

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Schedule 1: Consequential Amendments

Part 2: Other Enactments

Taxes Management Act 1970

Paragraphs 362, 365 and 371: sections 9D, 12AE(2) and 31(3) of TMA

3484. These amendments repeal the sections of TMA that give effect to the “Crown Option”. Under the “Crown Option” the Inland Revenue has the right to determine under what Case of Schedule D to charge income that falls both within Cases I or II and Cases III, IV or V. In practice this option is always exercised to tax the income under Schedule D Cases I or II.
3485. This Act includes sections that enact the Crown Option by giving priority to the trading income Part if income that is taxed under Schedule D in the source legislation falls within more than one Part. See *Change 66* in Annex 1. These priority sections mean that the determination powers in TMA are not required.

Taxation of Chargeable Gains Act 1992

3486. The following three sections rewrite paragraph 1 and paragraphs 4A(5) to (9) of Schedule 5AA to ICTA. They provide rules for computing a capital gain or loss where a chargeable profit or an allowable loss has arisen under Chapter 12 of Part 4 of this Act which deals with futures and options involving guaranteed returns. The rules are considered more appropriate to TCGA than to this Act.

Paragraph 435: sections 148A, 148B and 148C of TCGA

Section 148A Futures and options involving guaranteed returns

3487. This new section of TCGA prevents a profit or gain chargeable under Chapter 12 of Part 4 of this Act from being taxed again under TCGA or losses under that Chapter from being relieved other than under the provisions of new section 836B of ICTA (what is now Schedule D Case VI losses). It is based on paragraph 1 of Schedule 5AA to ICTA.

Section 148B Deemed disposals at a gain under section 564(4) of ITTOIA 2005

3488. **Section 564** (deemed disposal where futures run to delivery or options are exercised) deems a disposal to take place immediately before a future runs to delivery or an option is exercised. Eventually the asset acquired under that future or option may itself be sold for a capital gain. Any gain on that disposal will, under the TCGA rules, include that

*These notes refer to the Income Tax (Trading and Other Income)
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

part of the gain that has already been taxed under Chapter 12 of Part 4 of this Act as a result of the deemed disposal. This new section of TCGA provides rules to prevent that double taxation by excluding that element of the gain from the chargeable gain. It is based on paragraph 4A of Schedule 5AA to ICTA.

3489. *Subsection (2)* provides for the rules in sections 37 and 39 of TCGA to be disregarded. These sections prevent an amount taxed as income from being included in the disposal proceeds of an asset or sums deductible in an income tax computation from being deductible against the capital gains computation.
3490. *Subsection (4)* prevents indexation allowance being added to the increase in the acquisition cost made under subsection (3). This is because that adjustment is a notional adjustment only and not actual expenditure.
3491. *Subsection (6)* provides for the grant of an option and its deemed disposal to be treated as a single acquisition for the purposes of adjusting the capital gains computation under subsections (3) to (5). Treatment as a single acquisition allows the premium received by the grantor of the option to be taken into account in calculating the consideration for acquisition of the asset. Section 144 of TCGA, which applies by virtue of section 562 (when disposals of futures or options occur: general), performs the same service for disposals under Chapter 12 of Part 4 of this Act other than deemed disposals (see commentary on section 563 (timing of certain grants of options where related disposals occur later)). This subsection is needed because deemed disposals under section 564 (deemed disposals where futures run to delivery or options are exercised) are not disposals for the purposes of section 144 of TCGA.

Section 148C Deemed disposals at a loss under section 564(4) of ITTOIA 2005

3492. **Section 564** (deemed disposal where futures run to delivery or options are exercised) deems a disposal to take place immediately before a future runs to delivery or an option is exercised. Eventually the asset acquired under that future or option may itself be sold for a capital loss. Any loss on that eventual disposal will, under the TCGA rules, include that part of the loss that may be relieved under Chapter 12 of Part 4 of this Act as a result of the deemed disposal. This new section of TCGA provides rules to prevent a double allowance of that loss by excluding the loss allowable under Chapter 12 of Part 4 of this Act from the capital loss. The section is based on paragraph 4A of Schedule 5AA to ICTA.
3493. *Subsection (2)* provides for the rules in sections 37 and 39 of TCGA to be disregarded. These sections prevent an amount taxed as income from being included in disposal proceeds of an asset or sums deductible in an income tax computation from being deductible against the capital gains computation.
3494. *Subsection (3)* provides for the grant of an option and its deemed disposal to be treated as a single acquisition for the purposes of adjusting the capital gains computation under subsections (4) and (5). This allows the premium received by the grantor of the option to be taken into account in calculating the consideration for acquisition of the asset. Section 144 of TCGA which applies by virtue of section 562 (when disposals of futures or options occur: general) performs the same service for disposals under Chapter 12 of Part 4 of this Act other than deemed disposals (see commentary on section 563 (timing of certain grants of options where related disposals occur later)). But deemed disposals under section 564 (deemed disposals where futures run to delivery or options are exercised) are not disposals for the purposes of section 144 of TCGA.
3495. *Subsections (4) and (5)* apply where an asset has been disposed of at a loss by means of a future running to delivery or an option being exercised. The consideration for that asset for the purposes of the capital gains computation is decreased by the amount of the loss arising under Chapter 12 of Part 4 of this Act, thus effectively preventing a double allowance of the loss that arises on the deemed disposal under that Chapter. Under subsection (4) two distinct situations are foreseen, first where the person sustaining a

These notes refer to the Income Tax (Trading and Other Income) Act 2005 (c.5) which received Royal Assent on 24 March 2005

loss on the deemed disposal acquires an asset as a result of a future running to delivery or the exercise of an option and, second, where the person sustaining a loss on the deemed disposal disposes of an asset as a result of a future running to delivery or the exercise of an option.

3496. *Subsection (5)* ensures that the consideration cannot be reduced below zero. Where the loss under Chapter 12 of Part 4 of this Act exceeds the consideration, the consideration is reduced to nil and the excess is treated as a chargeable gain.
3497. *Subsections (6) and (7)* deal with occasions where the loss under Chapter 12 of Part 4 of this Act on the deemed disposal exceeds the consideration for the asset and is treated as a capital gain under subsection (5). The capital gain arises either when an asset acquired under the future or option is eventually disposed of, or, if the asset is already held but disposed of under the future or option, on that disposal.
3498. *Subsections (8) and (9)* supplement the rule in subsections (6) and (7). They establish when a chargeable gain under subsection (5)(b) is treated as arising in circumstances which involve special capital gains tax provisions.

Paragraph 438: section 151C of TCGA

3499. This new section of TCGA provides that where a capital loss accrues as part of any scheme or arrangement which has an unallowable purpose that loss is disregarded. Schedule 13 to FA 1996, relevant discounted securities, is rewritten in Chapter 8 of Part 4 of this Act. Because this paragraph of the Schedule deals with capital losses on such securities it is more appropriate to TCGA. The section is based on paragraph 14C of Schedule 13 to FA 1996.
3500. *Subsection (1)(b)* requires payment to be made other than for the acquisition or disposal of a strip – these payments will typically be payments under option agreements. An allowable loss may accrue on a payment while a comparable gain on a strip escapes tax under section 115 of TCGA. “Disposal” in this subsection takes the meaning in Chapter 8 of Part 4 of this Act (*subsection (4)*).

Paragraph 443: section 254(1)(c) of TCGA

3501. Section 254(1)(c) of TCGA has been repealed in relation to loans made after 16 March 1998. The amendment for deeply discounted securities is required because it still has life for loans made before that date.

Finance Act 1993

Paragraph 464: section 171(2) of FA 1993

3502. Section 171(2) of FA 1993 provides that the aggregate profits of an individual underwriter at Lloyd's are taxed under Schedule D Case I and under no other Case or Schedule. The integrated approach to foreign trade profits means that the trading income Part does not distinguish between income that is taxed under Schedule D Cases I and V in the source legislation. Where it is necessary to make this distinction this Act does so through the definition of “relevant foreign income” in section 830.
3503. This amendment also uses the concept of “relevant foreign income” to reproduce the reference to Schedule D Case I in section 171(2)(a) of FA 1993.

Income Tax (Earnings and Pensions) Act 2003

Paragraph 592: section 325A of ITEPA

3504. This new section of ITEPA gives a person receiving payments under an insurance policy which insures against a health and employment risk exemption from taxation on those payments as employment income.

*These notes refer to the Income Tax (Trading and Other Income)
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

3505. This rewrites section 580A(7) of ICTA to the extent that it relates to employment income.
3506. The payment must first have the capacity for exemption under section 735 (health and employment insurance payments) on the assumption that it is an annual payment (and thus exempt under that section). But it must also meet two further conditions.
3507. First the payments must be to an employee (or to his or her spouse) who contributed under a policy that another person took out for his or her benefit and secondly the payments must represent the contributions the employee has made.

Paragraph 594: section 360A of ITEPA

3508. This new section of ITEPA rewrites part of the rule in section 617(3) and (4) of ICTA, which prohibits the deduction of most social security contributions in calculating income for tax purposes. The remainder of the rule is rewritten, for income tax, in section 868 (social security contributions) of this Act.
3509. In some circumstances an employee may be allowed a deduction for wages paid. In that case, the associated employer's national insurance contributions may also be allowed. The deduction is allowed if it would meet the tests in section 336 of ITEPA (see section 617(4)(d) of ICTA). But it should also be allowed if it meets the tests in any of sections 337 to 342 of ITEPA. See *Change 153* in Annex 1.

Paragraph 606: section 575 of ITEPA

3510. Section 575 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.
3511. The paragraph provides rules for calculating the income charged by virtue of Chapter 4 of Part 9 of ITEPA. The income is treated as relevant foreign income for the purposes of Chapters 2 and 3 of Part 8 of this Act. See section 830(4) of this Act (meaning of "relevant foreign income") and the commentary on Part 8 of this Act (overview and Chapter 1 of that Part) for further detail.
3512. *Sub-paragraph (3)* rewrites the 10% deduction given from pension income in the source legislation by sections 65(2) and 68(5) of ICTA. It does not rewrite one of the conditions for that deduction imposed by section 68(5) of ICTA for pension income arising in the Republic of Ireland. See *Change 154* in Annex 1.
3513. Section 575(4) of ITEPA, which is inserted by sub-paragraph (3), reflects small differences in the source legislation between the conditions attached to the deduction for annual payments in section 68(3) of ICTA (income from the Republic of Ireland) and section 65(1) of ICTA (other foreign income).

Paragraph 607: section 613 of ITEPA

3514. Section 613 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.
3515. The commentary on paragraph 606, amending section 575 of ITEPA, applies equally here, with the necessary modifications for the fact that this section deals with annuities rather than a pension. See *Change 154* in Annex 1.
3516. The 10% deduction given in the source legislation by sections 65(2) and 68(5) of ICTA does not extend to annuities from the Republic of Ireland. This paragraph extends the deduction to such annuities. See *Change 155* in Annex 1.

Paragraph 608: section 631 of ITEPA

3517. Section 631 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65 and 68 of ICTA.
3518. Some of the commentary on paragraph 606, amending section 575 of ITEPA, applies equally here. See *Change 154* in Annex 1.
3519. The main difference between that section and this is that, although the income to which this section applies is treated as relevant foreign income, it is income paid in the United Kingdom. Chapters 2 and 4 of Part 8 of this Act (which rewrite sections 584 and 585 of ICTA) cannot apply. And the only provision in Chapter 3 of that Part which can apply is section 838 as the other provisions in that Chapter do not apply to income paid in the United Kingdom.

Paragraph 609: section 635 of ITEPA

3520. Section 635 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.
3521. The commentary on the paragraph 606, amending section 575 of ITEPA, applies equally here. See *Change 154* in Annex 1.

Paragraph 610: section 644A of ITEPA

3522. This new section of ITEPA gives a person receiving payments under an insurance policy which ensures against a health and employment risk exemption from taxation on those payments as pension or annuity income.
3523. This rewrites section 580A(7) of ICTA to the extent that it relates to pension income.
3524. The commentary on new section 325A of ITEPA applies equally to this section except that the insurance payments must be to the pensioner rather than the employee.

Paragraph 611: section 646A of ITEPA

3525. This new section of ITEPA provides a similar exemption for consular employees' foreign pension income to that in section 771 of this Act.
3526. The section is based on section 322 of ICTA and brings into ITEPA the exemption for income within subsection (1A)(b) and (c) of that section. This is income that was previously charged under Schedule D Case V. This section now brings the exemption for foreign pension income into ITEPA under which the income would be charged if it were not exempt.
3527. The commentary on section 771 (relevant foreign income of consular officers and employees) applies also to this paragraph when read as for pension income.

Paragraph 613: section 679 of ITEPA

3528. Section 679 of ITEPA is amended because the ICTA references on which it depended are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.
3529. The commentary on paragraph 606, amending section 575 of ITEPA, applies substantially here, with the necessary modifications for the fact that this section deals with social security income rather than a pension. This income does not benefit from the 10% deduction provided for pension income, nor are there any special rules affecting social security income from the Republic of Ireland to be mentioned.

Paragraph 614: section 681A of ITEPA

- 3530. This new section of ITEPA provides a similar exemption for consular employees' foreign social security benefits to that in section 771 of this Act.
- 3531. This new section is based on section 322 of ICTA and brings into ITEPA the exemption for income within subsection (1A)(d) of that section. This is income that was previously charged under Schedule D Case V. This section now brings the exemption for foreign benefits into ITEPA under which the income would be charged if it were not exempt.
- 3532. The commentary on section 771 of this Act (relevant foreign income of consular officers and employees) applies to this new section of ITEPA also when read as for foreign benefits.