or machinery at market value. This change prevents that happening.

Change 31 Effect of election for continuity on succession to qualifying activity: section 267(2)(a) and (3)

Section 267 is based on section 77(4) of CAA 1990. Section 77(4) deals with the effect of an election under section 77(3). The election is made where a person succeeds to a qualifying activity previously carried on by a person connected with him.

The closing words of section 77(4)(a) of CAA 1990 provide that the machinery or plant affected by the election is to be treated as sold by the predecessor to the successor at a price which does not give rise to a balancing allowance or balancing charge. There is nothing express as to when the sale is to be treated as happening. But section 267(2)(a) provides for the sale to be treated as occurring when the succession takes place. This is probably implicit in CAA 1990: in section 77(4)(a), sub-paragraphs (i) and (ii) are in terms of the time of the succession and it is difficult to find anything to suggest that the deemed sale is to be treated as occurring at a different time. But, in theory at least, making the time of the deemed sale explicit removes the opportunity for taxpayers to argue that a different time is intended. That might make a difference as the price that gives rise to neither a balancing allowance nor a balancing charge will be different according to when the sale is assumed to occur.

Section 77(4)(a) of CAA 1990 identifies the property that is treated as sold. This is property that, immediately before the succession, belonged to the predecessor and was in use for the purposes of the qualifying activity and, immediately after it, belonged to the successor and was in use for those purposes. Section 267(3) also catches property that was not actually in use but was provided and available for use before and after the succession. This enables the "continuity" election to have effect in relation to a greater range of property and so is beneficial to taxpayers. The change means that the property affected by the election is the same as that affected by the general succession rule in section 78(1) of CAA 1990 (section 265(3)) and the rule about succession on death in section 78(2) of CAA 1990 (section 268(4)).

Change 32 Buildings used by more than one licensee: section 278

Section 278 provides that a building used by more than one licensee of the same person is not in use for the purposes of a qualifying trade unless each licensee uses it, or the part of the building to which the licence relates, for the purposes of a qualifying trade.

In Part 3, "qualifying trade" includes not only a trade which would have fallen within section 18(1) of CAA 1990, but also an undertaking which would have fallen within section 18(1). (The undertakings in question are transport, dock, inland navigation, water, sewerage, electricity, hydraulic power, tunnel, bridge or highway undertakings.)

Section 278 is based on, but probably goes further than, section 18(6) of CAA 1990, because section 18(6) refers to a trade which falls within section 18(1) (and not to an undertaking). (Cf. subsections (2) and (3) of section 18 which refer to a trade or undertaking.)

Section 18(6) of CAA 1990 derives from an amendment made by section 74 of FA 1982. That amendment was part of a package designed to extend 100% initial allowances to cases where "small workshops" were used by licensees. I.e., the amendments were provoked by a need to deal with trades. And in practice use of buildings by more than one undertaking within section 18(1) is unlikely to be common.

But there seems to be no reason why industrial buildings allowances should be available where a building (or part of a building) is used by one licensee carrying on an undertaking within section 18(1) but denied if there is another licensee using the same building (or part of the building) and who is carrying on an undertaking or trade within section 18(1).

Change 33 Roads on industrial estates etc.: section 284

Section 284(1) provides that a road on an industrial estate is an industrial building if the estate consists wholly or mainly of buildings that are treated under Part 3 as industrial buildings. Section 284(2) extends the meaning of "industrial estate", in relation to qualifying enterprise zone expenditure, to include an area (such as a business park) which consists wholly or mainly of commercial buildings.

Section 284 is based on, but goes further than, section 18(8) of CAA 1990.

Under section 18(8) of CAA 1990 a road on an industrial estate is to be treated as used for the purposes of a trade within section 18(1) if the buildings and structures are used wholly or mainly for the purposes of a trade falling within section 18(1).

Section 18(8) overcomes the problem that a person who has an interest in the road may not have an interest in any buildings or premises used for the purposes of a trade within section 18(1).

But section 18(8) is limited, for a number of reasons.

> The estate might include buildings used for the purposes of the undertakings specified in section 18(1).
>
> The estate might include a "qualifying hotel" or a "qualifying sports pavilion". (These qualify for industrial buildings allowances by way of sections 1(2), 6 and 14 of CAA 1990.)
>
> In enterprise zones, industrial buildings allowances are available for "commercial buildings". (See sections 1(2) and 6 of CAA 1990.) A commercial building or structure is one used for the purposes of a profession or vocation or as an office or offices. (See section 21(5) of CAA 1990.)

The effect of section 284, therefore, is to extend the availability of industrial buildings allowances in respect of roads to include cases where the buildings on the industrial estate are wholly or mainly "industrial buildings" in the special sense used in the Act, and, in the case of enterprise zones, to make industrial buildings allowances available for roads in areas consisting wholly or mainly of commercial buildings (such as business park).

This change is wholly in favour of the taxpayer.

Change 34 Acquisition of interest as a result of incurring expenditure on construction: sections 287 and 496

Section 287 treats a person who incurs expenditure on the construction of a building and is entitled to an interest in the building on <u>or as a result of</u> the completion of the construction as having had that interest in the building when the expenditure was incurred.

This goes further than section 21(2) of CAA 1990. The literal effect of section 21(2) is that the interest that is back dated is the interest that the person has at the time when the construction is completed. If there is an interval between the completion of the construction and the acquisition of the interest, section 21(2) appears not to apply. But in practice section 21(2) has been operated on the basis that small intervals between the completion of the construction and the acquisition of the interest do not matter.

The change in section 287 is a change in favour of the taxpayer. The relevant interest is crucial to entitlement to industrial buildings allowances; so extending the circumstances when the taxpayer is treated as having the relevant interest can only work in the taxpayer's favour.

The same change is made in section 496, a corresponding section relating to assured tenancy allowances. Section 496 is based on section 97(3) of CAA 1990.

Assured tenancy allowances are available for expenditure incurred no later than 31st March 1992. The change in wording is nevertheless worth making because it means that the section reflects how section 97(3) has been applied in practice (and how it would be applied in any case where the building on which the expenditure was incurred has not been completed before Part 10 applies—a fairly unlikely scenario).

Change 35 Commercial buildings in enterprise zones: section 305(1)

Section 305(1) resolves a question of interpretation in section 1 of CAA 1990. It makes clear that initial industrial buildings allowances are available in respect of all commercial buildings in enterprise zones and not just commercial buildings occupied for the purposes of a trade. This clarification is favourable to the taxpayer.

100% initial allowances for buildings (and structures) in enterprise zones were introduced by section 74 of, and Schedule 13 to, FA 1980.

The buildings and structures for which the allowances were made available in 1980 were not only traditional industrial buildings and structures (those used for the purposes of various specified trades and undertakings carried on by way of trade) but also commercial buildings and structures.

"Commercial building or structure" was defined by section 74(4) of FA 1980 to mean a building or structure used for the purposes of a trade, profession or vocation or in use as an office or offices. A building or structure in use as a dwelling-house was excluded.

Section 1(1) of CAA 1968 contained a requirement that, for initial allowances to be available, the industrial building or structure was to be occupied <u>for the purposes of a trade</u> carried on by the person concerned or by a lessee.

FA 1980 extended initial allowances to commercial buildings and structures in enterprise zones by means of a drafting device which reduces the number and length of amendments required. Section 74(1)(b) of FA 1980 applied Chapter I of Part I of CAA 1968 (the pre-consolidation provisions relating to industrial buildings allowances) in relation to a commercial building or structure in an enterprise zone "as if it were an industrial building or structure".

The use of this drafting device meant that, in the case of a commercial building or structure in an enterprise zone, it was possible to infer that the requirement in section 1(1) of CAA 1968 that the building or structure was to be occupied "for the purposes of a trade" did not apply.

The fact that this was meant to be inferred is shown by ministerial statements made when FA 1980 was going through Parliament. The Chancellor of the Exchequer, Sir Geoffrey Howe, stated that in enterprise zones there would be "100 per cent. allowances for both industrial and commercial buildings" (without any exceptions mentioned). (See HC Deb. 26th March 1980 at col.1488.) The Financial Secretary to the Treasury, Nigel Lawson, during the Committee stage of the Bill gave as an example of an office that would obtain 100 per cent. allowances, an office of the Labour Party, if it set one up in an enterprise zone, despite the fact that it was not a trade, profession or vocation. (See HC Deb. 4th June 1980 at col. 1515.)

When the legislation was consolidated, the consolidator, perhaps unaware of the inwardness of section 74(1)(b), changed the wording so that it was more direct. Section 1(2) of CAA 1990 said—

> "In this section . . . any reference to an industrial building or structure shall include a reference to . . . a commercial building or structure."

The new wording made it more difficult to conclude that initial allowances are available for all commercial buildings (irrespective of whether they are occupied for the purposes of a trade).

Someone who is ignorant of the legislative history might conclude from section 1(2) of CAA 1990 that initial allowances are available for a subset of commercial buildings only: those to be occupied for the purposes of a trade. Commercial buildings occupied for the purposes of a profession or vocation, or as offices, might be meant to be entitled to writing-down allowances only.

On the other hand someone who knows the legislative history is likely to read section 1 as conferring entitlement to initial allowances in respect of commercial buildings occupied for the purposes of a profession or vocation or as offices.

In weighing up these two interpretations, a relevant question is whether there is any point in adding commercial buildings and yet keeping the "for the purposes of a trade" requirement in section 1(1).

If the answer to that is "no", that would be strong evidence that the first interpretation mentioned above must be wrong.

But the answer to that question is not "no". Buildings and structures which are industrial buildings and structures under section 18 of CAA 1990 do not include shops (see section 18(4)). But shops are usually run by traders. So it would be possible to read the legislation as giving entitlement to 100% initial allowances in respect of commercial buildings occupied by traders and for the other commercial buildings to have writing-down allowances only.

If a provision in a consolidation is ambiguous, a court can rely on the presumption that a consolidation does not change the law in order to preserve the effect of the pre-consolidation legislation. But there is an issue of interpretation here and section 305(1) may change the law in favour of the taxpayer.

Change 36 Miscellaneous changes consequential on Change 35: sections 306(4), 352(2) and 354(6)

Sections 306(4), 352(2) and 354(6) contain miscellaneous changes that follow through Change 35 to its logical conclusion.

Section 306(4) treats a person who has incurred expenditure for the purposes of a trade, profession or vocation that the person is about to carry on as if the expenditure were incurred on the first day on which the trade, profession or vocation is carried on. This postponement of the time when expenditure is treated as incurred applies for the purpose of identifying the chargeable period for which an initial allowance is to be made. Section 306(4) is based on section 1(10) of CAA 1990, which merely refers to a trade.

Section 352(2) provides for allowances and charges to be given effect in calculating the profits of a profession or vocation in cases where a commercial building is occupied for the purposes of the profession or vocation. CAA 1990 does not contain any provision enabling industrial buildings allowances to be given effect in calculating the profits of a profession or vocation. If the interest in the building is subject to a lease or licence, allowances could be given effect under section 9(2) of CAA 1990. But this is unlikely to be the case if the person concerned is occupying the building. It is thought that in practice allowances are given effect in calculating the profits of the profession or vocation.

Section 354 is based on section 15ZA of CAA 1990 and deals with giving effect to allowances and charges where a building is temporarily out of use. Subsection (6) of section 354 follows through the logic of the change in section 352 and enables section 354 to apply to professions and vocations.

Change 37 Withdrawal of initial allowances: section 307(4)

Section 307(4) provides for assessments and adjustments of assessments to be made to give effect to the section.

Section 307 provides for an initial allowance to be withdrawn if—

> when the building is first used, it is not an industrial building (see section 307(2)), or

> the relevant interest in the building is sold before the building is first used (see section 307(3)).

Subsection (4) of section 307, in so far as it relates to subsection (2), comes from section 1(6) of CAA 1990. (The only difference in wording—so small as to be hardly worth mentioning—is that subsection (4) follows the standard form of provision in referring to "adjustments of assessments" as well as "assessments".)

There is no express counterpart in CAA 1990 for subsection (4) of section 307 so far as it relates to subsection (3).

Section 307(3) comes from sections 10(1)(a) and 10A(2)(a) of CAA 1990, which provide that if there is such a sale "the expenditure . . . shall be left out of account for the purposes of [provisions which include the section enabling initial allowances to be given]".

The words "shall be left out of account" are mandatory. Sections 10(1)(a) and 10A(2)(a) make clear that the person is not entitled to an initial allowance if the building is sold before first use. The change goes to the mechanics for ensuring that the rule is given effect. Without this provision, the Revenue would normally be able to rely on the power to make assessments under the more elaborate provisions contained in section 29(1) and (5) to (8) of TMA 1970 or paragraphs 41 and 44 of Schedule 18 to FA 1998. (And no provision is needed unless time has run out for using section 34 of TMA or paragraph 46 of Schedule 18 to FA 1998.)

Change 38 Claim for reduction in amount of allowances: sections 309(2), 372(3), 418(6), 441(3), 458(4), 472(4), 487(6) and 507(2)

Section 309(2) enables a person claiming a writing-down allowance in respect of expenditure on an industrial building to require the allowance to be reduced to a specified amount. Sections 372(3), 418(6), 441(3), 458(4), 472(4), 487(6) and 507(2) make corresponding provision in relation to agricultural buildings allowances, mineral extraction allowances, research and development allowances, know-how allowances, patent allowances, dredging allowances and assured tenancy allowances.

CAA 1990 does not include any provision to this effect in respect of these allowances. So, on the face of it, if a taxpayer chooses to claim one of these allowances, he or she must claim the full amount. As the taxpayer can choose to claim no allowance at all, there is no reason to prevent him or her from claiming an allowance of a reduced amount. This is already permitted in practice.

The change also brings these allowances into line with those for which CAA 1990 makes express provision for claiming a reduced amount. Section 1(5) of CAA 1990 permits a claim for a reduced amount of an initial allowance in respect of industrial buildings and sections 22(7), 24(3) and 30(1)(b) of CAA 1990 do the same in relation to first-year allowances and writing-down allowances in respect of plant and machinery.

Change 39 Writing off research and development allowances for IBA purposes: sections 335(1), 441(1) and 442

Section 8(5) of CAA 1990 operates to treat expenditure incurred on the construction of a building or structure as reduced, for the purpose of Part I of CAA 1990, by the amount of any research and development allowance given under section 137 or 138 of CAA 1990. Section 8(5) of CAA 1990 is rewritten by section 335(1). But a change in approach in Part 6 in relation to research and development allowances means that the amount of the expenditure may in certain circumstances be treated as reduced by a smaller amount. That would benefit the taxpayer.

Under section 137(1) of CAA 1990, a person who incurs allowable research and development expenditure is entitled to an allowance equal to the whole of that expenditure. If an asset representing that expenditure ceases to belong to the person in the same or a later chargeable period, he may suffer a charge under section 138(2) of CAA 1990.

For example, suppose that X incurs allowable research and development expenditure of 100 on constructing a building and in the same chargeable period, but after using the building, sells the relevant interest in the building for 70. X would be entitled to an allowance of 100 under section 137(1) and subject to a charge of 70 under section 138(2).

Section 441(1) adopts a different approach in this case. The person would be entitled to a net allowance, i.e. an allowance equal to the expenditure less the disposal value, and would not be subject to a charge (see section 442). In our example, X would be entitled to an allowance of 30 (100 minus 70).

The effect for the purpose of Part 6 is therefore the same. But this change in approach has an impact on section 335(1) which rewrites section 8(5).

Section 8(5) requires the allowance under section 137(1)—in our example, 100—to be written off. But section 335(1) requires the amount of the allowance under Part 6—in our example, only 30—to be written off.

This change in approach in Part 6 means that the expenditure on which a person (in our example, the person buying the relevant interest in the building from X) can obtain allowances under Part 3 may be reduced by a smaller amount. So it benefits the taxpayer.

Section 335(1) refers to "an allowance under Part 6", whereas section 8(5) of CAA 1990 mentions allowances under sections 137 and 138 of CAA 1990. Section 138(3), which has not been rewritten, is discussed in Change 51.

Change 40 Just and reasonable apportionment: sections 356(1), 369(4) and (5), 370(3), 384(1), 412(2), 438(5), 439(4), 440(3), 485(2), 530(1) and 562(3)

Section 356(1) refers to so much of a sum as, on a just and reasonable apportionment, is attributable to particular assets. In contrast, section 21(3) of CAA 1990, on which section 356(1) is based, refers to an amount which, on a just apportionment, is so attributable.

Sections 369(4) and (5), 370(3), 384(1), 412(2), 438(5), 439(4), 440(3), 485(2), 530(1) and 562(3) also refer to apportionment on a just and reasonable basis, or such part as is just and reasonable. The provisions of CAA 1990 on which they are based are all in terms of apportionment on a just basis, or a just proportion. (Those sections are, respectively, sections 124(1)(a) and (b), 133(7) (for both sections 370(3) and 384(1) of the Act), 117(4), 137(3), 137(4), 137(2), 134(6), 97(4) and 150(1)).

The change from "just" to "just and reasonable" makes these provisions consistent with all the other provisions of the Act that require an apportionment to be made (whether expressed as such or in terms, for example, of an attribution of an amount). It is not thought that it will make much difference in practice to the outcome of the apportionment.

Change 41 Agricultural buildings: section 361(1)(a)

Section 361(1)(a) is based on part of section 123 of CAA 1990. Section 361 enables agricultural buildings allowances to be made if capital expenditure has been incurred on the construction of a building (such as a farmhouse, farm building or cottage) or on the construction of fences or other works.

In contrast, the equivalent part of section 123 of CAA 1990 applies where expenditure has been incurred on the construction of farmhouses, farm buildings, cottages, fences or other works.

The wording has been changed to take account of the fact that "husbandry" for the purposes of agricultural buildings allowances includes first, the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption and, secondly, short rotation coppicing.

The extension of the meaning of "husbandry" to include the intensive rearing of livestock was made in 1986 when agricultural buildings allowances were overhauled. It gave effect to ESC B2. The note to that concession explained—

> "In order that expenditure may qualify for agricultural capital allowances, it must be incurred for the purposes of husbandry. This term is not defined, but it is clear from dicta of the courts that many broiler houses cannot be regarded as coming within it. If a broiler house belonged to a farmer who raised the chicks or grew their food to a material extent on his own farm, the house would qualify for capital allowances, but if its proprietor had no agricultural land and bought in all his chicks and all their food, it would not . . .
>
> In principle, all broiler houses should qualify for capital allowances and at the same rates. It has, therefore, been decided to treat them all as though they were agricultural buildings . . ."

It does not seem entirely apt to describe a building which is not on agricultural land as a "farm building". The new wording is meant to be more apt to cover this case.

The phrase "farm building" may also not be entirely apt to describe buildings put up for the purposes of short rotation coppicing. Again, the new wording is meant to be more apt.

This relaxation in the wording ought not to open the floodgates to claims, because there is still a requirement that the expenditure must (under both the Act and CAA 1990) have been incurred "for the purposes of husbandry". So any extension in the availability of agricultural buildings allowances is likely to be of very limited scope.

Change 42 New lease of whole or part of agricultural land: section 368(2) and (3)

Subsections (2) and (3) of section 368 apply where the relevant interest is a leasehold interest in the agricultural land in question, that interest comes to an end, and a new lease is granted of the whole or a part of the agricultural land.

In contrast, paragraphs (a) and (b) of section 126(5) of CAA 1990 (on which subsections (2) and (3) of section 368 are based) apply if a new lease is granted. They make no express reference to the land in which the new lease must subsist.

It is implicit in section 126(5) of CAA 1990 that the new lease is one relating to the same land. (The reasons for this are given below, since it is a point on which some consultees expressed doubts.)

But section 368 goes further than CAA 1990 by dealing expressly with the situation where the new lease is a lease of <u>part</u>, rather than of the <u>whole</u>, of the land which was the subject of the old lease. Section 368 reflects the way in which section 126(5) has been operated in practice, namely, that if the new lease is of <u>part</u> of the land, the tenant under the new lease is treated as having the relevant interest in the <u>whole</u> of the related agricultural land.

This changes the law in favour of the tenant farmer, because it means that his allowances will not pass to the landlord.

The reasons for supposing that under CAA 1990 the new lease must relate to the same land as the old lease are as follows.

Section 126(5) deals with the situation where a lease "comes to an end". This implies that the subsection is dealing essentially with <u>replacement</u> leases, not with leases of entirely different land. If the land could be entirely different land, it would be irrelevant whether the old lease was coming to an end.

Section 126(5)(a) refers to the "outgoing lessee". The phrase "outgoing lessee" is apt to describe a situation where one lessee moves out and another lessee moves in. The phrase is entirely inapt to describe the situation where the new lessee has a lease of completely different land.

The interpretation just offered of section 126(5)(a) is supported by the legislative history. Amendments were made, in response to representations from the National Farmers' Union, during the Committee stage of the Bill from which sections 125 and 126 derive. (The Bill that became FA 1986.) The purpose of one of the amendments was to ensure that what is now section 126(5)(a) could apply where a father surrendered his lease so that his son could take over. (The amendment added the words now in section 125(4) "then, unless a new lease of the land concerned is granted to take effect on the extinguishment of the former lease".)

Section 126(5)(b) deals with a situation where a new lease is granted to a person who was the lessee under the old lease. It derives from another Committee stage amendment made in 1986. The need to tackle this point emerged when the representations of the National Farmers' Union mentioned in the previous paragraph were being considered. It was designed to ensure that a tenant farmer's allowances should not pass to the landlord simply because the tenant farmer took on a new lease.

If, contrary to what is suggested in the last three paragraphs, section 126(5)(b) could apply where the tenant under the old lease took on a lease of completely different land, then it would appear that the tenant under the old lease could acquire two new leases of different land, each of which would have to be treated as "the same relevant interest" as the old lease. That would not make much sense.

Change 43 Capital sum paid for relevant interest before first use of agricultural building: section 370(1)(d)

Section 370 provides for expenditure to be qualifying expenditure if the relevant interest is sold before the agricultural building etc. in question is used and the purchaser pays a capital sum for the interest.

In contrast, section 127 of CAA 1990 treats the purchaser as having incurred expenditure "falling within section 123" (the section providing for allowances) without any express requirement for the expenditure to be capital in nature.

One reading of section 127(2)(c) of CAA 1990 is that it enables the purchaser to obtain allowances under section 123 of CAA 1990 even if his expenditure is revenue expenditure.

But if the purchaser's expenditure is revenue in nature, he can obtain a deduction for all of it in calculating his profits. He would not want to write it down over 25 years by claiming writing-down allowances—unless, of course, he were able to claim writing-down allowances as well as a revenue deduction.

It seems unlikely that section 127(2)(c) of CAA 1990 was intended to enable allowances to be given in respect of revenue expenditure.

Giving allowances in respect of revenue expenditure would run counter to the purpose of capital allowances, which is to provide relief in respect of capital expenditure.

The corresponding provisions for industrial buildings allowances and assured tenancy allowances (sections 10, 10A, 10B and 91 of CAA 1990) do not provide relief for revenue expenditure. They treat the person who purchases the relevant interest in a building before the building is used as having incurred "expenditure" on the construction of the building concerned. They do not treat the expenditure as being "capital expenditure". To qualify for allowances, the expenditure still has to meet the requirement in section 1, 3 or 85 of CAA 1990 that it is capital in nature.

Whether the construction expenditure treated as incurred meets that requirement can only turn on the nature of the purchaser's actual expenditure on buying the relevant interest. The Act reflects this in sections 295(1), 296(2), 502(1) and 503(2), all of which require a capital sum to have been paid by the purchaser for allowances to be available.

It is possible to interpret section 127(2)(c) of CAA 1990 as producing a similar result for agricultural buildings allowances. Section 127(2)(c) can be read as merely intended to take the purchaser's expenditure over the hurdle in section 123 that the expenditure has to have been incurred on the construction of the agricultural building. The words "falling within section 123" are not meant to be read as converting revenue expenditure into capital expenditure. This interpretation produces an outcome that is consistent with other provisions relating to capital allowances and in particular with those relating to industrial buildings and assured tenancy allowances.

But the fact that (under the Act) it will no longer be possible for taxpayers to argue that agricultural buildings allowances are available in respect of revenue expenditure means that this change is at least in theory adverse to them.

Change 44 "Ceases to exist as such" and "ceases altogether to be used": sections 381(2)(c) and 383, Table, item 4

Sections 381(2)(c) and 383, Table, item 4 treat the fact that an agricultural building "ceases altogether to be used (without being demolished or destroyed)" as a balancing event. This is a change compared with section 129(1)(b) of CAA 1990 which refers to the fact that the building "otherwise [i.e., otherwise than by demolition or destruction] ceases to exist as such".

Section 129(1)(b) of CAA 1990 is in similar terms to sections 24(6)(c)(iii) (disposal event for plant and machinery allowances) and 101(8)(b) (disposal event for mineral extraction allowances) of CAA 1990. The disposal value for events within sections 24(6)(c)(iii) and 101(8)(b) is given by section 26 of CAA 1990. But the amount to be brought into account when a balancing event within section 129(1) occurs is determined by subsections (4) and (5) of section 128. Those subsections refer to the "sale, insurance, salvage or compensation moneys" received. Section 156 of CAA 1990 identifies what is meant by "sale, insurance, salvage or compensation moneys" by reference to different kinds of balancing events.

"Ceasing to exist as such" is not referred to in the list of events in paragraphs (a) to (d) of section 156. So, on a literal reading, section 156 appears not to provide any "sale, insurance, salvage or compensation moneys" in relation to a building or structure "ceasing to exist as such". But section 156 does identify "proceeds" for a case where a building or structure "ceases altogether to be used" (see section 156(d)). "Ceasing altogether to be used" is a balancing event for industrial buildings allowances (see section 4(1)(d) of CAA 1990) and assured tenancy allowances (see section 87(1)(c) of CAA 1990). A building or structure that has ceased to exist as such will have ceased altogether to be used and so it is arguable that section 156(d) is meant to apply in a case where the building or structure has ceased to exist as such.

Given the similarities between industrial buildings allowances and agricultural buildings allowances, it seems most likely that the balancing events described in section 129(1)(b) ought to have been the same as those described in section 4(1)(d): namely, that the building in question is demolished or destroyed or (without being demolished or destroyed) ceases altogether to be used.

The change cannot give rise to an unwanted balancing charge, because no event is a balancing event unless the taxpayer elects for it to be one. This is the position under CAA 1990 and the Act does not change that.

The change widens the range of circumstances in which a balancing allowance could be available, but could conceivably decrease the amount of the allowance in some cases. But the practical effects are limited by the fact that, under both CAA 1990 and the Act, the event is limited to the case where there is no demolition or destruction involved.

A taxpayer whose agricultural building ceases altogether to be used, without ceasing to exist as such, could be better off as a result of the change. Under CAA 1990, there would be no balancing event and so no possibility of any balancing allowance. But under the Act, the taxpayer may be entitled to a balancing allowance.

A taxpayer whose agricultural building ceases to exist as such might possibly be disadvantaged by this change. Before the change, the taxpayer could elect to treat the event as a balancing event and then argue that there were no "sale, insurance, salvage or compensation moneys" under section 156 to deduct from the residue of the expenditure. If this argument were successful, he would be able to have a balancing allowance without any deduction. But it is not clear whether the argument would succeed. A court might feel able to conclude that, since a building that has ceased to exist as such will have ceased altogether to be used, section 156(d) must be meant to apply. So the change can only affect taxpayers adversely if a very literal approach is taken to the interpretation of CAA 1990.

Change 45 Calculation of residue of qualifying expenditure: section 386

Section 386 defines the residue of qualifying expenditure as the qualifying expenditure, plus balancing charges made in respect of it, less allowances made in respect of it. In contrast, section 128(2)(a) of CAA 1990 defines it as qualifying expenditure less allowances made in respect of it.

So section 386 enables the residue to be increased by the amount of any balancing charges made. This change is advantageous to taxpayers. It reflects generally recognised practice.

Change 46 Overall limit on balancing charge: section 387

Section 387 restricts the amount of a balancing charge by reference to the total allowances made under Part 4 "for chargeable periods ending before that in which the balancing event occurs". In contrast, section 128(6) of CAA 1990 (on which section 387 is based) refers simply to the agricultural buildings allowances made "before the balancing event".

The literal effect of the wording in section 128(6) is that the amount of the limit on the balancing charge does not include an allowance which will be made for the chargeable period before the balancing event has occurred but which has not yet been made. (For example, an allowance for a chargeable period ending in July, where the balancing event occurs in August.)

But the literal effect of the wording cannot be the intended effect. It would defeat the purpose of section 128(6) if a person could reduce the limit on the balancing charge simply by delaying a claim for an allowance for the previous period. If faced with the question, a court might feel able to construe section 128(6) as not producing this literal result.

But it cannot be guaranteed that a court would reach this conclusion. If the correct interpretation of section 128(6) of CAA 1990 is that an allowance not yet made is not included in the limit on the balancing charge, section 387 contains a change which is adverse to the taxpayer.

Change 47 The condition that, for mineral extraction allowances, expenditure must be incurred for the purposes of a mineral extraction trade: sections 400, 403, 407, 408, 409, 414 and 415

Part 5 builds the requirement that expenditure must be incurred for the purposes of a mineral extraction trade into the definition of "qualifying expenditure". (The sections that contain this requirement are those listed in the heading.)

In contrast, section 98(1) of CAA 1990 does not build the "for the purposes of the trade" requirement into the definition of "qualifying expenditure". Instead, it requires that the qualifying expenditure is incurred by the person for the purposes of the mineral extraction trade.

The re-shuffling of concepts effected in the Act cannot make any difference except in relation to the qualifying expenditure consisting of "restoration" expenditure that is dealt with in section 109 of CAA 1990.

Here the new approach ensures that the rewritten legislation reflects how section 109 has been administered in practice. The practical administration of restoration expenditure is favourable to the taxpayer. The taxpayer is not expected to have incurred the restoration expenditure for the purposes of the trade. In many cases observing the strict letter of the law would rule out claims for allowances.

The following paragraphs explain the problem that the change is designed to cure in more detail.

Restoration expenditure is dealt with in section 109 of CAA 1990. Section 109 provides (very broadly speaking) that if a person who has ceased to carry on a mineral extraction trade incurs expenditure on the restoration of the site (for instance by landscaping) the expenditure is "qualifying expenditure".

Nothing in section 109 expressly exempts restoration expenditure from the requirement in section 98(1) of CAA 1990 that, for allowances to be available, the expenditure must have been incurred for the purposes of the mineral extraction trade.

But if the expenditure is incurred after the trade has ceased, it is difficult to see how it can be described as incurred for the purposes of the trade. It might, perhaps, be possible to say that the expenditure was incurred for the purposes of the trade if, in order to carry on the trade, the trader entered into a commitment to carry out post-trading restoration work.

To treat restoration expenditure as being subject to the requirement in section 98(1) that the expenditure must be incurred for the purposes of the mineral extraction trade would significantly restrict the availability of allowances for restoration expenditure. An accident of wording would be defeating the underlying purpose of CAA 1990. So in practice CAA 1990 has been operated on the basis that restoration expenditure is not subject to the "for the purposes of the trade" requirement.

Change 48 "Existing permitted development" in the case of land outside the UK: sections 404(5)(b), 422(4)(b) and 424(5)(b)

Sections 404(5)(b), 422(4)(b) and 424(5)(b) are about a test for determining whether development is "existing permitted development" in cases where the land in question is outside the United Kingdom. They provide that, in relation to land outside the United Kingdom, whether development could be lawfully carried out under planning permission granted by a general development order is to be determined as if the land were in <u>England</u>.

In contrast, section 110(3)(b) of CAA 1990 provides that, for land outside the United Kingdom, whether development is permitted under a general development order is to be determined as if the land were situated in <u>England or Wales</u>.

With devolution it has become possible for planning requirements to differ as between England and Wales. It is unclear how the test in section 110(3)(b) would apply. Who would be entitled to decide where the land was to be treated as situated? Since the test is merely a hypothesis, the simplest solution is to require the reader to assume that what is permitted under a general development order is what would be permitted if the land were situated in <u>England</u>.

At present the change in wording has no practical effect since the power to make a different general development order in relation to Wales has not yet been exercised.

Change 49 Research and development allowances: limiting balancing charges by reference to unclaimed allowance: sections 442(3) and (4) and 449

Under Part VII of CAA 1990 it is not clear that a person can claim part only of a research and development allowance. Section 441(3) makes it clear that he can do so—see Change 38. A corresponding change is necessary to ensure that a person who claims only part of an allowance to which he is entitled does not suffer a balancing charge where the disposal value he is required to bring into account does not exceed his unclaimed allowance. Sections 442(3)(a) and (4) and 449(2) make this taxpayer favourable change.

For example, suppose a person incurs allowable expenditure of 100 but claims an allowance of only 80. In a later chargeable period he disposes of the asset representing the expenditure for 10.

If section 442(3)(a) did not contain the "exceeds any unclaimed allowance" limb, he would suffer a balancing charge of 10. But the taxpayer has incurred net expenditure of 90 on the research and development so it would be unfair to reduce the allowance of 80 made to him. Subsection (3)(a) prevents him from suffering a balancing charge as his disposal value of 10 does not exceed his unclaimed allowance of 20.

In fact, if one were to assume that it is possible to claim a reduced allowance under CAA 1990, one would get the same result in this example. Section 138(2) of CAA 1990 imposes a charge where an asset representing allowable research and development expenditure incurred by a person ceases to belong to him. The amount of the charge is equal to the disposal value plus the allowance made minus the expenditure (section 138(2)(a)) subject to a limit of the amount of the allowance made (section 138(2)(b)). In this case the disposal value of 10 plus the allowance made of 80 minus the expenditure of 100 gives a total of -10. So he would not be charged.

However, CAA 1990 does not give this result where the charge arises because of the making of an additional VAT rebate. If in the above example the person had not ceased to own the asset but instead had received an additional VAT rebate of 10, he would be charged 10 under section 138(3A) of CAA 1990.

But section 442 applies equally in the case of disposal values arising from the making of additional VAT rebates. So the person would not suffer a balancing charge under section 442(3)(a) in such a case. The disposal value of 10 required to be brought into account under section 448(4)(a) would not exceed his unclaimed allowance of 20.

This is a change in the law in favour of the taxpayer. But section 442(3)(a) and (4) must be read with section 449(2) which is a new provision. Section 449(2) ensures that a disposal value which is brought into account as a result of making an additional VAT rebate but which escapes charge because of section 442(3)(a) is not simply ignored altogether. Under section 449(2) the disposal value "uses up" the unclaimed allowance for the purpose of later chargeable periods.

Suppose in our example that the person receives a further rebate of 15 in the next chargeable period. Without section 449(2) he would seem again to avoid a balancing charge because his disposal value of 15 is less than his unclaimed allowance of 20. But this is plainly not right. Had he received a single VAT rebate of 25, he would have suffered a balancing charge of 5 (i.e. disposal value of 25 minus unclaimed allowance of 20). His unclaimed allowance should have been partly "used up" by the first rebate of 10.

This is what section 449(2) does. In our example, the unclaimed allowance of 20 would have been reduced by the disposal value of 10 which escaped charge. So he would suffer a balancing charge of 5 in respect of the rebate of 15 (i.e. disposal value of 15 minus unclaimed allowance of 10). For the next chargeable period his unclaimed allowance would then be nil, i.e. 20 minus (25 minus 5).

Section 442(3)(b) limits the balancing charge so that a person does not suffer a charge exceeding the allowance made to him. This limit now appears to apply to charges arising as a result of additional VAT rebates. But the limit in section 138(2)(b) of CAA 1990 (on which it is based) does not apply to charges arising as a result of such rebates (which fall to be made under section 138(3A)).

Although this appears to be a change in the law, it is not right to regard it as such. This is because the amount of additional VAT rebates will never in practice (assuming a VAT rate of not more than 100%) exceed the amount of the expenditure in respect of which they are given. So section 442(3)(b) will not in practice apply to limit the balancing charge arising from the making of a VAT rebate. It could only apply—as section 138(2)(b) of CAA 1990 does—to limit the amount of the balancing charge arising from a real disposal (i.e. from ceasing to own an asset representing qualifying expenditure).

The limit in section 442(3)(b) which applies on a real disposal must be read with section 449(3). Section 449(3) reduces the limit by the total of any balancing charges imposed in respect of the qualifying expenditure in earlier chargeable periods as a result of additional VAT rebates. It is based on section 138(2A) of CAA 1990. That provision operates to reduce the limit in section 138(2)(b) by the total of any trading receipts treated as accruing in respect of the allowable research and development expenditure in earlier chargeable periods as a result of additional VAT rebates. So section 449(3) does not change the law.

Change 50 Disposal value for asset representing allowable research and development expenditure: section 443, Table, items 1 and 2

Section 443 sets out the general rule for the amount of the disposal value to be brought into account when a person ceases to own an asset representing allowable research and development expenditure incurred by him or such an asset is demolished or destroyed at a time when he owns the asset. This provision contains two small changes from the equivalent provision in CAA 1990.

The first limits the disposal value, on sale at not less than market value or on demolition/ destruction, to a net amount. The second limits the disposal value on demolition/ destruction so that compensation (other than insurance money) of a revenue nature is not brought into account. These changes are made for consistency with the approach in the rest of the Act and favour the taxpayer.

Section 138(4) and (5) of CAA 1990 sets out the disposal values to be brought into account in these cases. Under section 138(4)(a), the disposal value on a sale at not less than market value is given as "the proceeds of that sale". Under item 1 of the Table in section 443, the disposal value in such a case is given as "the net proceeds of the sale".

Section 138(4)(b) and (5) gives the disposal value on demolition or destruction. The basic rule is that the disposal value consists of money received for the remains of the asset together with any insurance money or other compensation of any description received. Item 2 of the Table in section 443 instead refers to the "net amount received" and limits the compensation received "so far as it consists of capital sums".

These changes are made for consistency with the approach in the rest of the Act. Compare the Tables in sections 61, 316, 383, 423 and 515. Both changes have the effect of reducing the disposal value which would otherwise be brought into account. So they both favour the taxpayer.

Change 51 Chargeable period for which a disposal value is to be brought into account for research and development allowances: section 444(3)(a) and (4)

Under section 138(1) and (2) of CAA 1990, a person is liable to a charge where an asset representing allowable research and development expenditure incurred by him ceases to belong to him in or after the chargeable period for which an allowance in respect of the expenditure is made. But the position is less clear where the asset ceases to belong to him before the chargeable period for which the allowance would be made. The Act changes the law with a view to clarifying the position. This change could be regarded as to some extent unfavourable to the taxpayer.

It is likely to be fairly unusual for an asset representing allowable expenditure to cease to belong to a person before the chargeable period for which the allowance would be made. But there are two cases where this could happen.

The first is where a person incurs expenditure on acquiring an asset and disposes of it before the chargeable period in which he sets up and commences the trade by reference to which the expenditure is allowable—see section 137(1)(b) of CAA 1990. Under section 137(5) the allowance then arises for the chargeable period in which the trade is set up and commenced (see Note 56).

The second is where a trader acquires an asset and then disposes of it but is not treated as incurring the expenditure (under section 159 of CAA 1990) until a chargeable period after the one in which he disposed of it. This might be because the obligation to pay for the asset becomes unconditional only in the later period (section 159(3)) or because the person agreed to pay for it—in the later period—more than four months after the obligation to pay became unconditional (section 159(5)).

At first blush section 138(3) of CAA 1990 seems to deal with such cases. It applies where the asset ceases to belong to the person before the chargeable period for which the allowance would be made. It provides that the normal allowance is not to be made, but instead gives an allowance equal to the excess of the expenditure over the disposal value for the chargeable period in which the disposal occurs.

But section 138(3) does not cater properly for the first case mentioned above, namely the pre-trading disposal. This is because it appears to give the nonsense of a deduction to be allowed in taxing the trade for a chargeable period before the trade in question has been set up and commenced.

The words "the person carrying on a trade" in section 138(1) may be thought to cast doubt on whether subsections (2) and (3) (and therefore also subsections (4) and (5)) of that section are intended to apply at all in the case of a pre-trading disposal. But the position is not very clear. They certainly cannot be read entirely literally as meaning that those subsections apply only where the disposal occurs while the person is carrying on a trade, because the latter part of subsection (2) makes it clear that the disposal may take place after discontinuance of the trade. They may be intended simply to identify the person who incurred the allowable expenditure.

Section 138(3) can also be awkward in the second case mentioned above. The provision gives a net allowance for the period in which the disposal occurs. But it may not be known until a later period whether there is any allowance to be made at all in the case of a conditional obligation to pay because the condition may not be satisfied.

In fact the legislative history suggests that the provision from which section 138(3) derives—the new section 337(2)(b) of ITA 1952 inserted by section 36(3) of FA 1963—was not aimed at either of the cases mentioned above. It is thought that section 337(2)(b) was included because of the prior year basis of assessment and was aimed at the situation where an asset was bought and sold in the same year in a case where the allowance would be given against the assessment for the next year. It instead provided for a net allowance to be given for the year of assessment in which the asset was bought and sold.

The Act seeks to adopt a coherent approach to the cases mentioned above. Section 444 sets out the chargeable period for which a disposal value is to be brought into account if a person ceases to own an asset representing qualifying expenditure. Subsections (2) and (3) largely mirror section 138(2) of CAA 1990 (see Note 57). But subsection (4) takes a different approach from section 138(3).

Section 444(4) provides that if the disposal of the asset occurs before the chargeable period for which the allowance in respect of the expenditure is made, the disposal value is to be brought into account for that chargeable period.

So in the first case mentioned above, this means that the disposal value is brought into account for the chargeable period in which the trade is set up and commenced—see section 441(2). The person would then be entitled to an allowance for that period on the excess of the expenditure over the disposal value—see section 441(1)(b). This avoids the nonsense of a trading allowance arising for a period before the trade is set up and commenced. (If the disposal occurred before, but in the same chargeable period as, the setting up of the trade, subsection (3)(a) of section 444 would bring the disposal value into account for that chargeable period.)

And in the second case mentioned above, this means that the disposal value is brought into account for the chargeable period in which the expenditure is incurred—see section 441(2). The person would then be entitled to an allowance for that period on the excess of the expenditure over the disposal value—see section 441(1)(b). This avoids the awkwardness mentioned above of not knowing whether a conditional obligation to pay will become unconditional.

This approach is consistent with the scheme underlying research and development allowances, namely to give a person incurring allowable research and development expenditure an allowance equal to the net capital cost to him of the research and development.

Since an equivalent of section 138(3) of CAA 1990 has not been rewritten, section 138(8) is unnecessary.

Change 52 Research and development allowances and pre-trading demolition costs: section 445(1)

Section 138(5)(a) and (b) of CAA 1990 applies where an asset representing allowable research and development expenditure is demolished. The cost of demolition to the person carrying on the trade reduces the disposal value which would otherwise arise. And if the cost exceeds that value, the excess may give rise to a further allowance. The words "the person carrying on the trade" in section 138(5)(a) may be thought to indicate that it does not apply when the demolition occurs before the trade is set up and commenced.

The use of similar words in section 138(1) of CAA 1990 is discussed in Change 51. Section 444(4) now makes it clear that if the expenditure is incurred and the asset disposed of before the chargeable period in which the person sets up and commences the trade, the disposal value is brought into account for that chargeable period. So it ought to follow that pre-trading demolition costs should be taken into account. And section 445(1) refers to the demolition of an asset representing qualifying expenditure incurred by a person (rather than to “the person carrying on the trade”) so as to avoid any inference that it does not apply in a pre-trading case. This is a change in favour of the taxpayer.

Change 53 Pre-trading additional VAT rebates in respect of allowable research and development expenditure: section 448(5)

Section 138(3A) of CAA 1990 provides that in certain circumstances additional VAT rebates in respect of allowable research and development expenditure incurred by a person carrying on a trade are treated as trading receipts of the trade. The words “a person carrying on a trade” in that provision may be thought to indicate that it does not apply to pre-trading VAT rebates.

The use of similar words in section 138(1) of CAA 1990 is discussed in Change 51. Section 448(5)(b) now makes it clear that if the additional VAT rebate accrues before the chargeable period in which the trade is set up and commenced, a disposal value (or an addition to a disposal value) must be brought into account for that chargeable period. (If the rebate accrues before, but in the same chargeable period as, the setting up of the trade, subsection (5)(a) of section 448 would bring the disposal value into account for that chargeable period.)

This clarification is made for consistency with the approach described in Change 51. This change also might be regarded as unfavourable to the taxpayer.

Change 54 Allocation of expenditure to know-how and patent pools: sections 460 and 474

Section 460 concerns the allocation to a pool of qualifying expenditure in respect of know-how. It does not require a person who would like to claim allowances to allocate the expenditure to the pool for the chargeable period in which the expenditure is incurred. The taxpayer is allowed to allocate expenditure to the pool for a later period. Most taxpayers are likely to want to allocate expenditure to the pool as soon as possible. But providing this flexibility could for example help a taxpayer who has inadvertently failed to include expenditure for the earliest possible period.

It is thought that the better view is that this is a change in the law—similar to that described at Change 8—which is favourable to the taxpayer. Section 474 makes a similar change for qualifying expenditure in respect of patent rights.

Section 460 derives from section 530(4)(a) of ICTA. That provides—

> “a person’s qualifying expenditure for a chargeable period is the aggregate of the following amounts—
>
> (a) any capital expenditure incurred by him on the acquisition of know-how, being expenditure incurred during the chargeable period or at any previous time, other than expenditure which, or any part of which, has formed part of his qualifying expenditure for any previous chargeable period”.

It is apparent that this wording is very similar to that of section 25(1)(a) of CAA 1990 which is discussed at Change 8.

The words from "or at any previous time" to the end suggest that expenditure incurred in a previous chargeable period can become qualifying expenditure for the current period. But the word "is", in the first line, makes it sound as if the old expenditure should already have automatically become qualifying expenditure in the chargeable period in which it was incurred.

It was explained at Change 8 that—in the context of section 25(1)(a) of CAA 1990—the automatic nature by which expenditure becomes "qualifying expenditure" can be reconciled with the possibility of expenditure from a previous chargeable period becoming "qualifying expenditure". But the reasoning for section 25(1)(a) does not apply in the case of know-how where there are no first-year allowances.

Pooling of know-how allowances was introduced by section 65 of, and Part II of Schedule 18 to, FA 1985. It seems clear that the wording of paragraph 6 of that Schedule (from which section 530(4) of ICTA derives) was based on the wording of the forerunner of section 25(1) of CAA 1990.

It could be argued that the words "or at any previous time" were deliberately included to show that qualifying expenditure on know-how need not be allocated to the pool automatically in the period in which it was incurred. But it is thought that a more plausible explanation is that these words were copied from the plant or machinery code without it being realised that they were not required because there are no first-year allowances for know-how. It is thought that this is the better view of the law.

So on the better view section 460 changes the law because it allows a person to allocate expenditure to the pool in a chargeable period after the one in which it is incurred.

Nothing in section 460 requires the taxpayer who has incurred expenditure and wishes to claim allowances to allocate the whole of the expenditure to the pool all at once. The references to "amount" in subsection (2) recognise that a part of the expenditure may be allocated to the pool for one chargeable period and a part for another.

This almost certainly represents a relaxation in the law. This is because section 530(4)(a) of ICTA prevents expenditure from being "qualifying expenditure" (in the Act's terminology, in the pool) if "any part" of it has formed part of the taxpayer's qualifying expenditure (i.e., pool) for a previous chargeable period. This change is in favour of the taxpayer. For example, a taxpayer who inadvertently allocates less than the full amount of the expenditure to the pool will not lose entitlement to allowances on the remainder.

Section 474—which is based on section 521(1)(a) of ICTA—makes a similar change for qualifying expenditure in respect of patent rights. Section 474 contains an extra provision—subsection (4)—which section 460 does not. Subsection (4) derives from sections 520(2) and 528(1) of ICTA, adjusted in light of the change of approach described above.

Change 55 Only capital sums to be included in proceeds of sale: sections 462(2) and 476(3)

Section 462(2) provides that the disposal value to be brought into account on the sale of know-how is the net proceeds of the sale, *so far as they consist of capital sums*. Section 476(3) makes similar provision in the case of patent allowances. The provisions of ICTA on which these sections are based—sections 530(5) (know-how) and 521(2) (patents)—do not limit the disposal value to capital sums. This change has the effect of reducing the disposal value which would otherwise be brought into account and so favours the taxpayer.

The sale proceeds of know-how often give rise to a trading receipt for tax purposes—see *Jeffrey v Rolls-Royce Ltd* (1962) 40 TC 443. This change recognises that if a sale of know-how may be taxed as a revenue item, then it ought not to restrict the seller's capital allowances as well. As to patents, this change simply reflects the pre-1st April 1986 regime for capital allowances which took into account only "the net proceeds of the sale (so far as they consist of capital sums)"—see section 523(1)(c) of ICTA.

Change 56 Final chargeable period for non-trade patent pool: section 471(6)

Section 471(6) makes provision as to the chargeable period for which a person entitled to an allowance in respect of non-trade patent expenditure may have a balancing allowance rather than a writing-down allowance. It widens the circumstances in which the person may receive a balancing allowance, and therefore favours the taxpayer.

Under section 520(4)(c) and (5) of ICTA, the person is entitled to a balancing allowance for the chargeable period in which the last of the relevant patent rights comes to an end without any of those rights being revived. "Relevant patent rights" means those on which he has incurred expenditure which has—in the language of the Act—been allocated to the pool and which he has not wholly disposed of. So under ICTA, it seems that the person is entitled to a balancing allowance if the last of the patent rights in question expires, but not if he disposes wholly of the last of the rights.

For example, suppose a non-trader pools his expenditure on two patent rights, P1 and P2, which are the only patent rights he has. If he disposes wholly of P1 in one chargeable period and P2 expires in a later chargeable period, he may be entitled to a balancing allowance for the later period. But if the order is reversed so that P2 expires in a chargeable period and P1 is wholly disposed of in a later chargeable period, there seems to be no possible entitlement to a balancing allowance in the later period.

Section 471(6) alters the position so that the order in this example does not matter. The person is entitled to a balancing allowance for the chargeable period in which the last of the patent rights in question comes to an end (without any of those rights being revived) or is wholly disposed of. This is a change in the law which favours the taxpayer.

Section 520(5)(a) of ICTA takes account only of patent rights on which the person has incurred qualifying expenditure which has been allocated to the pool. Section 471(6) on the other hand takes account only of patent rights on which the person has incurred qualifying expenditure. This change is the corollary of allowing the taxpayer to elect whether or not to allocate qualifying expenditure to the pool—see Change 54.

Change 57 Preliminary dredging expenditure: section 486(1)

Section 486(1) is based on sections 134(7) and 135(2)(b) of CAA 1990. Broadly speaking, sections 134(7) and 135(2)(b) enable a person who has incurred capital expenditure on dredging before the "qualifying trade" begins to obtain allowances for a period beginning when the qualifying trade begins. But section 486(1) is more generous than section 135(2)(b) of CAA 1990. The latter appears to require a person carrying on a qualifying trade consisting of the maintenance or improvement of the navigation of a harbour, estuary or waterway to occupy the premises in connection with which the expenditure has been incurred, before allowances start to be available.

The following paragraphs explain this point in more detail.

Part VI of CAA 1990 (dredging) provides for two kinds of "qualifying trade": first, a trade or undertaking consisting of the maintenance or improvement of the navigation of a harbour, estuary or waterway; and secondly, a trade or undertaking which complies with any condition in section 18(1) of CAA 1990 (which identifies the trades and undertakings that may be able to obtain industrial buildings allowances).

In the case of the second kind of "qualifying trade", but not the first, allowances are available only if the dredging is for the benefit of vessels coming to, or leaving or using a dock or other premises occupied by the person carrying on the trade or undertaking for the purposes of the trade (see section 134(1)(a)).

Section 134(7) treats a person who incurs expenditure before a trade is carried on as if the trade were being carried on when the expenditure is incurred. It also treats the person who incurs expenditure with a view to occupying a dock or other premises as if the person had been occupying the dock or premises when the expenditure was incurred.

But section 134(1) provides for allowances to start at "the first relevant chargeable period". Section 135(2)(b) defines "the first relevant chargeable period" as the period in which the person—

> "both carries on the trade or part of the trade for the purposes of which the expenditure was incurred, and occupies for the purposes of that trade or part of the trade the dock or other premises in connection

with which it was incurred."

(Part 9 avoids the need to employ the device of the "first relevant chargeable period", by treating the person as incurring the pre-trading etc. expenditure when the trade, etc. begins.)

There is no logic in enabling the person entitled to allowances by way of the first kind of trade to obtain dredging allowances without having to satisfy any occupation requirement if the expenditure is incurred while the trade or undertaking is carried on, but to require the trade to satisfy an occupation requirement before being able to obtain allowances in respect of pre-commencement expenditure.

Possibly the explanation for the curious terms of section 135(2)(b) is that it was assumed that a person carrying on a trade of maintaining or improving a harbour, estuary or waterway would inevitably, when doing so, be "occupying" the harbour, estuary or waterway once the trade began. This may often be so. But it cannot be guaranteed that it will be so. It is desirable to remove the apparent restriction that section 135(2)(b) imposes for the first kind of qualifying trade, even if the cases in which it might make a difference will not be frequent.

Change 58 Contributions to research and development expenditure: sections 535 and 536

Sections 535 and 536 are based on section 153(2) of CAA 1990. Part of section 153(4) provides that section 153(2) does not apply for the purposes of Part VII (which is about research and development allowances). Neither of the sections reproduces this part of section 153(4).

In broad terms, the approach taken in CAA 1990 is that a person who receives a contribution to expenditure from another should not be able to claim allowances based on the contribution, but that in certain circumstances the contributor should be entitled to allowances instead.

Section 153(2) of CAA 1990 contains two exceptions to the principle that a recipient of a contribution cannot claim allowances based on the contribution.

The purpose of the first (section 153(2)(a)) is to enable a person who uses insurance or compensation money to acquire a replacement asset to claim allowances in respect of the expenditure. The purpose of the second (section 153(2)(b)) is to enable a person to claim allowances in respect of expenditure funded by a person other than a public body, if that other person cannot obtain tax relief on the contribution.

These two exceptions have been rewritten as sections 535 and 536.

Not rewriting the part of section 153(4) that provides that section 153(2) does not apply for the purposes of Part VII means that a taxpayer who has expenditure on research and development funded by another is in a better position. This is because the person's expenditure can still qualify for allowances in spite of the contribution.

Change 59 Contributions, Part 2 and the meaning of "trade": sections 536(5) and 537(4)

Sections 536(5) and 537(4) extend the meaning of "trade" for the purposes of provisions relating to both recipients of contributions and contributors in connection with Part 2. This change is adverse to recipients of contributions but favourable to contributors.

Change 58 described the general purpose of section 153(2)(b) of CAA 1990 as being to enable a person to claim allowances in respect of expenditure funded by a person other than a public body, if that other person cannot obtain tax relief on the contribution.

But this is an oversimplification. The precise legal requirement is a little more complex. The relevant words in section 153(2) are—

> " . . . there shall be left out of account—
>
> (b) any expenditure met or to be met by any person other than the Crown or a government or public or local authority, being expenditure in respect of which . . . no allowance could be made under section 154, and not being expenditure which is allowed to be deducted in computing the profits of a <u>trade, profession or vocation</u> carried on by that person."

Section 154(1) of CAA 1990, which sets out the conditions for entitlement to contribution allowances, requires the contribution to be made for the purposes of a "trade" carried on by the contributor or by a tenant of land in which the contributor has an interest, and "trade" is then glossed in section 154(5) to include a "profession or vocation".

In contrast, Part 11, instead of referring to a "profession or vocation", refers to a "relevant activity". Section 536(5)(a) then defines "relevant activity" to mean, for the purposes of Part 2, an ordinary Schedule A business, a furnished holiday lettings business, an overseas property business, a profession or vocation, any concern listed in section 55(2) of ICTA (mines, transport undertakings etc.) and the management of an investment company. (For other purposes, the effect of CAA 1990 is maintained, by defining "relevant activity" to mean a "profession or vocation".) Section 537(4) gives "relevant activity" the same meaning for the purposes of contribution allowances under Part 2 for plant or machinery.

The following paragraphs discuss in more detail the extent to which the meaning of "relevant activity" for Part 2 purposes is a change in the law.

It is clearly a change in the law in relation to a concern listed in section 55(2) of ICTA (mines, transport undertakings, etc.). The change is consequential on Change 1.

It is almost certainly a change in the law in relation to the management of an investment company.

Section 28(1) of CAA 1990 provides that—

> "This Part and the other provisions of the Corporation Tax Acts relating to allowances and charges under this Part apply with the necessary adaptations in relation to machinery or plant provided for use or used for the purposes of the management of the business of an investment company . . ."

This extends the meaning of "trade" in relation to the company for whose use the plant or machinery is provided. But typically the contributor will not be using the plant or machinery. This is probably enough to establish that "trade" in section 153(2)(b) does not include, for the purposes of Part II of CAA 1990, the management of an investment company.

The waters become a little muddier for the various property businesses. Sections 28A and 29 of CAA 1990 are in less limited terms than section 28. They apply provisions outside Part II to Schedule A businesses and furnished holiday lettings businesses—

> "so far as relating to allowances or charges under this Part [i.e., Part II] . . ."

(Overseas property businesses are subject to the rule in section 28A by way of section 161(2A) of CAA 1990.)

Section 153(2)(b) is a provision "relating to" allowances and charges under Part II in a loose sense only—in the sense that if the contributor comes within these words, the recipient of the contribution will not be able to obtain an allowance based on the contribution. So it is unclear whether "trade" in section 153(2)(b) includes a property business. It may not do so.

It seems likely that "trade" has the same meaning in sections 154 and 155 of CAA 1990 as it has in section 153(2)(b). When the legislation was amended by FA 1989 to include professions and vocations, amendments were made not only to the precursor of section 153 but also to the precursor of section 154 so that trade includes a profession or vocation in all three sections. So, on the basis that "trade" in section 153 does not include the management of an investment business or a property business, "trade" in sections 154 and 155 probably does not include these activities either.

Change 60 Single asset pools for contributions to expenditure on plant and machinery: section 538(3)

Section 538(3) provides that expenditure which a person has contributed to plant or machinery is to be allocated to a single asset pool. This is based on section 155(6) of CAA 1990.

During the preparation of the Act, consultees expressed differing views about whether section 155(6) created what is generally referred to as, and is called in the Act, a "single asset pool". The effect of CAA 1990 is unclear.

Section 155(6)(a) of CAA 1990 treats a person who has made a contribution as having made it for the purposes of a separate trade. This proposition looks back to section 154(2) which in turn operates by way of section 154(1).

So the reference in section 155(6)(a) to the contribution is, by a somewhat circuitous route, a reference to the situation where a person—

> "contributes a capital sum to expenditure on the provision of an asset".

Under section 6(c) of the Interpretation Act 1978, "words in the singular include the plural and words in the plural include the singular". But this does not apply if the contrary intention appears.

If the words include the plural, then it looks as if the effect of section 155(6) is to create what is generally known as, and the Act calls, a class pool. (I.e., because section 154(1) can be read as saying "contributes capital sums to expenditure on the provision of assets".) If the words do not include the plural, the effect of section 155(6) appears to be to create a single asset pool.

A more subtle approach would be to identify "the contribution". Most commonly, perhaps, "the contribution" will be one payment towards the provision of one asset. But "the contribution" could consist of one sum contributed towards several assets. Or it could consist of several instalment payments towards the provision of one asset. On this approach, whether section 155(6) of CAA 1990 creates a single asset pool or a class pool would depend on the circumstances. It could be regarded as creating a pool for a contribution which does not fit neatly into the standard classification of pools.

Section 155(6) comes from an amendment made to the pre-consolidation capital allowances legislation by paragraph 5 of Schedule 13 to FA 1989 to cure a problem caused by the introduction in 1971 of pooling for plant and machinery allowances.

The reason for the amendment (given in the notes on clauses and Schedules) was to ensure that entitlement to allowances could be transferred when the contributor's trade was transferred. A class pool would not have provided a complete cure for that problem. Problems could still have arisen if the contributor made different contributions for the purposes of different parts of the trade and then transferred a part of the trade.

Section 538(3) is intended to achieve the original intention underlying the 1989 amendment.

Change 61 Omission of section 434E(1)(b) of ICTA: section 545(1) and (2)

Section 545(1) and (2) identifies an "investment asset" as one which is held by a company carrying on a life assurance business for purposes other than the management of the business.

In contrast, under section 434E(1) of ICTA, an "investment asset" is an asset which (unpacking the meaning of "Schedule A business" and "overseas property business" in paragraph (b) to take account of the definitions in ICTA)—

> (a) is held by a company for the purposes of its life assurance business otherwise than for the management of that business, and
>
> (b) is not let in the course of a business the profits or gains of which are chargeable to tax under Schedule A or the income of which is chargeable to tax under Case V.

So effectively section 545(1) and (2) omits section 434E(1)(b).

Section 434E(1) was substituted by paragraph 40 of Schedule 5 to FA 1998, as a perceived consequential on reforms relating to Schedule A businesses and overseas property businesses. But it is now thought that section 434E(1)(b) is unnecessary and may possibly produce unintended effects.

In most cases, the effect of leaving out paragraph (b) is to remove a provision which does not achieve anything. But in a few cases leaving out paragraph (b) could conceivably change the law. Identifying these cases is difficult, because the legislation relating to life assurance business has become extremely complicated.

To understand the possible effects of the change it is vital to know two basic points about the taxation of life assurance business.

First, life assurance business is divided up into categories for tax purposes. The relevant categories are: basic life assurance and general annuity business ("BLAGAB"), pension business, ISA business, life reinsurance business and overseas life assurance business.

Secondly, if profits can be charged under either Case I or some other Case of Schedule D, the Revenue has the choice as to which Case is to be used. The phrase the "I minus E" basis refers to the basis on which the profits of life assurance business are taxed when the Revenue chooses to tax the profits of the life assurance business that are taxable under Schedule D under Cases III to VI of Schedule D instead of Case I. The "I" in "I minus E" stands for income and the "E" for expenses of management. Where the I minus E basis is used, tax is based on income computed in accordance with Cases III to VI of Schedule D, the other Schedules (of which only Schedule A is currently relevant) and on gains under TCGA 1992 as it applies to companies. Expenses of management are set off in computing the total profits of the life assurance business.

The intention in 1998 (as indicated above) was to make consequential amendments only.

The intention was that allowances should continue to be available to an insurance company in respect of assets held for the purposes of BLAGAB if it was taxed on the I minus E basis. The allowances would be available because the company would be entitled to allowances through having a Schedule A or overseas property business or by way of section 61(1) of CAA 1990.

But allowances were not meant to be available in respect of assets not held for the purposes of management which were referable to other categories of life assurance business or if the company was charged to tax under Case I of Schedule D. The rule intended to deny capital allowances in these latter cases is contained in section 434E(5) of ICTA.

The omission of section 434E(1)(b) in section 545(1) and (2) does not affect an insurance company in relation to BLAGAB if it is taxed on the I minus E basis. The next two paragraphs explain why.

If a company is taxed in relation to BLAGAB on the I minus E basis, the company is not subject to denial of capital allowances under section 434E(5). This remains true whatever the definition of investment asset.

An insurance company taxed on the I minus E basis in respect of BLAGAB is subject to section 434E(2) if the asset is an investment asset. The effect of section 434E(2) is that plant and machinery allowances are available in respect of assets not held for management purposes and not let in the course of a Schedule A business or overseas property business by way of section 61 of CAA 1990. Although the Act omits section 434E(1)(b) for the purposes of section 434E(5), it does not do so for the purposes of section 434E(2). (See section 19(5).) So again the insurance company with BLAGAB taxed on an I minus E basis is unaffected by the change in section 545(1) and (2).

So the only possible significance of the omission of section 434E(1)(b) is in relation to insurance companies with categories of life assurance business other than BLAGAB, or which are charged to tax under Case I of Schedule D. Insurance companies charged under Case I used to be rare, but have become more frequent as a result of the insertion of section 439A of ICTA (pure reinsurance business) by paragraph 26 of Schedule 8 to FA 1995.

Section 434E(5) provides—

> "(5) No allowance under the 1990 Act in respect of an investment asset shall be taken into account—
>
> (*a*) in computing the profits of any class of life assurance business under section 436, 439B or 441, or
>
> (*b*) where the company is charged to tax in respect of its life assurance business under Case I of

Schedule D, in computing the profits of that business."

The general effect of omitting section 434E(1)(b) appears at first sight to be adverse to insurance companies denied allowances under section 434E(5). Its effect appears to be that allowances will not now be available, in the cases dealt with by section 434E(5)(a) and (b), in respect of assets held for non-management purposes even if the asset is let in the course of a business the profits or gains of which are chargeable to tax under Schedule A or the income of which is chargeable to tax under Case V.

But in many cases, leaving out section 434E(1)(b) has no effect, because, although the asset can be described as let in the course of a land exploitation business, it cannot be described as let in the course of a business the profits or gains of which are chargeable to tax under Schedule A or the income of which is chargeable under Case V.

This is because of the way various statutory provisions (and in particular section 83 of FA 1989) step in and remove the charge to tax under Schedule A or Case V in relation to the cases dealt with in section 434E(5)(a) and (b).

Section 83 of FA 1989 applies whenever section 434E(5) applies.

Section 83 applies where the profits of an insurance company in respect of its life assurance business are computed in accordance with the principles applicable to Case I of Schedule D. (See section 83(1).) This means that section 83 applies whenever section 434E(5)(b) applies.

Section 83 also applies whenever section 436, 439B or 441 of ICTA applies. This is because sections 436(1)(b), 439B(1)(b) and 441(2)(b) provide for computations under sections 436, 439B and 441 to be done in accordance with the principles applicable to Case I of Schedule D. However, 436(3)(a), 439B(3)(a) and 441(4)(a) apply section 83 with "the necessary modifications". (An example of a modification that is needed is that the reference in section 83(1) to "life assurance business" needs to be read as a reference to the relevant category of life assurance business.)

Section 83(2) of FA 1989 provides—

> "So far as referable to that business, the following items, as brought into account for a period of account (and not otherwise), shall be taken into account as receipts of the period—
>
> (a) the company's investment income from the assets of its long term business fund, and
>
> (b) any increase in the value (whether realised or not) of those assets."

The long term business fund is not defined in FA 1989. It refers to the fund maintained in respect of the company's long-term business (a wider concept than life assurance business). The assets of the long term business fund could include assets consisting of rights in or over land which produce rents or other receipts—the sort of assets whose profits would in other circumstances be charged to tax under Schedule A or Case V.

Section 83A of FA 1989 defines "brought into account". In general terms it means brought into account in a revenue account prepared for the purposes of the Insurance Companies Act 1982.

Section 83(2) of FA 1989 is mandatory. The amounts "shall be taken into account as receipts". "Receipts" here can only mean "Case I receipts" (i.e., receipts in the computation in accordance with the provisions applicable to Case I of Schedule D).

If the amounts are taken into account as Case I receipts they cannot be taken into account under Schedule A and so the company would appear not to be chargeable to tax under Schedule A in respect of any assets in its long term business fund that are referable to its life assurance business. (And similarly for Case V and overseas property businesses.)

If this were so, omitting section 434E(1)(b) would not affect life companies in the cases mentioned in section 434E(5). It would appear that they could not have assets let in the course of a business the profits of which are chargeable to tax under Schedule A (or Case V).

This is the result in relation to the case dealt with in section 434E(5)(b) (i.e., where the company is charged to tax under Case I).

But the issue is more complicated in relation to the cases dealt with in section 434E(5)(a) (where the company is charged by way of section 436, 439B or 441 of ICTA), because of the effect of sections 432AA and 432B to 432F of ICTA.

Under section 432AA of ICTA an insurance company is treated for tax purposes as having various separate businesses consisting of the exploitation of land.

Section 432AA creates separate land exploitation businesses for—

> the exploitation of land held as an asset of the insurance company's long term business fund (section 432AA(2))
>
> the exploitation of land held as an asset of the insurance company's overseas life assurance fund (section 432AA(3)

the exploitation of land held as an asset linked to pension business, life reinsurance business, BLAGAB or long term business other than life assurance business (section 432AA(4)), and

the exploitation of land held otherwise than as an asset of the insurance company's overseas life assurance fund or as an asset linked in any of the ways just mentioned (section 432AA(5)).

These separate businesses created by section 432AA are potential Schedule A or overseas property businesses.

But they cannot become actual Schedule A or overseas property businesses unless the profits or gains of the business are chargeable to tax under Schedule A or Case V.

In relation to companies dealt with under sections 436, 439B or 441, whether the profits and gains of these notional land exploitation businesses are chargeable under Schedule A or Case V turns on section 83 of FA 1989 as affected by sections 432B to 432F of ICTA.

Under section 432B of ICTA, sections 432C to 432F apply where it is necessary to determine in accordance with section 83 of FA 1989 what parts of any items brought into account are referable to life assurance business or any class of life assurance business. It is only the items that are "referable" to the class of business that are taken out of the charge to tax under Schedule A and Case V by section 83.

The general effect of section 83 of FA 1989, read with sections 432AA to 432F of ICTA, is that sometimes all the profits from the relevant land exploitation business will be turned into Case I receipts and sometimes part will be turned into Case I receipts and part not.

In the former case the company will not have any assets let in the course of a Schedule A or overseas property business and the omission of section 434E(1)(b) will not make a difference.

In the latter case it is not clear whether, on a literal reading of section 434E(1) and (5), an asset is capable of generating capital allowances, in so far as it is generating profits which are chargeable under Schedule A. Here omitting section 434E(1)(b) may change the law, and, if it does do so, it changes it in a way that is adverse to the taxpayer.

In broad summary, the omission of section 434E(1)(b) in section 545(1) and (2) may change the law in a way that is adverse to insurance companies in relation to a category of life assurance business whose profits are computed in accordance with sections 436, 439B or 441 of ICTA, to the extent that they have assets the profits on which are not attributable only to that category of business. However, it does so only so as to give effect to the original intention behind the legislation.

Change 62 Permanent discontinuance etc. of a property business: sections 558(5), 559(5) and 577(2)(b)

Sections 558(5), 559(5) and 577(2) are based on sections 152(1) and (3) and 161(9) of CAA 1990. But they go further than these sections of CAA 1990 in referring to a property business as well as to a trade, profession or vocation. This corrects missed consequentials on recent reforms relating to property businesses.

Section 152(1) of CAA 1990 deals with situations where a person succeeds to a trade, profession or vocation and the trade, profession or vocation is treated as permanently discontinued under section 113 or 337 of ICTA. Section 152(3) of CAA 1990 deals with situations where there are partnership changes and the trade, profession or vocation is treated as not permanently discontinued under section 113 of ICTA. Section 152 follows through the implications of the discontinuance or otherwise of the trade, profession or vocation for capital allowances purposes.

Section 161(9) of CAA 1990 provides that references to the setting-up, commencement or permanent discontinuance of a trade include references to any event which under the Income Tax Acts or the Corporation Tax Acts is treated as equivalent to the setting up, commencement or permanent discontinuance of a trade. Sections 113 and 337 are provisions under which events are treated as equivalent to permanent discontinuance, etc.

Sections 113 and 337 of ICTA are applied to Schedule A businesses by section 21B of ICTA (which was inserted by paragraph 4 of Schedule 5 to FA 1998).

Sections 113 and 337 of ICTA are also generally interpreted as applying to overseas property businesses. But the extension of sections 113 and 337 to overseas property businesses is less transparently clear than their extension to Schedule A businesses.

Sections 65A(5) and 70A(5) of ICTA provide that the income from an overseas property business shall be computed for the purposes of Schedule D in accordance with the rules applicable to the computation of profits of a Schedule A business. At first sight sections 65A(5) and 70A(5) look as if they are trying to borrow section 21A of ICTA only. Section 21A looks as if it is providing an exhaustive list of provisions about the computation of profits for Schedule A purposes. But the provisions in section 21B can also affect the computation of profits (though they have other effects as well). So sections 65A(5) and 70A(5) of ICTA are generally interpreted as applying sections 113 and 337 so far as they affect the computation of profits.

It is clear that sections 152 and 161(9) of CAA 1990 should apply in relation to a trade, profession, vocation or business to which section 113 or 337 of ICTA applies. The references to a "property business" in sections 558(5), 559(5) and 577(2)(b) have been added in order to achieve this result.

Whether the change in the law is favourable or adverse to the taxpayer will depend on the circumstances. But it is thought that the practical effects of the change will be small, on the ground that it brings the legislation into line with the way it is operated in practice.

Change 63 Procedure for determination of questions affecting tax liability of two or more persons and section 152B(8) of CAA 1990: section 564(4)

Section 564(4) applies section 563 to the determination of apportionments under section 561(3). In contrast, section 152B of CAA 1990 contains free-standing provisions (at subsections (8) and (9)) which are in almost identical terms to section 151 of CAA 1990.

The reason for "borrowing" section 563 rather than repeating its effect is that this is a simple way of correcting missed consequentials arising when section 152B was inserted. It means that a reference in another Act to section 563 will (under the Interpretation Act 1978) pick up section 563 as applied by section 564(4).

There are such references in section 58(3) of, and paragraph 10 of Schedule 3 to, TMA 1970. The new approach in section 564(4) ensures that these provisions of TMA 1970 work as intended.

Change 64 The Inland Revenue and tax inspectors: section 576(1)

Section 576(1) provides that "the Inland Revenue" means any officer of the Board of Inland Revenue.

The effect of this, in relation to some provisions in the Act, is to enable things to be done by or in relation to an officer of the Board instead of (as would be the case under the corresponding provisions of CAA 1990) by or in relation to an inspector. (The change does not affect what can be done by or in relation to the Board of Inland Revenue.)

This change is a minor one because a similar result could in many cases be achieved by a different means under section 1(2B) of TMA 1970. Under section 1(2B), a person who is not an inspector may exercise functions conferred on inspectors, if, in accordance with the Board's administrative practices, he has been authorised to act as an inspector for specific purposes.

The following paragraphs give more detail about the provisions affected by this change.

Various provisions in the Act come from provisions of CAA 1990 which require notice to be given to an inspector. These have been rewritten so as to require notice to be given to the Inland Revenue (i.e., an officer of the Board). One provision refers to an agreement with an inspector. This has been rewritten so as to refer to an agreement with the Inland Revenue.

The provisions of CAA 1990 and the Act just referred to are—

section 11(3) of CAA 1990, rewritten in section 291(4);

section 33F(4) to (6) of CAA 1990 rewritten in section 142(2);

section 37(2) and (9) of CAA 1990 rewritten in sections 85(2) and 89(7);

section 48(2) and (5) of CAA 1990 rewritten in sections 119(1) and 120(3);

section 55(3) of CAA 1990 rewritten in section 183(2);

section 62A(5) of CAA 1990 rewritten in section 164(2);

section 77(3) of CAA 1990 rewritten in section 266(4);

section 78(2) of CAA 1990 rewritten in section 268(1)(c);

section 143(1) of CAA 1990 rewritten in section 565(1); and

section 158(1) of CAA 1990 rewritten in section 570(5).

Change 65 Claims for postponed first-year allowances in respect of ships: paragraph 1 of Schedule 2

Paragraph 1 of Schedule 2 replaces paragraph (c) of section 42(7) of TMA 1970, referring to provisions of CAA 1990, with a new paragraph referring to the corresponding provisions of the Act. The provisions listed provide for a claim or election to be made.

The version of section 42(7)(c) of TMA 1970 that is being replaced does not include claims under section 30(2)(c) of CAA 1990, but does include claims under section 31(4)(c) of CAA 1990. But the new section 42(7)(c) includes all claims made under section 131. These include the claims that, under CAA 1990, are made under section 30(2)(c).

Section 30(2)(c) of CAA 1990 provides that, where a first-year allowance in respect of a ship has been postponed, the person postponing the allowance may claim first-year allowances up to the amount postponed for later chargeable periods. Section 31(4)(c) of CAA 1990 makes corresponding provision for cases where a writing-down allowance in respect of a ship has been postponed. Section 131 deals both with claims for a postponed first-year allowance to be made (subsection (2)) and with claims for a postponed writing-down allowance to be made (subsection (3)).

Section 42(6) of TMA 1970 makes provision for the way in which the claims listed in section 42(7) are to be made where a trade, profession or business is carried on in partnership. Where notice has been given under section 12AA of TMA 1970 requiring a partnership return to be made, the claim must be included in the return. Otherwise, it must be made by a nominated partner.

There seems to be no reason for section 42(6) of TMA 1970 not to apply to claims for postponed first-year allowances to be made. It is simpler to administer partners' tax affairs if the same rules apply for all claims relating to capital allowances.

Change 66 Reduced writing-down allowance for patent allowances on pre-1st April 1986 expenditure: paragraph 98(3) of Schedule 3

Sections 522 and 523 of ICTA provide for allowances on capital expenditure incurred before 1st April 1986 on the purchase of patent rights. Under section 522, the person is entitled to writing-down allowances over a 17 year period.

Section 523(4) applies if a person sells part of the patent rights and the net proceeds of the sale do not exceed the amount of the expenditure remaining unallowed. It gives a reduced writing-down allowance for the chargeable period in which the sale occurs and later chargeable periods.

Section 523(4) is rewritten by paragraph 98 of Schedule 3. Paragraph 98(3) is new. It provides that the reduced writing-down allowance is proportionately increased or reduced if the chargeable period for which it is given is more or less than a year. This ensures that a person with a longer chargeable period will be entitled to a larger allowance for that period. And a person with a shorter chargeable period will be entitled to a smaller allowance for that period.

This proposition is not set out expressly on the face of section 523(4) and so could be argued to be a change in the law. On the other hand, it might be thought to be implicit. If this were to be regarded as a change in the law, it would benefit a person with a chargeable period of more than a year, but disadvantage a person with a chargeable period of less than a year. But it is thought likely to have little impact in practice given that the provisions giving patent allowances on pre-1st April 1986 expenditure will soon be spent.