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

INCOME TAX ACT 2007

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the Income Tax Act 2007 (c.3) which received Royal Assent on 20 March 2007. They have been prepared by the Tax Law Rewrite project at HMRC in order to assist readers in understanding the Act. They do not form part of the Act and have not been endorsed by Parliament.

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

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

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

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

Summary

5. The main purpose of the Income Tax Act 2007 is to rewrite the income tax legislation that has not so far been rewritten so as to make it clearer and easier to use.

6. The Act covers:

   - the basic provisions about the charge to income tax, income tax rates, the calculation of income tax liability and personal reliefs;
   - various specific reliefs, including relief for losses, the enterprise investment scheme, venture capital trusts, community investment tax relief, interest paid, gift aid and gifts of assets to charities;
   - specific rules about settlements and trustees, manufactured payments and repos, accrued income profits, tax avoidance and deduction of tax at source; and
   - general income tax definitions.

7. The Act does not generally change the meaning of the law when rewriting it. The minor changes which it does make are within the remit of the Tax Law Rewrite project and the Parliamentary process for the Act. In the main, such minor changes are intended

to clarify existing provisions, make them consistent or bring the law into line with established practice.

Background

The Tax Law Rewrite project

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

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

10. The project team was given the task of rewriting the United Kingdom's existing primary direct tax legislation. The aim is that the rewritten legislation should use simpler language and structure than previous tax legislation. The members of the project are drawn from different backgrounds. They include HMRC employees, private sector tax professionals and parliamentary counsel including (as head of the drafting team) a senior member of the Parliamentary Counsel Office.

Steering Committee

11. The work of the project is overseen by a Steering Committee, chaired by the Rt Hon the Lord Newton of Braintree OBE DL (who took over from the Rt Hon the Lord Howe of Aberavon CH QC at the beginning of 2006). The membership of the Steering Committee as at 31 October 2006 was:

The Rt Hon the Lord Newton of Braintree OBE DL (Chairman)

Dr John Avery Jones CBE

Adam Broke

Baroness Cohen of Pimlico

Ian Dewar

Mike Eland CB

The Rt Hon Michael Jack MP

Eric Joyce MP

District Judge Rachel Karp

David Swaine

Professor John Tiley CBE

Consultative Committee

12. The work is also reviewed by a Consultative Committee, representing the accountancy and legal professions and the interests of taxpayers. The membership of the Consultative Committee as at 31 October 2006 was:

Mark Nellthorp	Chairman
Derek Allen	Institute of Chartered Accountants of Scotland

Brian Atkinson	100 Group
Adam Broke	Special Committee of Tax Law Consultative Bodies
Colin Campbell	Confederation of British Industry
Taha Dharsi	London Chamber of Commerce and Industry
Mary Fraser	Association of Chartered Certified Accountants
Malcolm Gammie CBE QC	The Law Society of England and Wales
Julian Ghosh	Revenue Bar Association
Keith Gordon	Chartered Institute of Taxation
Terry Hopes	Institute of Chartered Accountants in England and Wales
Isobel d'Inverno	Law Society of Scotland
Simon McKie	Institute of Chartered Accountants in England and Wales
Francis Sandison	The Law Society of England and Wales
Simon Sweetman	Federation of Small Businesses
Michael Templeman	Institute of Directors
Wreford Voge	Chartered Institute of Taxation
Professor David Williams	Office of the Social Security Commissioners
Mervyn Woods	Confederation of British Industry

Consultation

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

14. This consultation took the form of a series of papers which publish clauses in draft. There were 30 of these, published between April 2004 and October 2005. A draft Bill was published for consultation in February 2006. And two further papers on provisions in FA 2006 were published in July 2006. All these documents were made available on the Tax Law Rewrite website.

15. In addition to formal consultation, the project presents its papers to the Committees to inform the Committees and seek their views on particular issues. The project has also consulted on an informal basis with specialists in particular subject areas. For example, there have been regular meetings of the VCS (venture capital schemes) rewrite group during the development of the EIS and VCT Parts of the Act. This is a small group of practitioners (who represent a number of professional bodies), policy and technical specialists from HMRC and members of the project.

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

Anne Wilson

Anthony Davis

Association of Charitable Foundations

BDO Stoy Hayward LLP

Boodle Hatfield

British Bankers' Association

Building Societies Association

Chartered Institute of Taxation

Charity Commission

Charity Law Association

Charles King-Farlow

Charles Pocock

Christine Harpin

City of Westminster & Holborn Law Society

Colin Campbell

Confederation of British Industry

David F Williams

Deloitte & Touche LLP

Department for Constitutional Affairs

Department of Finance and Personnel for Northern Ireland

Department for Social Development in Northern Ireland

Ernst & Young LLP

Euroclear

Francis Sandison

Freshfields Bruckhaus Deringer

George Harrison

Helen Billing

Horwath Clark Whitehill LLP

Investment Management Association

Institute of Chartered Accountants in England and Wales

Institute of Chartered Accountants of Scotland

James Kessler QC

John Avery Jones

John Clark

John Jeffrey-Cook

Ken Moody

KPMG LLP

Law Society of England and Wales

London Investment Banking Association

London Society of Chartered Accountants

Lovells

Low Incomes Tax Reform Group

Mark Whitehouse

Mazars LLP

Office of the Legislative Counsel, Northern Ireland

PricewaterhouseCoopers LLP

Sayer Vincent

Society of Trust and Estate Practitioners

Terry Hopes

Wedlake Bell

Wellcome Trust

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

Income Tax Act 2007

17. The Act:

- applies for income tax, continuing the general approach of previous rewrite Acts of separating income tax and corporation tax legislation;
- contains the basic provisions of income tax, such as the charge to income tax, tax rates, how a person's income tax liability is calculated, personal reliefs, and general definitions which apply for income tax purposes;
- deals with various specific reliefs, including reliefs for losses, the enterprise investment scheme, venture capital trusts, community investment tax relief, interest paid, gift aid and gifts of assets to charities;
- broadens the picture by filling in the rest of the income tax picture, in particular in relation to settlements and trustees, avoidance and deduction of tax at source; and
- will take the place of ICTA as the main Act about income tax, complemented by ITEPA and ITTOIA (which dealt with the charges to income tax on employment, pension, trading and other income).

18. The Act has 1035 sections and 4 Schedules.

19. The sections are arranged as follows:

Part 1: Overview

Part 2: Basic provisions

Part 3: Personal reliefs

Part 4: Loss relief

Part 5: Enterprise investment scheme

Part 6: Venture capital trusts

Part 7: Community investment tax relief

Part 8: Other reliefs

Part 9: Special rules about settlements and trustees

Part 10: Special rules about charitable trusts etc

Part 11: Manufactured payments and repos

Part 12: Accrued income profits

Part 13: Tax avoidance

Part 14: Income tax liability: miscellaneous rules

Part 15: Deduction of income tax at source

Part 16: Income Tax Acts definitions etc

Part 17: Definitions for purposes of Act and final provisions

20. The Schedules are:

Schedule 1: Minor and consequential amendments

Schedule 2: Transitionals and savings

Schedule 3: Repeals and revocations

Schedule 4: Index of defined expressions

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

Glossary

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

CAA	the Capital Allowances Act 2001
CAA 1990	the Capital Allowances Act 1990 (and similarly CAA 1968)
CRCA	the Commissioners for Revenue and Customs Act 2005
ESC	extra-statutory concession
HMRC	Her Majesty's Revenue and Customs
FA 1989	Finance Act 1989 (and similarly for other Finance Acts)
F(No 2)A	Finance (No. 2) Act
FISMA	the Financial Services and Markets Act 2000
ICTA	the Income and Corporation Taxes Act 1988
ICTA 1970	the Income and Corporation Taxes Act 1970
IHTA	the Inheritance Tax Act 1984
ITEPA	the Income Tax (Earnings and Pensions) Act 2003

ITTOIA	the Income Tax (Trading and Other Income) Act 2005
MOD	manufactured overseas dividend
PAYE	Pay As You Earn
R&D	research and development
TCGA	the Taxation of Chargeable Gains Act 1992
TMA	the Taxes Management Act 1970
VAT	value added tax

COMMENTARY ON SECTIONS

Part 1: Overview

Section 1: Overview of Income Tax Acts

23. This section provides an overview of the location of the main legislation dealing with income tax. It is new.

Section 2: Overview of Act

24. This section provides an overview of the Act. It is new.

Part 2: Basic provisions

Overview

25. This Part contains basic provisions about the charge to income tax.

Chapter 1: Charges to income tax

Overview

26. This Chapter sets out the provisions of the Income Tax Acts where the main charges to income tax are to be found and contains basic rules about the annual nature of income tax.

Section 3: Overview of charges to income tax

27. This section is based on section 1(1) of ICTA.

28. *Subsection (1)* lists the principal provisions that contain charges to income tax, which are all in ITEPA and ITTOIA.

29. *Subsection (2)* makes it clear that there are also charges to income tax in other legislation. The main ones are shown, but the list is not exhaustive.

Section 4: Income tax an annual tax

30. This section is based on sections 1(2), 2(2) and 832(1) of ICTA.

31. Section 2(1) of ICTA, which provides for the due proportion of income tax to be charged for every fractional part of one pound, has not been rewritten as it is otiose.

Section 5: Income tax and companies

32. This section provides that income of companies that is liable to corporation tax is not charged to income tax. It is based on sections 6(2) and 11(1) of ICTA.

33. In brief, a company's income (other than income arising to it in a fiduciary or representative capacity) is within the charge to corporation tax if:

- the company is UK resident; or
- the company is non-UK resident and:

  (a) the income is trading income arising through or from a permanent establishment in the United Kingdom of the company; or

  (b) the income arises from property or rights used by, or held by or for, the permanent establishment.

See the commentary on section 835 in relation to the residence of companies.

Chapter 2: Rates at which income tax is charged

Overview

34. This Chapter sets out all the rates of income tax and provides rules about the rates of tax at which income is charged. It is based on sections 1, 1A, 1B and 686(1A) of ICTA.

35. Two main principles are at work:

- first, the rate of tax depends on the type of income concerned; and
- second, income may be subject to progressively higher rates of tax depending on the overall amount of income of the person concerned.

36. The second principle applies only to individuals (subject to a special rule about the first £1,000 of trustees' trust rate income in Chapter 6 of Part 9 of this Act).

Section 6: The starting rate, basic rate and higher rate

37. This section sets out the main rates at which income tax is charged. It is based on section 1(2) of ICTA.

38. With some exceptions, notably savings and dividend income (see sections 12 and 13), any income of an individual is taxed at either the starting rate, the basic rate or the higher rate, depending on the level of the individual's income.

39. *Subsection (2)* specifies that the main rates are determined each year by Parliament.

40. Other rates at which income tax is charged do not have to be specified by Parliament annually and are instead set out in the sections signposted by s*ubsection (3)*.

Section 7: The savings rate

41. This section sets out the savings rate of income tax. It is based on section 1A(1B) of ICTA.

42. The "savings rate" is a new name for what is called "the lower rate" in the source legislation.

Section 8: The dividend ordinary rate and dividend upper rate

43. This section sets out these two rates of income tax that apply to dividend income. It is based on section 1B(2) of ICTA.

Section 9: The trust rate and dividend trust rate

44. This section sets out the two rates of income tax that apply, in particular, to accumulation or discretionary income of trustees. It is based on section 686(1A) of ICTA.

45. The "trust rate" is a new name for what is called "the rate applicable to trusts" in the source legislation.

Section 10: Income charged at the starting, basic and higher rates: individuals

46. This section sets out that the three main rates of income tax charged on the income of individuals are charged in three slices. It is based on section 1(2) of ICTA.

47. The first slice (*subsection (1)*) is income up to the starting rate limit – the starting rate band. The second slice (*subsection (2)*) is income between the starting rate limit and basic rate limit – the basic rate band. The third slice (*subsection (3)*) is income above the basic rate limit – the higher rate band.

48. *Subsection (4)* is a signpost to provisions that apply different rates of tax to certain types of income falling within each band. Income has to be placed in order so that the rates which would otherwise apply can be established. The rules on how this is to be done are in section 16.

Section 11: Income charged at the basic rate: other persons

49. This section charges tax at the basic rate on income of persons other than individuals. It is based on section 1(2) of ICTA.

50. Of the three main rates, only the basic rate applies. But other rates apply to specific sorts of income. In particular, savings income is charged at the savings rate and dividend income at the dividend ordinary rate. And income of discretionary and accumulation settlements is charged at the trust rates. There is a signpost to these exceptions in *subsection (2).*

Section 12: Income charged at the savings rate

51. This section charges savings income at the savings rate to the extent that it would otherwise fall within the basic rate band. It is based on section 1A(1) of ICTA.

52. There are a number of exceptions that provide that certain savings income is charged differently, usually at the trust rate. These are signposted in *subsection (2).*

Section 13: Income charged at the dividend ordinary and dividend upper rates: individuals

53. This section applies either the dividend ordinary rate or the dividend upper rate to dividend income of individuals. It is based on sections 1A(1), (1AA), (1A) and (4) and 1B(1) of ICTA.

54. To the extent that the dividend income (other than dividend income charged on the remittance basis) would otherwise fall within the starting rate or basic rate bands, *subsection (1)* provides that the dividend ordinary rate applies instead.

55. To the extent that the dividend income would otherwise fall within the higher rate band, *subsection (2)* provides that the dividend upper rate applies instead.

56. *Subsection (3)* provides that subsections (1) and (2) are subject to any provisions to the contrary.

57. "Dividend income" includes income chargeable under Chapter 5 or 6 of Part 4 of ITTOIA (see the definition in section 19). See *Change 1* in Annex 1.

Section 14: Income charged at the dividend ordinary rate: other persons

58. This section applies the dividend ordinary rate to dividend income of persons other than individuals. It is based on section 1A(1), (1A) and (4) of ICTA.

59. *Subsection (1)* applies the dividend ordinary rate in place of the basic rate to dividend income (other than dividend income charged on the remittance basis). A number of provisions which override this rule (typically to provide that one of the trust rates applies instead), are signposted by *subsection (2)*.

Section 15: Income charged at the trust rate and the dividend trust rate

60. This section provides a signpost to Chapters 3 to 6 of Part 9, which are about the circumstances in which income tax is charged at the trust rate and the dividend trust rate. It is new.

Section 16: Savings and dividend income to be treated as highest part of total income

61. This section provides the ordering rules that determine at what rate a particular type of income would be charged but for the sections imposing the savings rate or the dividend rates. It is based on section 1A(5) of ICTA.

62. *Subsection (2)* says that the rules apply for all other income tax purposes as well, except in the cases mentioned.

63. *Subsections (3)* to *(5)* contain the ordering rules. In essence, dividend income is the top part of income, savings income the middle part, and other income the lowest part.

64. *Subsection (6)* is a signpost to section 1012 which deals with the relationship between the rules in this section and other rules requiring particular income to be treated as the highest part.

65. *Subsection (7)* ensures that dividend income charged on the remittance basis does not count as dividend income for the purposes of this section.

Section 17: Repayment: tax paid at basic rate instead of starting or savings rate

66. This section allows a repayment claim outside Self Assessment if a person has suffered tax at the basic rate on income received and the person is only liable at the starting rate or the savings rate on that income. It is based on sections 1(6A) and 1A(6A) of ICTA.

Section 18: Meaning of "savings income"

67. This section defines "savings income". It is based on section 1A(1AA), (2), (3) and (4) of ICTA.

68. The definition includes income on which personal representatives are liable under section 466 of ITTOIA (gains from contracts for life insurance etc), removing an anomaly in the source legislation. See *Change 2* in Annex 1.

Section 19: Meaning of "dividend income"

69. This section defines "dividend income". It is based on section 1A(1AA), (2), (3) and (8) and section 1B(1) and (3) of ICTA.

Section 20: The starting rate limit and the basic rate limit

70. This section sets out the starting rate limit and the basic rate limit. It is based on section 1(2) to (3) of ICTA.

71. The figures used in this Act are those for 2006-07. They will be updated for 2007-08 by means of an indexation order.

Section 21: Indexation of the starting rate limit and the basic rate limit

72. This section provides for indexation of the starting rate and basic rate limits. It is based on section 1(4) to (6) of ICTA.

73. *Subsections (2)* and *(3)* set out in step form how to compute the limit for a given year by reference to the limit for the previous year and the percentage rise in the retail prices index. The words "unless Parliament otherwise determines" in section 1(4) have been omitted as it is always open to a Finance Act to disapply this provision, so no express provision to this effect is needed.

74. *Subsection (4)* is an administrative provision to reflect the fact that it is usually only known at the time of the Chancellor's Budget speech whether statutory indexation will apply. This leaves insufficient time before the start of the tax year for employers to update their payroll systems. This rule gives employers until the first pay-day after 17 May to make the necessary changes.

75. *Subsection (5)* obliges the Treasury to specify the indexed amounts in a statutory instrument which must be made in the tax year before the tax year to which they are to apply.

Chapter 3: Calculation of income tax liability

Overview

76. This Chapter deals with the calculation of a person's income tax liability for a tax year.

77. The calculation sets out how the rules about the rates at which income is charged, and provisions about reliefs, allowances, tax reductions etc, are applied to the components of a person's total income to arrive at the person's income tax liability.

78. The calculation does not deal with amounts of tax suffered (eg under PAYE or by way of deduction of tax at source) as these are set off against a person's liability rather than deducted in arriving at it. See section 59B(1) of TMA.

79. Nor does it deal with relief given by discharge or repayment, as here too the relief can operate only once the amount of a person's liability has been determined. Examples of such reliefs include paragraph 6 of Schedule 14 to ICTA (life insurance relief for non-residents) and section 416 of CAA (mineral extraction allowance - expenditure on restoration within 3 years of ceasing to trade).

Section 22: Overview of Chapter

80. This section provides an overview of the Chapter. It is new.

81. The persons liable to income tax include individuals, trustees, personal representatives, non-UK resident companies, and companies acting in a fiduciary or representative capacity.

82. But where non-UK resident companies carry on a trade in the United Kingdom through a permanent establishment, they are liable to corporation tax instead of income tax on their chargeable profits. See the commentary on section 5.

Section 23: The calculation of income tax liability

83. This section sets out the steps to be taken in calculating a taxpayer's liability to income tax for a tax year. It is based on many provisions in the source legislation, in particular section 835 of ICTA.

84. *Step 1* brings together all the amounts of income on which a taxpayer is charged to income tax for the tax year. The sum of these amounts is called "total income", and each of the amounts is a "component" of total income.

85. In the source legislation there were some contexts in which "total income" was used in a different sense (eg in section 1 of ICTA, where it meant what is defined in Step 2 as "net income"). But in this Act it is used consistently to denote this first stage result. And the consequential amendments to other legislation in Schedule 1 ensure that it will always be used in this sense elsewhere.

86. *Step 2* deals with those reliefs (other than personal allowances) which are given by deduction from income.

87. Most of the reliefs listed in section 24 may be deducted from any type of income. But some may only be deducted from certain components of total income. See section 25(3).

88. Step 2, combined with the provisions about the reliefs themselves and the rules in section 25 about the way in which deductions are made, ensures that the reliefs are allowed in the proper way to arrive at "net income".

89. It is important that this is done by reference to the components of total income, to pave the way for Step 4.

90. *Step 3* deals with the deduction of the personal allowance and blind person's allowance from the components of net income. This step only affects individuals. The rule that these deductions come last is based on section 835(5) of ICTA.

91. Again, it is important that this is done by reference to the components of total income, to pave the way for Step 4.

92. *Step 4* applies the rates of tax specified in Chapter 2 (and, where the taxpayer is a trustee, the relevant Chapters of Part 9 of this Act) to the amounts of the components remaining after Step 3.

93. *Step 5* adds together the amounts of tax on each component.

94. *Step 6* then deducts any tax reductions. These are listed in section 26. Further rules about how these tax reductions are made are in sections 27 to 29.

95. *Step 7* then adds on certain other amounts of income tax for which a taxpayer may be liable, as listed in section 30.

Section 24: Reliefs deductible at Step 2

96. This section lists all the reliefs that may be deducted from components of total income at Step 2 of the calculation. It is based on many provisions in the source legislation.

97. The section is arranged to highlight those reliefs which apply only to individuals, and to avoid duplication of references to particular reliefs.

98. This section, and others in the Chapter, contains lists of provisions some of which are in this Act and some which are elsewhere. Such lists are arranged by reference to the order that the provisions appear in this Act and by reference to the date on which other legislation was enacted.

99. The entries in the lists are not each given their own sub-paragraph reference. This will reduce the scope for confusion should any amendments need to be made to the lists in future Finance Acts.

100. One of the reliefs deducted at this step is for annual payments and patent royalties under Chapter 4 of Part 8. See *Change 81* in Annex 1 and the overview commentary on Chapter 4 of Part 8.

101. The opportunity has been taken to clarify the way in which reliefs under sections 446 and 454 of ITTOIA work. See the amendments made to those sections in Schedule 1.

102. The list of reliefs does not include section 811 of ICTA. That section allows a reduction of a component of income for foreign tax suffered on that income where no credit is available. It has been excluded on the basis that the relief reduces the amount of income from the source (and where appropriate can create or augment a trading loss) before it enters into the calculation in section 23.

103. For the same reason, the list does not include relief under section 798C of ICTA which was introduced by FA 2005.

104. For the rules about what (if anything) may be done with any excess relief over the amount of income from which it can be deducted it is necessary to refer to the particular provisions dealing with the relief concerned. But see also the provisions of section 25.

Section 25: Reliefs and allowances deductible at Steps 2 and 3: supplementary

105. This section contains rules about the way deductions are made against components of income. It is based on section 835(3), (4) and (5) of ICTA.

106. The main rule, in *subsection (2)* is that deductions are allowed in the way that results in the greatest reduction of income tax liability.

107. This rule means that where a deduction may be set against more than one component of income or there are two or more deductions available, they are allowed in the way that produces the least income tax liability. The order in which deductions that are allowable against a particular component of income are made under Step 2 cannot affect the liability for the tax year concerned. If there is sufficient income then all deductions are allowed in full. If there is insufficient income then unrelieved income is nil. But the order in which they are made can affect the amount of relief that is available to carry forward or back (in the case of reliefs where that is a possibility).

108. *Subsection (3)* is a signpost to provisions that modify the rule in subsection (2), in particular in the case of reliefs given only against certain types of income.

109. *Subsections (4)* and *(5)* ensure that a deduction is only given to the extent that there is income to absorb the deduction, taking into account deductions already made.

110. Some, but not all, of the source provisions contain the rule that income cannot be reduced below nil, but even where not explicitly mentioned, it has always been the accepted practice that a deduction can only be made from income to the extent that there is income to absorb the deduction. The position is now explicit for all income deductions.

111. A similar point arises in connection with deductions that operate as tax reductions. See the commentary on section 29.

Section 26: Tax reductions

112. This section lists the tax reductions that are allowed in terms of tax at Step 6 of the calculation in section 23. It is based on many provisions in the source legislation.

113. The approach adopted to the layout of this section is in line with that adopted in relation to section 24.

114. One of the tax reductions is for relief under section 539 of ITTOIA. See *Change 3* in Annex 1.

Section 27: Order of deducting tax reductions: individuals

115. This section provides rules about the order in which tax reductions are to be given for individuals. It is based on many provisions in the source legislation.

116. In the source legislation, many of the provisions dealing with tax reductions contain rules which specify how that reduction interacts with other tax reductions. These rules, so far as they relate to individuals, are brought together in *subsections (4)* to *(6)*.

117. But those rules are not comprehensive. As well as bringing the existing rules together into one place, the section introduces a new rule in *subsections (2)* and *(3)* providing that, subject to the following subsections, the reductions are allowed in the way that gives the greatest reduction in liability for the year. See *Change 4* in Annex 1.

118. Subsections (4) and (5) list those provisions where rules setting out some priority are contained in the source legislation. Subject to the point mentioned in the next paragraph, the provisions are listed in the order in which the source rules require the reliefs to be allowed. If any other reduction (except double taxation relief) is due then it may be allowed at whatever stage (before or after any of the provisions in subsection (5)) gives the maximum reduction.

119. It is clear from section 256 of ICTA that reductions under Chapter 1 of Part 7 of ICTA are given after all other reductions (except double taxation relief), but no order of priority between the two reductions within that Chapter is given. Since the reduction for married couples and civil partners is transferable whereas the reduction under section 273 of ICTA is not, it will always be beneficial if any reduction under section 273 of ICTA comes first. Subsection (5) reflects this. See *Change 4* in Annex 1.

Section 28: Order of deducting tax reductions: other persons

120. This section provides rules about the order in which tax reductions are to be given for persons other than individuals. It is based on sections 790(3) and 796(1) of ICTA and sections 26 and 27(1) of FA 2005.

121. There are fewer tax reductions available than for individuals, so the rules are less complex. *Subsection (2)* corresponds to section 27(2) in providing a new rule that the reductions are allowed in the way that gives the greatest reduction in liability. See *Change 4* in Annex 1 and the commentary on section 27.

122. *Subsection (5)* is a special rule concerning the tax reduction given to certain trustees under section 26 of FA 2005.

Section 29: Tax reductions: supplementary

123. This section contains additional rules about the giving of tax reductions. It is based on a number of provisions in the source legislation.

124. *Subsections (2)* and *(3)* ensure that a reduction is only given to the extent that there is tax to absorb the reduction, taking into account reductions already made. Many of the source provisions contain the rule that the tax cannot be reduced below nil (see for example section 256(2) of ICTA). And top-slicing relief under section 535 of ITTOIA cannot give a greater tax reduction than the tax increase resulting from including the gain concerned within total income. The position is now explicit for all tax reductions. See the commentary on section 25.

125. *Subsection (4)* ensures that the rules in this section limiting the amount of a tax reduction by reference to the amount of tax against which it is set will not affect the calculation under section 796 of ICTA of the limit on income tax credit relief for double taxation. It also ensures that those rules will not affect the operation of any other provisions limiting the amount of a tax reduction.

126. *Subsection (5)* ensures that any reference in this Chapter to double taxation relief under section 788 of ICTA brings in relief allowed in accordance with arrangements made under that section.

Section 30: Additional tax

127. This section lists provisions under which amounts of tax are added to the tax liability at Step 7 of the calculation. It is based on a number of provisions in the source legislation.

Section 31: Total income: supplementary

128. This section provides supplementary rules, in particular about the tax year in which income received under deduction of tax or with a tax credit is to be taken into account. It is based on section 835(6) and (7) of ICTA.

Section 32: Liability not dealt with in the calculation

129. This section lists income tax liabilities not dealt with in the calculation. It is new.

130. These liabilities arise in connection with:

- the recovery of excessive relief (eg the withdrawal or reduction of EIS relief or the recovery of excess credit for overseas tax) where the taxpayer's self-assessment for the tax year is final;
- deduction of tax at source (eg Chapters 15 to 17 of Part 15 and the reverse charge provisions), where the liability is not in respect of the person's own liability; and
- stand-alone charges (eg Chapter 1 of Part 13, or in relation to the administration of pension schemes).

Part 3: Personal reliefs

Overview

131. This Part contains rules relating to personal reliefs for individuals. It is based on Chapter 1 of Part 7 of ICTA.

132. The reliefs dealt with in this Part fall into two distinct categories. First, there are two reliefs that operate as a deduction from net income. They are the personal allowance and blind person's allowance. The rules for those reliefs are in Chapter 2.

133. Second, there is one relief which operates by way of a reduction in terms of tax. That is the tax reduction for certain married couples and civil partners. The rules for that relief are in Chapter 3.

134. Chapter 4 contains general provisions, in particular relating to residence and indexation of allowances.

135. The reliefs under Chapters 2 and 3 are available only to individuals meeting the residence etc requirements of section 56, which is based on section 278 of ICTA. Individuals who, under the source legislation, could claim these reliefs only by virtue of meeting the condition in section 278(2)(a) are catered for by corresponding provisions in ICTA, as amended by this Act, rather than by this Part. This is because if the condition concerned (which, in particular, operates by reference to whether the individual is a Commonwealth citizen) were included in this Act it would not have been possible to certify that the Act was compatible with the Human Rights Act 1998.

136. In addition, to limit the extent to which the provisions of this Act depend on reliefs given by virtue of an individual meeting the condition in section 278(2)(a) of ICTA, transfers of blind person's allowance and married couple's allowance will no longer be available unless the two individuals concerned make their claims to relief under the

same set of provisions. This rule is subject to a transitional provision providing that it will not apply to those entitled to such allowances immediately before the Act comes into force until the start of the 2009-10 tax year. See Part 4 of Schedule 2 and *Change 7* in Annex 1.

137. The figures used for allowances and income thresholds throughout this Part are those for 2006-07. An indexation order will be made before 6 April 2007 setting the figures for 2007-08 (unless those figures are then changed by FA 2007). Although that order will expressly apply only to ICTA, the continuity of the law provisions in Schedule 1 to this Act will ensure that the figures here are also updated.

Chapter 1: Introduction

Section 33: Overview of Part

138. This section explains where to find the rules relating to each relief that is dealt with in this Part. It is new.

Chapter 2: Personal allowance and blind person's allowance

Overview

139. This Chapter makes provision for the personal allowance and the blind person's allowance. It is based on sections 256(1), 257, 265 and 278 of ICTA.

140. The residence requirement for each allowance has been built into sections 35 to 39 with no special provision for claims by non-UK residents to be made to the Commissioners for Her Majesty's Revenue and Customs. Claims for allowances are made to officers of Revenue and Customs, and no appeals are reserved to the Special Commissioners. This is achieved by not specifying to whom claims are to be made. See *Change 5* in Annex 1.

Section 34: Allowances under Chapter

141. This section introduces the Chapter and explains where to find the rules relating to those allowances given by deduction from income. It is new.

Section 35: Personal allowance for those aged under 65

142. This section sets out the conditions for an individual aged under 65 to be entitled to a personal allowance. It is based on sections 256(1), 257 and 278 of ICTA.

143. Section 256 of ICTA makes it clear that a claim is required. Although in practice this personal allowance is often given automatically for years for which a valid claim would still be possible (a practice which will continue), it is necessary to retain the formal claims procedure in order to provide a mechanism to resolve disputed claims. For claims generally, see *Change 5* in Annex 1 and the overview commentary on this Chapter.

Section 36: Personal allowance for those aged 65 to 74

144. This section provides a higher level of allowance for individuals aged 65 to 74. It is based on sections 256(1), 257 and 278 of ICTA.

145. *Subsection (2)* is the rule that the allowance is reduced if the individual's adjusted net income exceeds a threshold. But the allowance cannot be reduced below the amount of the personal allowance in section 35.

Section 37: Personal allowance for those aged 75 and over

146. This section provides a higher level of allowance for individuals aged 75 and over. It is based on sections 256(1), 257 and 278 of ICTA.

147. As in section 36, *subsection (2)* rewrites the rule that provides for the reduction of the allowance if the claimant's income exceeds a threshold. But the allowance cannot be reduced below the amount of the personal allowance in section 35.

Section 38: Blind person's allowance

148. This section deals with the conditions for blind person's allowance. It is based on sections 256(1), 265 and 278 of ICTA.

149. As with the personal allowances, the residence requirement has been built into *subsection (1)*. In fact, due to the particular conditions of the relief set out in the following subsections, it is very rare for a non-resident to be entitled to the allowance.

150. Section 265(1) of ICTA requires the claimant to be a "registered blind person". This term is defined in section 265(7) in two legs.

151. The first leg refers to registers compiled under section 29 of the National Assistance Act 1948. That Act never applied to Northern Ireland and was repealed in relation to Scotland by the Social Work (Scotland) Act 1968 (section 95(2) and Part 1 of Schedule 9). It follows that any registers maintained by local authorities in Scotland or Northern Ireland or by Societies for the Blind on their behalf are not registers under section 29. So *subsection (2)* makes it clear that this condition can only apply to registers kept by local authorities in England and Wales.

152. The second leg of the definition in section 265(7), which applies only to Scotland and Northern Ireland, refers to persons who are blind within the meaning of section 64(1) of the National Assistance Act 1948. This definition, which is that the individual is unable to do any work for which eyesight is essential, is the same as that underpinning entitlement to registration by local authorities in England and Wales, and is set out in *subsection (3)*.

153. *Subsection (4)* legislates ESC A86. This treats a claimant as satisfying the registration condition in the year prior to formal registration where evidence of blindness on which registration is based had been obtained in that prior year. See *Change 6* in Annex 1.

Section 39: Transfer of part of blind person's allowance to a spouse or civil partner

154. This section allows the transfer of any excess allowance due to a blind person to his or her spouse or civil partner if the blind person's income is insufficient to absorb the allowance fully. It is based on sections 256(1), 265 and 278 of ICTA.

155. It is implicit in section 265 of ICTA that a spouse or civil partner receiving all or part of an allowance under this provision must be an individual entitled to claim allowances in their own right. *Subsection (1)* makes this explicit by incorporating the residence requirement for the receiving spouse or civil partner.

156. *Subsection (2)* specifies that it is only the excess allowance that can be transferred, that the transferor must make an election (see section 40), and makes it clearer that in order to be entitled to the allowance the transferee must claim it.

157. *Subsection (3)* provides rules for determining the amount by which the allowance exceeds income for the purposes of this section. It takes the amount of net income as the starting point. The appropriate personal allowance is then deducted.

158. Section 265(3)(c) of ICTA has not been rewritten as it is obsolete.

Section 40: Election for transfer of allowance under section 39

159. This section sets out rules about elections under section 39. It is based on section 265(5) and (6) of ICTA.

160. There is no need to specify that the election must be in the form specified by the Commissioners for Her Majesty's Revenue and Customs since paragraph 2(3) of Schedule 1A to TMA achieves that result.

161. *Subsection (2)* provides that if an individual has made an election for the transfer of his or her excess blind person's allowance in a tax year then this is also treated as an election for the transfer of any excess tax reduction for married couples and civil partners.

Section 41: Allowances in year of death

162. This section addresses the position if an individual dies in the tax year for which an allowance may be due. It is based on section 257(4) of ICTA.

163. *Subsection (1)* is new, but states what is implicit in the current legislation. The amount of the allowance for any tax year is not reduced on account of death, so that the full amount is due, even if death occurs on 6 April.

164. *Subsections (2)* and *(3)* provide that the age-related personal allowances are given for a tax year on the basis that an individual will reach 65 or 75 in that year and are not affected if death occurs before the relevant birthday.

Chapter 3: Tax reductions for married couples and civil partners

Overview

165. This Chapter provides for a tax reduction where a party to a marriage or civil partnership was born before 6 April 1935. It is based on sections 257A, 257AB, 257BA, 257BB and 278 of ICTA, as amended by the Tax and Civil Partnership Regulations 2005 (SI 2005/3229).

166. The residence requirement has been built into sections 45 to 49 with no special provision for claims by non-UK residents to be made to the Commissioners for Her Majesty's Revenue and Customs. Claims to allowances are made to officers of Revenue and Customs, and no appeals are reserved to the Special Commissioners. This is achieved by not specifying to whom claims are to be made. See *Change 5* in Annex 1.

167. A tax reduction is only due if the parties live together. The meaning of living together is in section 1011.

Section 42: Tax reductions under Chapter

168. This section explains where to find the rules about the relief for married couples and civil partners given as a reduction in terms of tax. It is new.

169. These reliefs are often known as married couple's allowances (the term referring to the amounts by reference to which the tax reductions are calculated).

170. Relief is available only if one spouse or civil partner was born before 6 April 1935.

171. The general rule in section 256(2)(b) of ICTA that prevents the tax reduction exceeding the liability is reflected in section 29.

Section 43: Meaning of "the minimum amount"

172. This section specifies the minimum amount of the allowance by reference to which relief is given. It is based on sections 257A(5A) and 257AB(5) of ICTA.

173. The tax reduction for married couples and civil partners is a percentage of a specified amount known as the "married couple's allowance" (see sections 45(3) and 46(3)). The allowance depends on the ages of the couple and the level of the claimant's income. But that amount cannot be reduced below a certain level which is given a new label "the minimum amount".

Section 44: Election for new rules to apply

174. This section defines, and provides rules about, elections for the rules introduced by the Tax and Civil Partnership Regulations 2005 to apply. It is based on section 257AB(8) of ICTA.

175. The new rules concern marriages taking place and civil partnerships formed on or after 5 December 2005. Existing marriages are not affected. But the husband and wife of an existing marriage may jointly elect for the new rules to apply. The main effect of an election is that the spouse with the higher income, rather than the husband, is the individual entitled to make the primary claim to relief.

Section 45: Marriages before 5 December 2005

176. This section applies if a marriage took place before 5 December 2005 unless an election for the new rules is in force. It is based on sections 256 and 257A of ICTA.

177. *Subsection (1)* provides that the husband may claim the relief and that if the conditions in *subsection (2)* are met he is entitled to a tax reduction. The amount of the tax reduction is 10% of the amount specified in *subsection (3)*.

178. *Subsection (4)* provides that the allowance is reduced if the husband's adjusted net income exceeds a threshold. The calculation of adjusted net income for this purpose is similar to, but slightly more complicated than, that under section 36(2) because it takes into account the fact that he will have already suffered a reduction in his personal allowance if he is aged 65 or over.

Section 46: Marriages and civil partnerships on or after 5 December 2005

179. This section applies if a marriage takes place or a civil partnership is formed on or after 5 December 2005, or if a married couple elect for the new rules to apply. It is based on sections 256 and 257AB of ICTA.

180. Where a same-sex couple registered their relationship in an overseas jurisdiction listed in Schedule 20 to the Civil Partnership Act 2004 before 5 December 2005 they are treated under that Act as having formed a civil partnership on 5 December 2005. According, in those circumstances a claim may be made under this section.

181. *Subsection (1)* provides that on a valid claim a tax reduction is due to the individual who makes the claim. As is made clear in *subsection (2)*, that individual is the spouse or civil partner with the higher income.

182. *Subsection (2)* sets out the conditions for the relief under this section. The "higher income" test operates by reference to net income. If, exceptionally, both parties have the same income, then they jointly nominate either party as the claimant.

183. *Subsection (4)* provides that the allowance is reduced if the claimant's adjusted net income exceeds a threshold. The calculation of adjusted net income for this purpose is similar to, but slightly more complicated than, that under section 36(2) because it takes into account the fact that the individual will have already suffered a reduction in the personal allowance if the individual is aged 65 or over.

Section 47: Election by individual to transfer relief under section 45 or 46

184. This section allows an individual to claim a transfer of part of the relief available to that individual's spouse or civil partner. It is based on section 257BA(1) of ICTA.

185. The tax reduction is claimed by and given to the husband under section 45, or to the party with the higher income under section 46.

186. The transfer that can be made (from this primary claimant) to the wife or to the lower income party (as appropriate) is of a tax reduction calculated by reference to one half of the "the minimum amount" in section 43.

187. *Subsection (1)* provides that the recipient is entitled to a tax reduction of 10% of one half of the minimum amount provided the primary claimant is entitled to a tax reduction, and the conditions in *subsection (2)* are met.

188. The procedure for making an election is set out in section 50. In addition to the election, which remains in force until withdrawn, the spouse or civil partner must claim the tax reduction for a particular tax year.

189. *Subsections (3)* and *(4)* ensure that if a spouse or civil partner does receive a tax reduction under this section then the primary claimant's tax reduction (calculated after any reduction attributable to income exceeding the threshold or due to marriage or entry into civil partnership in the year) is correspondingly reduced.

Section 48: Joint election to transfer relief under section 45 or 46

190. This section allows spouses or civil partners to make a joint claim for the transfer between them of the part of the relief attributable to the whole of the minimum amount. It is based on section 257BA(2) of ICTA.

Section 49: Election for partial transfer back of relief

191. This section provides that if a joint election has been made under section 48, then the primary claimant may unilaterally elect to transfer back the tax reduction attributable to one half of the minimum amount. It is based on section 257BA(3) of ICTA.

192. This is in addition to that individual benefiting from any tax reduction attributable to the allowance in excess of the minimum that remained with that individual in the first place. The election remains in force until withdrawn and the procedure is set out in section 50. The individual also has to make a claim for each tax year for which a transfer back is wanted.

Section 50: Procedure for making and withdrawing elections under sections 47 to 49

193. This section details the procedure for making elections for the transfer of relief to a spouse or civil partner and for the re-transfer of relief back and for the withdrawal of those elections. It is based on section 257BA(4), (5), (7) and (8) of ICTA.

194. *Subsection (2)* concerns the making of an election. The election must be in the form specified by the Commissioners for Her Majesty's Revenue and Customs, in accordance with paragraph 2(3) of Schedule 1A to TMA.

195. *Subsection (3)* sets out the two circumstances in which an election first takes effect in the year in which it is made rather than in the following year. Where "appropriate notice" is to be given, it must be in writing (see section 989).

Section 51: Transfer of unused relief

196. This section provides for the transfer to a spouse or civil partner of so much the relief as cannot be used in calculating the primary claimant's liability to income tax. It is based on section 257BB(1), (2) and (3A) of ICTA.

197. In looking to see whether the claimant has unused relief, *subsection (1)* provides for a comparison to be made between that individual's tax reduction (including any tax reduction transferred back from the spouse or civil partner) and the individual's "comparable tax liability". The meaning of this new term is given in section 53. The

unused part of the total tax reduction under this Chapter is the amount eligible for transfer.

198. In order for this provision to apply the spouse or civil partner must be entitled to relief and the primary claimant must give notice that the transfer is to apply. These rules are contained in *subsection (4).*

Section 52: Transfer back of unused relief

199. This section is effectively the reverse of section 51. It is based on section 257BB(3) and (3A) of ICTA.

200. It applies if a spouse or civil partner has claimed a tax reduction based on the whole or half of the "minimum amount", but cannot use that relief in full. In such a case, if that spouse or civil partner gives due notice, the excess relief goes back to the primary claimant.

Section 53: Transfer of unused relief: general

201. This section contains general provisions about transfers of unused relief. It is based on sections 256(2) and (3) and 257BB(1), (3) and (5) of ICTA.

202. In particular, the section explains how an individual's "comparable tax liability" is determined in calculating whether there is excess relief eligible for transfer to a spouse or civil partner under section 51 or 52.

203. *Subsection (2)* makes it clear that the comparison is made before deducting any double taxation relief. This ensures that any double taxation relief is given last.

204. Certain tax liabilities are ring-fenced so that they cannot be reduced by reliefs given by tax reductions. If an individual makes gift aid donations, the tax reduction under this Chapter may have to be restricted under the gift aid rules. This means that there is a greater reduction potentially available to transfer to the spouse or civil partner. The same applies in reverse if the spouse or civil partner makes gift aid donations and there is a transfer back to the primary claimant. *Subsection (3)* ensures that these rules work as intended by restricting the amount that may be transferred.

Section 54: Tax reductions in the year of marriage or entry into civil partnership

205. This section provides rules that apply in the year of marriage or entry into civil partnership. It is based on sections 257A(6), 257AB(7) and 257BA(6) of ICTA.

206. *Subsection (2)* provides that in the year of marriage or entry into civil partnership, the allowance by reference to which the tax reduction is calculated is reduced by one twelfth for each complete month in the tax year prior to the marriage or civil partnership.

207. *Subsection (3)* makes it clear that the allowance to be reduced under this section is the allowance after it has been adjusted on account of the primary claimant's income exceeding the threshold.

208. *Subsection (4)* addresses the situation where an individual has been married or in a civil partnership in the tax year and remarries or enters into a new civil partnership.

209. It may be advantageous for the claim to be made for the later marriage or civil partnership rather than the earlier one even though the later one (but not the earlier one) will usually give rise to an adjustment under subsection (2).

210. The wording here makes it clear that the individual can choose to claim for the later marriage or civil partnership but that, if the claim is made for the marriage or civil partnership which existed at the start of the tax year, the individual will not suffer the adjustment under this section.

211. *Subsection (5)* ensures that if tax reductions based on the minimum amount are being transferred between spouses or civil partners, the minimum amount is also reduced by one twelfth for each complete month in the tax year prior to the marriage or civil partnership.

Section 55: Sections 45 to 53: supplementary

212. This section contains miscellaneous rules based on several source provisions.

213. *Subsection (1)* provides that an individual is entitled to only one tax reduction under sections 45 to 48 in a tax year. It is based on sections 257A(6), 257AB(6) and 257BA(9) of ICTA.

214. *Subsection (2)* corresponds to the rule in section 41(3) in relation to allowances under Chapter 2 that the higher level of relief under this Chapter is given for the tax year in which an individual will reach 75 and is not affected if death occurs before the 75th birthday. It is based on sections 257A(4) and 257AB(3) of ICTA.

215. *Subsection (3)* is new, but reflects the current law. It addresses the position where an individual dies and corresponds to the rule in section 41(1). It is a clear statement that the amount of the relief is not reduced on account of death, so that the full amount is due, even if death occurs on 6 April.

Chapter 4: General

Overview

216. This Chapter contains the residence requirement for personal reliefs, provides for the indexation of allowances and income thresholds and makes provision about the determination of an individual’s income in connection with the age-related allowances.

Section 56: Residence etc of claimants

217. This section provides details of residence conditions which have to be satisfied for personal reliefs to be available. It is based on section 278 of ICTA.

218. *Subsection (1)* provides that the section applies in relation to personal allowances, blind person’s allowance and tax reductions for married couples and civil partners. Section 460 provides corresponding rules for certain other reliefs given in Chapter 6 of Part 8.

219. S*ubsection (2)* provides that the requirements of this section are met if the individual is UK resident or meets one of the alternative tests in subsection (3).

220. Residence is a concept that applies to a tax year so that an individual is either resident in or not resident in the United Kingdom for a complete tax year. But ESC A11 allows tax years to be split, and will continue to do so. Personal reliefs are given in full for any tax year in which a qualifying individual is resident in the United Kingdom whether or not the tax year is split under ESC A11.

221. *Subsection (3)* is based on section 278(2) of ICTA. If the individual is not UK resident then one of conditions (a) to (f) must be satisfied. The drafting makes it explicit that a test only has to be met at some time in the tax year. In rewriting section 278(2)(e) of ICTA it has been assumed that the word “employed” is implicit before the word “service”.

222. Individuals who, under the source legislation, were able to claim the reliefs only by virtue of meeting the condition in section 278(2)(a) are catered for by provisions remaining in ICTA, as amended by this Act. See the overview commentary on this Part.

Section 57: Indexation of allowances

223. This section provides for the annual indexation of allowances. It is based on sections 257C and 265(1A) of ICTA.

224. *Subsection (1)* lists all the amounts within Chapters 2 and 3 of this Part that are subject to indexation.

225. *Subsections (2)* to *(4)* set out how the increases due to indexation are to be calculated. The words "unless Parliament otherwise determines" in section 257C(1) have been omitted as it is always open to a Finance Act to disapply this provision, so no express provision to this effect is needed.

226. *Subsection (5)* is an administrative provision to reflect the fact that it is usually only known at the time of the Chancellor's Budget speech whether statutory indexation will apply. This leaves insufficient time before the start of the tax year for employers to update their payroll systems. This rule gives employers until the first pay-day after 17 May to make the necessary changes.

227. *Subsection (6)* obliges the Treasury to specify the indexed amounts in a statutory instrument which must be made in the tax year before the tax year to which they are to apply.

Section 58: Meaning of "adjusted net income"

228. This section brings together the rules from several source provisions about calculating income for the purposes of the age-related personal allowances. It is based on section 835(5) of ICTA, section 25(9A) of FA 1990 and section 192(5) of FA 2004.

229. The starting point is the measure of an individual's net income as set out in Step 2 in section 23. An individual's net income is determined before allowances under Chapter 2 of this Part are deducted. Section 835(5) of ICTA makes it clear that such allowances are not deducted in determining the income threshold for the purpose of sections 257(5) and 257A(5) of ICTA. Due to an oversight in the amendments made by the Tax and Civil Partnership Regulations 2005 (SI 2005/3229), the rule was not applied to the calculation of the income threshold in section 257AB(4) of ICTA. That oversight is corrected here. See *Change 8* in Annex 1.

230. *Subsection (1)* makes a number of adjustments to the amount of net income.

231. Before FA 2000, covenanted donations to charities were charges on income. But section 41 of FA 2000 amended that rule so that charitable donations are no longer charges on income. In order that the measure of income used in the calculation of age-related personal allowances was not affected by this change, section 25(9A) of FA 1990 was inserted to ensure that charitable donations continued to reduce income for this purpose. *Step 2* gives effect to this rule.

232. Under the gift aid rules the donor gives an amount (the net amount) which is grossed up at the basic rate of tax to provide a "grossed up amount". *Step 2,* together with s*ubsection (2),* make it clear that, as has always been understood, it is the gross amount that is to be deducted.

233. *Step 3* together with *subsection (3)* provide for a deduction to be made from income for the gross amount of certain pension contributions paid under deduction of tax. This rule is based on section 192(5) of FA 2004.

234. *Step 4* ensures that any relief given under section 457 or 458 that has been deducted in arriving at net income is added back. That reflects section 835(5) of ICTA in relation to the income threshold in the age-related personal allowances and in married couple's allowance for marriages taking place before 5 December 2005. This provision applies the rule also to the calculation of the income threshold for marriages and civil partnerships entered into to on or after that date. See *Change 8* in Annex 1.

Part 4: Loss relief

Overview

235. This Part contains rules relating to various reliefs for losses that are deducted in calculating net income (see Step 2 of section 23). It is based on sections 117 to 118ZO and Chapter 1 of Part 10 (sections 379A to 392) of ICTA.

236. The reliefs are set out in separate Chapters following (so far as relevant) the order in which the types of income concerned are set out in ITTOIA.

Chapter 1: Introduction

Section 59: Overview of Part

237. This section provides an overview of the Part. It is new.

238. *Subsection (2)* provides that the Part is to be read with Chapter 3 of Part 2. In particular that Chapter provides rules about the order in which different reliefs are deducted in calculating net income.

239. *Subsection (3)* provides a signpost to rules about the calculation of the amount of losses, for which relief may be available under this Part.

Chapter 2: Trade losses

Overview

240. This Chapter provides relief for trading losses.

Section 60: Overview of Chapter

241. This section provides an overview of the Chapter. It is new.

242. *Subsection (1)* lists the various reliefs available for trade losses and certain restrictions on the reliefs.

243. *Subsection (2)* provides a signpost to Schedule 1B of TMA. Schedule 1B gives rules for the mechanics where there is a claim that relief for losses of one tax year be given against income of an earlier tax year.

244. *Subsection (3)* provides a signpost to provisions which treat an individual as starting or permanently ceasing to carry on a trade, profession or vocation in certain circumstances. It is based on section 384(4) of ICTA.

245. *Subsection (4)* introduces a label ("sideways relief") for the two reliefs that allow trading losses for a tax year to be set against other income arising in the same tax year or an earlier tax year.

Section 61: Non-partners: losses of a tax year

246. This section provides that references to losses made in a tax year means losses made in the basis period for the tax year. It is based on sections 382(3) and 385(1) of ICTA.

Section 62: Partners: losses of a tax year etc

247. This section sets out certain rules that apply if the losses are made by a person who is a partner and provides signposts to the relevant provisions in ITTOIA. It is based on sections 110(1A), 118ZE(5) and (6), 382(3), 385(1) and 389(4) of ICTA.

Section 63: Prohibition against double counting

248. This section ensures relief is only given once for a particular loss or part of a loss. It is based on sections 380(1), 381(3), 385(7), 388(2), 504A(5) of ICTA and section 72(2) of FA 1991.

249. This section does not reproduce the rule in section 382(4) of ICTA that an amount of a loss of a trade, which would otherwise be included in calculations for two successive years, is not to be included in the calculation for the second of those years. That rule is covered by section 206 of ITTOIA, to which section 61(5) provides a signpost.

Section 64: Deduction of losses from general income

250. This section provides for trade loss relief against general income. It is based on section 380(1) of ICTA.

251. "Trade loss relief against general income" is a descriptive label for the relief covered by this section; the words "general income" are not used in Chapter 3 of Part 2 (calculation of income tax liability).

252. The section makes explicit what is only implicit in section 380(1) of ICTA:

- in *subsection (2)*, that a claim may be made for both the tax year in which the allowable loss is incurred and the previous tax year;
- in *subsection (3)*, what is required in practice to establish how the claim is to apply to each year;
- in *subsection (4)*, that, in the case of a claim in respect of one year only, the claim must specify which year; and
- *in subsection (6)*, that a claim specifying one year does not prevent a further claim (in respect of an unused part of the loss) which specifies the other.

Section 65: How relief works

253. This section specifies how deductions for the loss are to be made. It is based on section 380(1) and (2) of ICTA.

254. *Subsection (1)* makes explicit what is only implicit in section 380(1) of ICTA, that:

- the whole amount of the loss must be deducted in calculating the claimant's net income for the specified tax year;
- if a claim is made in respect of two tax years, then only so much, if any, of the amount of the loss which it has not been possible to deduct from the claimant's income for the specified year can be deducted in calculating the claimant's net income for the other year.

255. This section does not deal with the parts of section 380(1)(a) and (b) of ICTA that limit the amount of the deduction for any tax year to the whole of the claimant's income for the year, where the income is less than the amount of the loss. That limit is in section 25(4) and (5). Section 25 contains rules about how the reliefs listed in section 24, which include trade loss relief, are to be deducted at Step 2 of section 23 in order to calculate the claimant's net income.

256. *Subsections (2)* and *(3)* provide that if claims are made in respect of trade losses incurred in successive tax years and both claims specify that relief is to be given against income of the same tax year, then the claim in respect of the loss in the earlier year takes priority.

257. *Subsection (4)* makes it explicit that this rule also operates in relation to the interaction between claims for trade loss relief and claims for employment loss relief.

Section 66: Restriction on relief unless trade is commercial

258. This section denies trade loss relief in relation to trades which are not commercial. It is based on section 384 of ICTA.

259. *Subsections (2)* and *(5)* provide that whether the trade is commercial is determined by reference to the basis period for the tax year, rather than by reference to the tax year as in the source legislation. See *Change 9* in Annex 1.

260. *Subsection (4)* provides for the case where the trade is carried on as part of a larger undertaking. In such a case the larger undertaking (that is the undertaking as a whole) may be carried on with a view to the realisation of profits even if the smaller trade is not.

261. In s*ubsection (6)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See section 1018 and *Change 152* in Annex 1.

Section 67: Restriction on relief in case of farming or market gardening

262. This section restricts, in certain cases, the use of losses arising from a trade of farming or market gardening. It is based on section 397(1), (3) to (5) and (8) of ICTA.

263. *Subsection (2)* sets out the circumstances in which loss relief is restricted. Broadly, this is once losses have arisen for six successive tax years. A signpost to section 70 is included since that section sets out the way in which losses are determined in previous tax years.

Section 68: Reasonable expectation of profit

264. This section sets out the "reasonable expectation of profit" test which, if met, prevents relief being restricted under section 67. It is based on section 397(3) and (5) of ICTA.

Section 69: Whether trade is the same trade

265. This section sets out a number of assumptions to make in determining whether section 67 restricts relief for losses. It is based on section 397(8) and (10) of ICTA.

Section 70: Determining losses in previous tax years

266. This section provides rules for deciding whether a trade of farming or market gardening made losses in earlier tax years. It is based on section 397(7) and (10) of ICTA.

267. *Subsection (2)* provides that, for earlier tax years, losses are calculated for actual tax years (6 April to following 5 April) rather than (as is normally the case) for the basis period ending in the tax year.

268. The difference in approach (which prevents any manipulation of periods of account directed at side-stepping the restriction) arises from the fact that losses used to be calculated for actual tax years, but following the move to a current year basis of assessment (in FA 1994) the calculation of losses for the main loss relief provisions was changed to mirror the calculation of profits.

269. *Subsection (4)* adapts rules in section 203 of ITTOIA to deal with cases where profits or losses have not actually been calculated by reference to tax years. In such cases, the calculation of profits or losses for tax years is an arithmetical exercise, involving apportioning (on a time basis) the profits or losses of periods falling partly within the tax year, and combining these with the profits or losses of any periods falling completely within the tax year.

Section 71: Treating trade losses as CGT losses

270. This section is a signpost to a capital gains tax relief. It is new.

271. Capital gains tax relief may be available for a tax year in which there is insufficient income to absorb a claim for trade loss relief against general income. Details of that relief are set out in new sections 261B and 261C of TCGA, inserted by Schedule 1 to this Act.

Section 72: Relief for individuals for losses in first 4 years of trade

272. This section provides relief for losses made in the first four tax years in which an individual carries on a trade. It is based on sections 380(1) and 381(1), (2) and (7) of ICTA.

273. An individual can make a claim for such losses to be deducted in calculating net income for the three tax years which precede the tax year in which the loss is made.

Section 73: How relief works

274. This section sets out the order in which losses, for which a claim is made under section 72, are deducted from income of the three preceding tax years. It is based on section 381(2) of ICTA.

275. The deduction for the loss is made first from income of the earliest of the three tax years referred to in subsection (2) of section 72, with any remaining loss deducted from income of the next tax year and then from income of the third of those tax years. Any remaining loss is available for a different loss relief claim.

Section 74: Restrictions on relief unless trade is commercial etc

276. This section denies early trade loss relief in relation to trades which are not commercial. It is based on section 381(4), (5) and (7) of ICTA.

277. *Subsection (2)* provides that whether the trade is commercial is determined by reference to the basis period for the tax year, rather than by reference to the tax year as in the source legislation. There is a similar provision in section 66. See *Change 9* in Annex 1.

278. *Subsection (3)* provides for the case where the trade is carried on as part of a larger undertaking. In such a case the larger undertaking (that is the undertaking as a whole) may be carried on with a view to the realisation of profits even if the smaller trade is not.

Section 75: Trade leasing allowances given to individuals

279. This section denies sideways relief in relation to losses derived from trade leasing allowances if the individual carrying on the trade does not meet the time commitment test. It is based on section 384(6) and (7) of ICTA.

280. *Subsection (2)* defines a “trade leasing allowance”.

281. The time commitment test requires that conditions A and B are met.

282. *Subsection (5)* sets out condition A. Its reference to “a continuous period of at least 6 months beginning or ending in the basis period for the tax year in which the loss was made” covers cases of a commencement or a cessation of the trade. In such cases the basis period may be shorter than six months.

283. *Subsection (6)* sets out condition B. Its reference to “a continuous period of at least 6 months beginning or ending in the loss-making basis period” also covers cases of a commencement or a cessation of the trade. In such cases the basis period may be shorter than six months.

284. The section removes an inconsistency in the source legislation between:

- the period during which substantially the whole of the individual’s time must be devoted to carrying on the trade;

- the period during which the individual must carry on the trade; and
- the basis period in respect of which the loss is calculated.

285. The inconsistency arose because of the change from the preceding year basis of assessment to the current year basis of assessment, made by FA 2004. This change resulted in losses being calculated by reference to basis periods ending in a tax year while the time commitment test continued to relate to the tax year itself. This section provides that the time commitment test also relates to the basis period in which the loss is made. See *Change 10* in Annex 1.

Section 76: First-year allowances: introduction

286. This section denies sideways relief for any part of the loss that derives from a first-year allowance in the circumstances set out in either section 77 or section 78. It is based on section 384A(1) of ICTA.

Section 77: First-year allowances: partnerships with companies

287. This section sets out the first circumstance in which section 76 may deny sideways relief for part of a loss. It is based on section 384A(2) and (3) of ICTA.

Section 78: First-year allowances: arrangements to reduce tax liabilities

288. This section sets out the second circumstance in which section 76 may deny sideways relief for part of a loss. It is based on section 384A(4) and (5) of ICTA.

Section 79: Capital allowances restrictions: supplementary

289. This section supplements sections 76 to 78. It is based on sections 384(8) and (11) and 384A(6) and (8) of ICTA.

Section 80: Ring fence income

290. This section provides that sideways relief in respect of a trading loss cannot be given against income arising from oil extraction activities or oil rights, unless the loss also arises from such activities or rights. It is based on sections 492(2) and 502(1) of ICTA.

Section 81: Dealings in commodity futures

291. This section denies sideways relief for a loss made by a person in a trade of dealing in commodity futures, where that person carries on the trade in partnership with a company and arrangements have been made to reduce a tax liability by means of sideways relief. It is based on section 399(2), (3) and (5) of ICTA.

Section 82: Exploitation of films

292. This section provides signposts to sections in Chapter 3 of Part 4 that provide for a restriction on loss relief if an individual carries on a trade as a partner in certain types of partnership, and to a section in Chapter 5 of Part 13 (avoidance involving trading losses). It is new.

Section 83: Carry forward against subsequent trade profits

293. This section provides carry-forward relief for trade losses. It is based on section 385(1) of ICTA and section 72(8) of FA 1991.

294. A person who makes a trading loss in a tax year may claim to carry it forward, to the extent that relief has not been given for it under any other provision.

295. The carry-forward trade loss can only be deducted from profits of the trade in which the loss arose. And a carry-forward trade loss must be deducted from the trading profits of a future tax year before those profits can be reduced by way of any other loss relief.

Section 84: How relief works

296. This section sets out the way in which deductions for the carry-forward trade loss are to be made. It is based on section 385(1) of ICTA.

Section 85: Use of trade-related interest and dividends if trade profits insufficient

297. This section provides that certain interest and dividends are treated as trade profits if the profits are otherwise insufficient to use some or all of a carry-forward trade loss. It is based on section 385(4) of ICTA.

298. Interest and dividends are normally taxed separately from trade profits so, in the absence of this provision, a carry-forward trade loss could not be set against such income. But it is only interest and dividends that would otherwise be treated as receipts of the trade that can attract this treatment.

299. The source legislation refers to interest or dividends on investments arising in that year – meaning interest or dividends arising in the year from investments. But as interest and dividends can only arise from investments, the word "investments" has been dropped, just as it was when earlier legislation was consolidated in ICTA for the purposes of terminal loss relief. See the commentary on section 92.

Section 86: Trade transferred to a company

300. This section provides for certain cases in which an individual's carry-forward trade losses may be used against income that the individual derives from a company to which the trade has been transferred and in which that individual was allotted shares. It is based on section 386(1) and (3) of ICTA.

301. Section 386(2) of ICTA has not been rewritten. See *Change 11* in Annex 1.

Section 87: Ring fence trades

302. This section provides that a loss in a tax year derived from oil-related activities can be deducted from the profits of a trade in a future tax year so far as the profits are derived from activities which would be treated as part of the same trade as the oil-related activities but for the ring-fencing rules. It is based on section 492(4) of ICTA.

Section 88: Carry forward of certain interest as loss

303. This section provides for cases where interest paid by an individual in a tax year, and eligible for relief under certain provisions, may be treated as a loss qualifying for carry-forward trade loss relief. It is based on section 390 of ICTA.

304. The interest must be incurred wholly and exclusively for the purpose of a trade, profession or vocation carried on wholly or partly in the United Kingdom and there must be insufficient income for relief to be given under Chapter 1 of Part 8.

Section 89: Carry back of losses on a permanent cessation of a trade

305. This section provides for terminal trade loss relief. It is based on section 388(1) of ICTA.

306. A claim for terminal trade loss relief may be made by a person who permanently ceases to carry on a trade if the person makes a loss in the trade in the final tax year or in the previous tax year. But only that part of a loss from the previous tax year that falls within a period starting 12 months before the cessation is available for this purpose.

307. If a claim is made the full amount of the terminal losses, or as much of them as possible, must be used to reduce the trading profits of the final tax year and the three previous tax years.

308. *Subsection (3)* omits the concept, in section 388(1) of ICTA, of the trading profits having been “charged” to income tax. See *Change 12* in Annex 1.

309. Section 388(5) of ICTA, which is concerned with the interaction between terminal loss relief and charges on income, is not rewritten. This is linked to the approach adopted by this Act to the rules in ICTA about charges on income. The Act gives relief for the payments concerned as a deduction in computing net income, and repeals section 387 of ICTA and section 51 of ITTOIA. See *Change 81* in Annex 1.

Section 90: Losses that are “terminal losses”

310. This section sets out how terminal losses are to be calculated. It is based on section 388(6) of ICTA.

311. The relievable loss is calculated by adding (a) any loss in the final tax year to (b) any loss in the part of the previous tax year falling within 12 months of the date of cessation. Each of these losses is called a terminal loss. If a profit arises in either of the periods, it is ignored.

312. *Subsections (2)* to *(4)* provide that profits or losses for each of these terminal loss periods are calculated by allocating profits or losses of periods of account to them. *Subsection (5)* makes it explicit how any deduction allowed for overlap profit arising under section 205 of ITTOIA is taken into account. *Subsection (6)* makes explicit provision in relation to partnerships. See *Change 12* in Annex 1.

Section 91: How relief works

313. This section sets out the way in which terminal trade loss relief is given. It is based on section 388(3) of ICTA.

Section 92: Use of trade-related interest and dividends if trade profits insufficient

314. This section provides that certain interest and dividends are treated as trade profits if the profits are otherwise insufficient to use some or all of a terminal trade loss. It is based on section 388(4) of ICTA.

315. Interest and dividends are normally taxed separately from trade profits so, in the absence of this provision, a terminal trade loss could not be set against such income. But it is only interest and dividends that would otherwise be treated as receipts of the trade that can attract this treatment.

316. The provisions on which the source legislation is based referred to interest or dividends on investments arising in that year, meaning interest or dividends arising in the year from investments. But as interest and dividends can only arise from investments, the word “investments” was dropped when earlier legislation was consolidated in ICTA.

Section 93: Mineral extraction trade and carry back of balancing allowances

317. This section provides that a terminal trade loss relief claim takes precedence over a claim for balancing allowances in circumstances in which both are claimed on the cessation of a mineral extraction trade. It is based on section 389(2) of ICTA.

Section 94: Carry back of certain interest as loss

318. This section provides that where an individual has paid interest in a tax year which is eligible for relief, but is unable to utilise the deduction in full, the amount remaining may be treated for the purposes of terminal trade loss relief as a trade loss made at

the date of payment, provided the interest is incurred wholly and exclusively for the purposes of a trade carried on wholly or partly in the United Kingdom. It is based on section 390 of ICTA.

Section 95: Foreign trades etc: reliefs only against foreign income

319. This section provides that losses arising from trades carried on wholly outside the United Kingdom can only be used to reduce profits from certain categories of foreign income, depending on the type of relief being claimed. It is based on section 391 of ICTA.

320. *Subsection (2)(c)* makes it explicit that losses arising from trades carried on wholly outside the United Kingdom are not available for use for capital gains tax purposes. See *Change 13* in Annex 1.

Section 96: Post-cessation trade relief

321. This section provides relief for certain payments made, or certain losses on debts made, after a trade has ceased (and for which relief would not otherwise be available). It is based on section 109A(1) and section 110(1A) and (1B) of ICTA.

322. A claim for post-cessation trade relief is possible if a person ceases carrying on a trade and within seven years makes a qualifying payment (see section 97) or a qualifying event occurs in relation to a debt of the trade owed to the person (see section 98).

Section 97: Meaning of "qualifying payment"

323. This section sets out the meaning of qualifying payment. It is based on section 109A(2) of ICTA.

Section 98: Meaning of "qualifying event" etc

324. This section sets out the meaning of a qualifying event occurring in relation to a debt owed to the person concerned and the amount that may be relievable in relation to such an event. It is based on section 109A(4) and (4A) of ICTA.

325. The source legislation treated the release of a debt or the occasion of a debt proving to be bad as if it were a payment which qualified as post-cessation expenditure. These sections are structured so that such deeming is not needed.

326. *Subsection (2)(c)* refers to a debt being released as part of a statutory insolvency arrangement. This term is defined by reference to section 259 of ITTOIA. The source legislation used the term "relevant scheme or arrangement". See *Change 14* in Annex 1.

Section 99: Reduction of relief for unpaid trade expenses

327. This section reduces post-cessation trade relief by reference to expenses claimed as a deduction in computing trading profits, but which were unpaid at the time that the trade ceased. It is based on section 109A(5) of ICTA.

328. The section provides that post-cessation trade relief is reduced by the amount of the expenses that are still unpaid at the end of the tax year in question, but that the reduction shall not include any amount taken into account as a reduction in a previous tax year. And it adds that any such expenses paid subsequently are to be treated as a qualifying payment.

Section 100: Prohibition against double counting

329. This section prevents a person from claiming post-cessation trade relief for an amount for which relief is given or available under other provisions of the Income Tax Acts. It is based on section 109A(6) of ICTA.

Section 101: Treating excess post-cessation trade relief as CGT loss

330. This section is a signpost to a capital gains tax relief that may be available where there is insufficient income to absorb an amount claimed by way of post-cessation trade relief. It is new.

Chapter 3: Restrictions on trade loss relief for certain partners

Overview

331. This Chapter sets out restrictions on trade loss relief that apply in certain cases where an individual carries on a trade as a member of a partnership. The restrictions do not apply to persons other than individuals, or in relation to professions.

332. The main restrictions are on deducting trading losses from income (other than income from the trade) or capital gains. Broadly, the amount of such deductions must not exceed the amount that the individual stands to lose commercially.

333. In various places, source legislation expresses the amount that a partner stands to lose commercially by reference to the partner's contribution to the trade that a partnership carries on (the "contribution to the trade"). But, in such cases, the amount that a partner stands to lose commercially is more likely to be reflected in the partner's contribution to the partnership that carries on the trade.

334. So this Chapter, and Chapter 5 of Part 13 (avoidance involving trading losses), makes a change by expressing the amount that a partner stands to lose commercially in terms of the partner's contribution to the partnership (the "contribution to the firm"). The change to contribution to the firm requires that the possibility of there being partnerships with more than one trade is addressed by the change. And for consistency with other partnerships, the possibility of a limited liability partnership carrying on more than one trade is also addressed. This change affects many sections in this Chapter and it also makes a number of other clarifications as to what is included in a partner's contribution. See *Change 16* in Annex 1.

Section 102: Overview of Chapter

335. This section introduces the Chapter. It is new.

336. *Subsection (1)* is a signpost to the main restrictions, which apply in certain cases where the individual is a limited partner, a member of a limited liability partnership or a non-active partner.

337. *Subsection (2)* is a signpost to a further restriction applying where the trade consists of or includes the exploitation of films.

338. *Subsections (3)* and *(4)* provide signposts to sections in Chapter 5 of Part 13 (avoidance involving trading losses).

Section 103: Meaning of "sideways relief", "capital gains relief" and "firm"

339. This section defines these terms. It is new.

340. The definition of "capital gains relief" refers to section 261B of TCGA, which is inserted by Schedule 1 to this Act.

Section 104: Restriction on reliefs for limited partners

341. This section restricts the use of a trade loss made in a tax year by an individual carrying on the trade as a limited partner. It is based on section 117(1) and (2) of ICTA.

342. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual's contribution to the firm.

343. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit. See *Change 13* in Annex 1.

344. The individual's contribution to the firm is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

345. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

Section 105: Meaning of "contribution to the firm"

346. This section sets out details of what is included in determining the contribution to the firm. It is based on section 117(3) and (5) of ICTA.

347. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

348. The individual's contribution of capital to the firm is reduced by any amounts drawn out or received back. *Subsection (5)* provides an exception. The exception is for an amount drawn out or received back which is treated as income chargeable to income tax. This exception is similar to the one in section 111(5), based on section 118ZG(5) of ICTA. See *Change 17* in Annex 1.

Section 106: Meaning of "limited partner"

349. This section defines "limited partner". It is based on section 117(2) of ICTA.

350. A limited partner of a limited partnership registered under the Limited Partnerships Act 1907 is someone who is not entitled to take part in the management of the firm's business and is not liable for the debts or obligations of the firm beyond a certain limit. And a limited partner of any other firm is someone who is similarly not entitled to take part in management and not liable for debts or obligations in accordance with the rules applying to the firm in question.

351. *Subsection (4)* is introduced as part of drafting in terms of an individual's "contribution to the firm" in place of "contribution to the trade". See *Change 16* in Annex 1.

Section 107: Restriction on reliefs for members of LLPs

352. This section restricts the use of a trade loss made in a tax year by an individual carrying on a trade as a member of a limited liability partnership (LLP). It is based on sections 117(1) and (2) and 118ZB(1) and (2) of ICTA.

353. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual's "contribution to the LLP".

354. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit. See *Change 13* in Annex 1.

355. The individual's contribution to the LLP is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

356. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

Section 108: Meaning of "contribution to the LLP"

357. This section sets out details of what is included in determining the contribution to the LLP. It is based on sections 118ZB(1) and 118ZC of ICTA.

358. An LLP formed under the Limited Liability Partnerships Act 2000 is an entity with separate legal personality. That Act defines what is meant by contribution to the limited liability partnership.

359. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

360. The individual's contribution of capital to the LLP is reduced by any amounts drawn out or received back. *Subsection (6)* provides an exception. The exception is for an amount drawn out or received back which is treated as income chargeable to income tax. This exception is similar to the one in section 111(5), based on section 118ZG(5) of ICTA. See *Change 17* in Annex 1.

Section 109: Unrelieved losses brought forward

361. This section specifies how the amount of any loss, which could not be relieved because of section 107, may be brought forward for use in a later tax year in which the individual continues to carry on the trade as a member of an LLP. It is based on sections 118ZD and 118ZM(8) of ICTA.

362. The section treats the unrelieved loss as a trading loss of the later tax year, unless it is an excluded loss (see s*ubsection (3)*).

363. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit in section 107, to which this section refers. See *Change 13* in Annex 1.

Section 110: Restriction on reliefs for non-active partners in early tax years

364. This section restricts the use of trade losses made by an individual carrying on a trade as "a non-active partner" in an "early tax year". It is based on sections 118ZE and 118ZF of ICTA.

365. A non-active partner is an individual who does not devote a significant amount of time to the trade and is not a limited partner. See section 112.

366. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual's "contribution to the firm".

367. The restriction applies only to losses made in the first tax year in which the individual carries on the trade or in any of the next three tax years. See section 112(6).

368. The interaction between section 72 of FA 1991 and section 118ZE of ICTA is made explicit. See *Change 13* in Annex 1.

369. The individual's contribution to the firm is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

370. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

371. *Subsection (8)* disapplies the rules in the case of losses from a trade of underwriting at Lloyd's. Lloyd's underwriters are subject to a specific tax regime which reflects the nature of the business and the partners' liabilities for the underwriting losses.

Section 111: Meaning of "contribution to the firm"

372. This section sets out details of what is included in determining the individual's contribution to the firm. It is based on section 118ZG of ICTA.

373. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

374. The definition differs slightly from the definition of "contribution to the firm" for limited partners. The definition for a non-active partner includes a reference to any additional amount contributed on a winding-up, whereas the definition for a limited partner includes no such reference, as a limited partner is under no obligation to contribute any amounts beyond the amount originally agreed as the required contribution.

Section 112: Meaning of "non-active partner" and "early tax year" etc

375. This section sets out details of who is carrying on a trade as a non-active partner in an early tax year. It is based on sections 118ZE, 118ZH and 118ZM of ICTA.

376. The definition excludes limited partners. So only a general partner (that is, a partner other than a limited partner) or a member of an LLP may be a non-active partner.

377. In broad terms, a non-active partner is an individual who does not devote a significant amount of time to the trade and is, therefore, unlikely to be anything more than a financial investor.

378. *Subsection (2)* provides that a significant amount of time is taken as being a minimum of ten hours per week, on average taken across the period.

379. *Subsections (3)* and *(4)* define the "relevant period" for the purposes of subsection (2) as the whole of the basis period for the tax year, or a continuous period of at least six months either beginning with the date of commencement or ending with the date of cessation. For example, if an individual commences a trade on 1 April 2007, the basis period for 2006-07 is 1 April 2007 to 5 April 2007. And the relevant period ends on 30 September 2007 for the purposes of this section in relation to the tax year 2006-07. So the individual must meet the "significant amount of time" test for six months rather than just for five days.

380. *Subsection (5)* provides that where relief is given but the activity rules prove not to be satisfied, relief is withdrawn by making an assessment under this section.

Section 113: Unrelieved losses brought forward

381. This section specifies how the amount of any loss, which could not be relieved because of section 110, may be brought forward for use in a later tax year in which the individual continues to carry on the trade as a partner (or contributes to the firm on its winding up). It is based on sections 118ZI and 118ZM of ICTA.

382. The section treats the unrelieved loss as a trading loss of the later tax year unless it is an excluded loss (see *subsection (4)*).

383. The interaction between section 72 of FA 1991 and section 118ZE of ICTA is made explicit in section 110, to which this section refers. See *Change 13* in Annex 1.

384. The section reflects the contribution to the firm being measured at the end of the basis period for a tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

Section 114: Exclusion of amounts in calculating contribution to the firm or LLP

385. This section enables regulations, which can apply on a retrospective basis, to exclude certain amounts from the calculation of the contribution to the firm or LLP. It is based on section 118ZN of ICTA.

386. Regulations made under this section are subject to the affirmative resolution procedure.

387. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

388. Some regulations have been made under section 118ZN of ICTA, with effect from 22 July 2005. See the Partnerships (Restrictions on Contributions to a Trade) Regulations 2005 (SI 2005/2017). See also the commentary on Part 5 of Schedule 2 about consequential amendments made to these regulations by this Act.

389. In s*ubsection (4)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See section 1018 and *Change 152* in Annex 1.

Section 115: Restrictions on reliefs for firms exploiting films

390. This section extends the restriction on the use of sideways relief and capital gains relief to (effectively) non-active partners carrying on a trade that exploits films, where there is a relevant agreement that guarantees the individual an amount of income. It is based on sections 118ZL and 118ZM of ICTA.

391. The interaction between section 72 of FA 1991 and section 118ZL of ICTA is made explicit. See *Change 13* in Annex 1.

Section 116: Exclusion from restrictions under section 115: certain film expenditure

392. This section specifies that the restriction under the previous section does not apply to the extent any loss qualifying for relief derives from unrestricted film expenditure. It is based on sections 118ZL and 118ZM of ICTA.

Chapter 4: Losses from property businesses

Overview

393. This Chapter provides relief for losses from property businesses.

Section 117: Overview of Chapter

394. This section provides an overview of the Chapter. It is new.

395. *Subsection (1)* lists the types of relief available for property losses and refers to the various sections where the details of the reliefs and associated miscellaneous provisions can be found.

396. *Subsection (2)* highlights the fact that a UK property business, so far as it consists of the commercial letting of furnished holiday accommodation, is treated as a trade for loss relief purposes.

Section 118: Carry forward against subsequent property business profits

397. This section provides relief for property losses against property business income of later years. It is based on sections 379A and 379B of ICTA.

398. Section 272 of ITTOIA specifies that the same rules apply in calculating profits and losses of a property business as apply for calculating profits and losses of a trade. So rewriting section 379A(7) of ICTA is unnecessary. See the reference to section 272 of ITTOIA in section 59.

Section 119: How relief works

399. This section explains how the deductions are made. It is based on sections 379A(1) and 379B of ICTA.

Section 120: Deduction of property losses from general income

400. This section provides relief for property losses against general income, if the loss has a capital allowances or relevant agricultural connection. It is based on sections 379A and 379B of ICTA.

Section 121: How relief works

401. This section explains how the deductions are made. It is based on sections 379A and 379 B of ICTA.

Section 122: Meaning of "the applicable amount of the loss"

402. This section defines "the applicable amount of the loss", with the effect that a claim by a person for property loss relief against general income is restricted to the lesser of the loss itself and the amount arising from the relevant connection. It is based on sections 379A(4) and 379B of ICTA.

Section 123: Meaning of "the loss has a capital allowances connection" and "the business has a relevant agricultural connection"

403. This section defines the meaning of "the loss has a capital allowances connection" and "the business has a relevant agricultural connection". It is based on section 379A and 379B.

Section 124: Supplementary

404. This section provides the time limit for making a claim under section 120 and supplementary matters if a claim is made. It is based on sections 379A(3) and 379B of ICTA.

Section 125: Post-cessation property relief

405. This section provides relief for payments of certain expenses etc after a property business has ceased (and for which relief would not otherwise be available). It is based on section 109A and section 110 of ICTA.

406. A claim for post-cessation property relief is possible if a person ceases carrying on a UK property business and within seven years makes a qualifying payment (see section 97) or a qualifying event occurs in relation to a debt of the business (see section 98).

Section 126: Treating excess post-cessation property relief as CGT loss

407. This section is a signpost to a capital gains tax relief that may be available where there is insufficient income to absorb an amount claimed by way of post-cessation property relief. It is new.

Section 127: UK furnished holiday lettings business treated as trade

408. This section provides, subject to modifications, the same range of reliefs for a loss from a UK furnished holiday lettings business as is available for a trade loss. It is based on section 504A of ICTA.

409. *Subsection (4)* applies Chapter 2 (trade losses) with the omission of the section restricting the availability of trade leasing allowances, as an individual letting furnished holiday accommodation cannot lease out equipment as part of that business.

410. *Subsections (5)* and *(6)* deny early trade loss relief to an individual in respect of a tax year if any of the accommodation was first let by the individual as furnished accommodation more than three years before the start of the tax year.

Chapter 5: Losses in an employment or office

Overview

411. This Chapter provides relief for losses in an employment or office.

Section 128: Employment loss relief against general income

412. This section provides relief for a person's losses in an employment or office. It is based on section 380(1) of ICTA.

413. The reference to "office" is new, but reflects the long-standing HMRC practice of allowing the holder of an office to set off losses against general income. See *Change 18* in Annex 1.

414. Section 384A of ICTA restricts relief under section 380 of ICTA in relation to avoidance schemes entered into by individuals carrying on a leasing trade, or another qualifying activity, and involving first-year allowances. See section 76.

415. As section 380 of ICTA provides relief for losses in an employment (as well as in a trade) the restriction in section 384A of ICTA is, in principle, applicable to an employment loss.

416. In view of the remote possibility of section 384A of ICTA ever applying to employment losses, this section is not subject to a restriction equivalent to that in section 76. See *Change 19* in Annex 1.

Section 129: How relief works

417. This section explains how deductions are made. It is based on section 380(1) and (2) of ICTA.

418. *Subsections (2)* and *(3)* provide that, if claims are made in respect of employment losses incurred in successive tax years and both claims specify that the relief is to be given against income of the same tax year, the claim in respect of the loss in the earlier year takes priority.

419. *Subsection (4)* makes it explicit that this rule also operates in relation to the interaction between claims for employment losses and those for trade losses.

Section 130: Treating loss in employment or office as CGT loss

420. This section is a signpost to a capital gains tax relief that may be available where there is insufficient income to absorb an amount claimed by way of employment loss relief. It is new.

Chapter 6: Losses on disposal of shares

Overview

421. This Chapter is based on sections 305A and 574 of ICTA and, to the extent that they supplement section 574 of that Act, sections 575 and 576 of that Act. So far as sections 575 and 576 of ICTA supplement section 573 of that Act (share loss relief for companies), they continue in force, together with new sections 576A to 576L of ICTA (see Schedule 1 to this Act and the commentary on those new sections of ICTA).

422. Section 574 of ICTA provides for relief against income tax for allowable losses for capital gains tax purposes incurred on the disposal of ordinary shares in qualifying trading companies for which an individual has subscribed.

423. Section 305A of ICTA provides that section 574 of that Act also applies, with minor modifications, on the disposal by an individual of shares to which enterprise investment scheme income tax relief is attributable under Chapter 3 of Part 7 of ICTA. The provisions of section 305A of ICTA are included as an integral part of this Chapter and a signpost to this Chapter is included in section 161 in Part 5 (Enterprise investment scheme).

424. Section 125A of TCGA introduced by Schedule 1 to this Act is based on section 576(2) and (3) of ICTA, which have effect only for the purposes of capital gains tax or corporation tax on chargeable gains, and on sections 573(4) and 574(1) of ICTA which have effect only for the purposes of corporation tax on chargeable gains and capital gains tax respectively. See the commentary on section 125A of TCGA in Schedule 1.

425. This Chapter contains 21 sections structured as follows:

- three setting out the basic conditions for share loss relief, the entitlement of the individual to make a claim and how the relief works;
- thirteen applying only to shares to which EIS relief is not attributable and setting out requirements to be satisfied if relief is to be available on the disposal of such shares;
- three applying generally and dealing with limits on relief and the identification of shares disposed of; and
- two containing miscellaneous and supplementary provisions.

Section 131: Share loss relief

426. This section deals with eligibility for share loss relief and the requirements relating to the kinds of disposal and to the type of shares disposed of. It is based on sections 305A(1), 574(1) and 575(1) and (3) of ICTA.

427. *Subsection (1)(b)* provides that the disposal must be of "qualifying shares". *Subsection (2)* provides that shares are qualifying shares if either EIS relief is attributable to them or they are shares in a qualifying trading company for which the individual has subscribed. EIS relief is defined in section 151(1) and includes not only relief under Part 5 of this Act attributable to shares issued on or after 6 April 2007 (see section 201) but also relief under Chapter 3 of Part 7 of ICTA attributable to shares issued after 31 December 1993 and before 6 April 2007 (see section 289B of that Act).

428. *Subsection (3)(a)* is based on section 575(1)(a) of ICTA which specifies as one of the kinds of disposal:

"a disposal by way of a bargain made at arm's length for full consideration.

Subsection (3)(a) omits the words "for full consideration" on the basis that they add nothing. See *Change 20* in Annex 1.

Section 132: Entitlement to claim

429. This section deals with the making of a claim for share loss relief. It is based on section 574(1) of ICTA.

430. This section makes explicit what is only implicit in section 574(1) of ICTA:

- in *subsection (1)*, that a claim may be made for both the tax year in which the allowable loss is incurred and the previous tax year;
- in *subsection (2)*, what is required in practice to establish how the claim is to apply to each year; and
- in *subsection (3)*, that, in the case of a claim in respect of one year only, the claim must specify which year.

Section 133: How relief works

431. This section explains how deductions for the loss are to be made. It is based on section 574(1) and (2) of ICTA.

432. *Subsection (1)* states explicitly what is implicit in section 574(1) of ICTA, that:

- the whole amount of the loss must be deducted in calculating the claimant's net income for the specified tax year; and
- if a claim is made in respect of two tax years, then only so much, if any, of the amount of the loss which it has not been possible to deduct from the claimant's income for the specified year can be deducted in calculating the claimant's net income for the other year.

433. This section does not include the words in section 574(1)(a) and (b) of ICTA which limit the amount of the deduction for any tax year to the whole of the claimant's income for the year, where the income is less than the amount of the loss. That limit is included in section 25(5) and (6). Section 25 explains how the reliefs listed in section 24, which include share loss relief, are to be deducted at Step 2 of section 23 in order to calculate the claimant's net income.

434. *Subsection (5)* is new. It makes explicit that the balance of any allowable loss for which share loss relief is not obtained continues to be capable of being claimed as a deduction under TCGA.

Section 134: Qualifying trading companies

435. This section is the first of 13 sections which apply only to shares to which EIS relief is not attributable. It is based on section 576(4) of ICTA. It defines what is a qualifying trading company. Shares, other than shares to which EIS relief is attributable, must form part of the ordinary share capital of a qualifying trading company if they are to be qualifying shares (see section 131(2)(b) and the definition of "shares" in section 151(1) and (3) to (6)).

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

437. This section avoids the double layer of definition in section 576(4) of ICTA and omits the concept of an "eligible trading company".

438. *Subsection (2)*, therefore, directly introduces the four requirements of section 293 of ICTA (as modified and applied by section 576(4A) and (4B) of that Act) which must be met on a continuing basis (see also *subsection (3)*).

439. Subsections (2)(b) and (3)(b) omit the words “that is not an eligible trading company” which qualify “trading company” in section 576(4)(a)(ii) and (b)(ii) of ICTA on which those paragraphs are based. Those words are otiose.

440. *Subsection (4)* directly introduces the two requirements of section 293 of ICTA (as modified and applied by section 576(4A) and (4B) of that Act) which are to be met only when the shares in respect of which share loss relief is claimed are issued.

441. This direct application of these two requirements resolves the apparent inconsistency between sections 293 and 576(4) of ICTA. Section 293 of ICTA requires them to be met only at the time of issue of the shares. But section 576(4) of that Act requires the company to be an eligible trading company at a subsequent time and during a continuous period. Section 576(4) of ICTA thus appears to require the company to meet these requirements also at that subsequent time and during that period.

Section 135: Subscriptions for shares

442. This section sets out the requirements relating to the subscription for shares in a qualifying trading company. It is based on section 574(3) of ICTA and includes a new provision relating to “corresponding bonus shares”.

443. *Subsection (2)* provides that shares are subscribed for by the individual if they have been issued to the individual in consideration of money or money’s worth. See also *subsection (4)*.

444. *Subsection (3)* is based on section 574(3)(b) of ICTA, which provides that:

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

445. Subsection (3)(a) is extended to cover not only the case where A is the actual subscriber but also cases where A is treated as having subscribed under the provisions relating to the issue of “corresponding bonus shares” (see subsection (4)) or under an earlier application of this subsection. See *Change 21* in Annex 1.

446. Subsection (3)(c), read with the definitions of “civil partner” and “spouse” in section 151(1), makes explicit that the relevant time at which A and B must be spouses or civil partners living together is the time of the transfer. See *Change 22* in Annex 1.

447. Subsection (4) is new and treats “corresponding bonus shares” issued in respect of shares which have been subscribed for as themselves having been subscribed for. See *Change 23* in Annex 1.

Section 136: Disposals of new shares

448. This section applies to the disposal of qualifying shares (other than shares to which EIS relief is attributable) which are identified by virtue of section 127 of TCGA with shares previously held by the individual. The section denies or restricts share loss relief unless certain conditions are met. It is based on section 575(2) of ICTA.

449. The cross-reference to section 145(3) at the end of *subsection (2)* makes clear that this section does not apply to an exchange of shares to which section 145(1) applies. See the commentary on section 145 and *Change 24* in Annex 1.

Section 137: The trading requirement

450. This section is the first of ten new sections relating to the requirements for a company to be a qualifying trading company. These sections replace the provisions of section 576(4A) and (4B) of ICTA which apply section 293 and certain associated provisions of Chapter 3 of Part 7 of that Act, with modifications and omissions.

451. All these sections correspond to sections in Part 5 of this Act (Enterprise investment scheme). So far as possible cross-references to sections of Part 5 have been minimised. Cross-references have, however, been retained where the material referred to is lengthy, for example the definition of "excluded activities" in sections 192 to 199.

452. This section corresponds to section 181 with modifications. Section 181 is based on section 293(2) and (3A) to (3F) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period, which is the effect of the modification of section 293(2) of ICTA made by section 576(4A)(d) of that Act.

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

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

455. In the definition of "incidental purposes" in *subsection (7)* the words "capable of", which appear in the definition in section 293(2) of ICTA on which it is based, have been omitted. This mirrors the definition of "incidental purposes" in section 181(8), which is also based on the definition in section 293(2) of ICTA. See the commentary on section 181.

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

Section 138: Ceasing to meet trading requirement because of administration or receivership

457. This section corresponds to section 182 with two changes. Section 182 is based on section 293(4A) to (6) and (8A) of ICTA.

458. The first change modifies section 182(3) by substituting for the reference to "the end of period B" a reference to "the time that is relevant for the purposes of section 134(2)". This is the substitution required by section 576(4A)(d) of ICTA to section 293(5) of that Act, on which section 182(3) is based.

459. The second change modifies section 182(4) by omitting the reference to dissolution and adding the condition that the company continues, during the winding up, to be a trading company. These are the modifications required by section 576(4A)(b) of ICTA to section 293(6) of that Act, on which section 182(4) is based.

Section 139: The control and independence requirement

460. This section corresponds to section 185 with modifications. Section 185 is based on section 293(8) and (8A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period, which is the effect of the modification of section 293(8) of ICTA made by section 576(4A)(d) of that Act.

461. *Subsections (1)* to *(3)* correspond to section 185, with the omission in subsections (1)(a) and (2)(a) of the words "at any time in period B" and the substitution in subsection (3) of a reference to section 145(3) for the reference to section 247(4). *Change 44* in Annex 1 relating to section 185(1)(a) is replicated in this subsection.

462. The term "control" is used in both subsection (1)(a) and subsection (2)(a)(ii). There is a definition of "control" in *subsection (4)*, which refers to section 416(2) to (6) of ICTA, but this applies only to the use of that term in subsection (1)(a). This reflects section 257(3), which applies the definition of "control" in section 416(2) to (6) of ICTA in section 185(1)(a) but not in section 185(2)(a)(ii). By virtue of section 1021(2),

the term “control” in sections 139(2)(a)(ii) and 185(2)(a)(ii) has the meaning given by section 995.

Section 140: The qualifying subsidiaries requirement

463. This section corresponds to section 187 with modifications. Section 187 is based on sections 293(3A) and 308(1) and (5A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period. This, together with the omission of the words “at any time in period B”, gives effect to the modification of sections 293(3A) and 308(1) of ICTA made by section 576(4A)(d) of that Act.

Section 141: The property managing subsidiaries requirement

464. This section corresponds to section 188 with modifications. Section 188 is based on section 293(6ZA) to (6ZC) and (8A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period. This, together with the omission of the words “at any time in period B”, gives effect to the modification of section 293(6ZA) of ICTA made by section 576(4A)(d) of that Act.

Section 142: The gross assets requirement

465. This section corresponds to section 186 with modifications. Section 186 is based on section 293(6A) to (6C) of ICTA. This requirement has to be met only at the times specified in *subsections (1)* and *(2)* (see section 134(4)(a)).

466. Section 576(4A)(c) of ICTA requires that for the words “the eligible shares” in section 293(6A) of that Act there be substituted the words “the shares in respect of which the share loss relief is claimed under section … 574”. This substitution has been reflected in subsections (1)(a) and (2)(a). Section 150 applies for the purposes of those paragraphs to determine the time of issue of the shares in certain circumstances.

Section 143: The unquoted status requirement

467. This section corresponds to section 184 with modifications. Section 184 is based on sections 293(1A), (1B) and (8A) and 312(1), (1B), (1C) and (1E) of ICTA. This requirement has to be met only at the time specified in *subsection (1)* (see section 134(4)(b)).

468. Subsection (1) corresponds to section 184(1) with the substitution for “the beginning of period B” of “the time at which the shares in respect of which the share loss relief is claimed are issued”. This is the substitution required by section 576(4A)(ab) of ICTA to section 293(1A) of that Act, on which section 184(1) is based. Section 150 applies for the purposes of this subsection to determine the time of issue of the shares in certain circumstances.

469. In subsection (1)(c)(i) a reference to section 145 is substituted for the reference in section 184(1)(c)(i) to section 247.

Section 144: Power to amend requirements by Treasury order

470. This section is included to enable sections 137 to 143 to be amended by Treasury order whenever the corresponding sections in Part 5 are amended by such an order under the power in section 200. It is based on sections 298(4) and 576(4A) of ICTA.

471. This preserves the position under the source legislation if an amendment were made under the power in section 298(4) of ICTA. In the case of an amendment of a provision which is applied by section 576(4A) of ICTA, the amendment would also have effect for the purposes of section 574 of that Act.

Section 145: Relief after an exchange of shares for shares in another company

472. This section corresponds to section 247 with modifications. Section 247 is based on section 304A(1), (2), (6), (7) and (8) of ICTA.

473. Section 576(4A)(e) of ICTA requires that for the words "eligible shares" in section 304A(1)(e)(i) of that Act there are substituted the words "shares in respect of which relief is claimed under section … 574". Those words are not entirely apposite, as the relief will be claimed, if at all, in respect of the new shares not the old shares.

474. Section 304A(1)(e)(i) of ICTA is needed in the context of EIS relief (see section 247(1)(e)(i)). But that provision is unnecessary in the context of share loss relief. Section 576(4A)(a) and (4B)(d) require the omission of section 304A(1)(e)(ii) of that Act. Accordingly, section 247(1)(e) has not been replicated in this section.

475. The provision in *subsection (1)(e)* has been based on paragraph 8(1)(f) of Schedule 5B to TCGA (Enterprise investment scheme: re-investment) rather than section 304A(1)(f) and (8) of ICTA. Accordingly, section 247(2), which is based on section 304A(8) of ICTA, has not been replicated in this section. See *Change 25* in Annex 1.

476. *Subsection (3)* corresponds to section 247(4) with two modifications.

477. Subsection (3)(a) is new and resolves the apparent conflict between section 136 and this section. See *Change 24* in Annex 1.

478. In subsection (3)(b) reference to section 139(1) has been substituted for the reference in section 247(4) to section 185.

Section 146: Substitution of new shares for old shares

479. This section corresponds to section 249 with modifications. Section 249 is based on section 304A(3) and (4) of ICTA.

480. Section 249 makes separate provision for circumstances where the shares are held by the individual who subscribed for them and for circumstances where the shares have been transferred to the individual by the individual's spouse or civil partner.

481. The structure of section 249 is dictated by the differing forms of subsections (2)(d) and (4)(d) which are based on section 304A(3)(d) and (4)(d) of ICTA. The difference between those provisions is necessary for the purposes of EIS relief. But section 576(4B)(d) of ICTA requires that section 304A(3)(d) and (4)(d) of that Act are omitted in the application of section 304A for the purposes of share loss relief.

482. Section 135 provides that references in this Chapter to an individual having subscribed for shares include, in relation to shares to which EIS relief is not attributable, references to the individual being treated as having subscribed for shares for which the individual's spouse or civil partner subscribed. The structure of section 146 is, therefore, simpler than that of section 249.

483. *Subsection (1)* corresponds to section 249(1) and (3), with the omission, as required by section 574(4B)(d) of ICTA, of the words "to which EIS relief becomes attributable under section 247" and with two further changes.

484. The first of these changes is that the words "and issued to" in section 249(1) have not been reproduced having regard to the meaning given to "subscribed for" by section 135(2).

485. The second of these changes is that the words "or by a nominee for an individual" have been added. These words reflect so much of section 250(1) as relates to the holding or disposal of shares by a nominee for an individual. In this way, the requirements of section 135 relating to the subscription for the shares by the individual are preserved,

while recognising that the individual may have subsequently transferred the shares into the name of a nominee for the individual.

486. *Subsection (2)(a)* and *(b)* correspond to section 249(2)(a) and (b) and (4)(a) and (b), with the substitution of "this Chapter" for "this Part". As required by section 576(4B)(d) of ICTA, section 249(2)(c) and (d) and (4)(c) and (d) are not reproduced in this subsection. Section 150 applies for the purposes of subsection (2)(b) to determine the time of issue of the shares in certain circumstances.

487. *Subsection (2)(c)* is new. It expressly sets out the effect of sections 145 and 146. This is that, in determining whether the shares in the new company are, on their disposal, qualifying shares, any requirements of this Chapter for the new company to be a qualifying trading company which were met by the old company before the exchange are to be treated as met by the new company.

Section 147: Limits on share loss relief

488. This section deals with the calculation of the amount of share loss relief. It is based on section 576(1) of ICTA. It is the first of a group of three sections which apply generally for the purposes of this Chapter.

489. Section 576(1) of ICTA provides that, if a person disposes of shares for which the person has subscribed and which form part of a holding, the share loss relief in relation to those shares is not to exceed the sums which would have been allowable as deductions in computing the allowable loss for capital gains tax purposes if the shares had not formed part of the holding.

490. To cater for the abolition of pooling in relation to shares issued on or after 6 April 1998 and the changes in section 148 described in *Change 29* in Annex 1, section 147 refines the circumstances in which the provision applies. See *Change 26* in Annex 1.

491. *Subsection (8)* explains what is meant by shares "that are not capable of being qualifying shares" for the purposes not only of this section but also of section 148. *Change 27* in Annex 1 contains a detailed explanation of why a mixed holding is defined for the purposes of section 148 in terms of a holding which includes such shares.

492. *Subsection (9)* extends this meaning for the purposes only of *subsection (5)* to cover reorganisations involving the issue of shares of a different class.

Section 148: Disposal of shares forming part of mixed holding

493. This section deals with the identification of shares disposed of where those shares form part of a "mixed holding". It is based on section 576(1) to (1B) and (5) of ICTA, with a number of changes.

494. Section 576(1) of ICTA defines a mixed holding as one which comprises shares for which a person has subscribed and shares which the person has acquired otherwise than by subscription.

495. *Subsection (1)* provides that this section applies to a holding in which some only of the shares are shares "that are not capable of being qualifying shares" (as defined in section 147(8)). See *Change 27* in Annex 1 which contains a detailed explanation of why a mixed holding has been defined in terms of a holding which includes such shares.

496. *Subsection (2)* provides that the section applies for the purpose of answering the questions:

- whether the shares disposed of are qualifying shares; and
- which of any qualifying shares acquired at different times are disposed of.

497. This is a change from section 576(1) of ICTA, which is not expressed to apply for the purpose of determining which of any qualifying shares are disposed of. See *Change 28* in Annex 1.

498. *Subsection (3)* introduces the rules for determining the answers to the questions in subsection (2).

499. Section 576(1) of ICTA, on which subsection (3)(a) is based, identifies the shares disposed of on a last in first out (LIFO) basis. Section 576(1) of ICTA and its predecessor, section 37 of FA 1980, were enacted at a time when shares were pooled and treated as a single asset for capital gains tax purposes. Accordingly, it was and remains necessary to have a rule identifying the order in which shares in the pool are disposed of, in order to ensure that share loss relief is obtained only on the disposal of qualifying shares.

500. FA 1998 made changes to the identification rules in TCGA, as a result of which shares acquired on or after 6 April 1998 are not pooled but, on a disposal, are in most cases identified on a LIFO basis.

501. Taking account of those changes, subsection (3)(a) applies the FA 1998 rules (see *subsection (4)*) or, in the case of shares acquired on different dates before 6 April 1998, a specific LIFO rule (see *subsection (5)*). See *Change 29* in Annex 1.

502. Subsection (3)(b) is based on section 576(1A) of ICTA and applies the rules in *subsection (6)*, based on section 576(1B) of that Act, if the mixed holding includes any of:

- shares issued before 1 January 1994 to which business expansion scheme relief is attributable;
- shares to which EIS income tax relief is attributable; and
- shares to which EIS deferral relief is attributable.

503. *Subsection (7)* is new and puts on a statutory basis the practice under which questions which cannot be determined by the specific provisions of this section are to be determined on a just and reasonable basis. This subsection will principally be required in cases where some but not all of the shares of the same class acquired, or treated as having been acquired, on the same day are shares that are not capable of being qualifying shares. See *Change 29* in Annex 1.

Section 149: Section 148: supplementary

504. This section supplements section 148. It is new.

505. *Subsection (1)* corrects the absence of an amendment to section 299 of ICTA as applied by section 576(1B) of that Act consequential upon the enactment of section 105A of TCGA by FA 2002. It applies if an individual has a mixed holding which includes shares to which business expansion scheme relief, EIS income tax relief or EIS deferral relief is attributable.

506. Subsection (1) ensures that, if the individual makes an election for the alternative identification rule under section 105A of TCGA to apply for the purposes of capital gains tax on the disposal of shares in the holding where “approved scheme shares” are acquired on the same day as other shares of the same class, the alternative rule will also apply for the purposes of share loss relief. See *Change 30* in Annex 1.

507. *Subsection (2)* determines the time of acquisition for the purposes of section 148 of shares issued in a reorganisation within the meaning of section 126 of TCGA to which section 127 of that Act applies. See *Change 31* in Annex 1.

508. *Subsection (3)* clarifies that shares held or disposed of by a nominee or bare trustee for an individual are part of the individual's holding for the purposes of section 148. See *Change 32* in Annex 1.

Section 150: Deemed time of issue for certain shares

509. This section contains provisions which determine the time of issue of shares for the purposes of the provisions listed in *subsection (1)*. It is based on section 574(3) of ICTA.

510. *Subsection (2)* mirrors section 135(3) and applies in cases where the shares have been transferred to an individual by that individual's spouse or civil partner. See *Change 33* in Annex 1.

511. *Subsection (3)* mirrors section 135(4) and applies to corresponding bonus shares. See *Change 34* in Annex 1.

Section 151: Interpretation of Chapter

512. This section explains the meaning of expressions used in this Chapter. It is based on section 576(5) of ICTA.

513. *Subsection (1)* includes the definition of "corresponding bonus shares". *Subsection (2)* amplifies that definition. See *Change 23* in Annex 1.

514. The introduction of sections 137 to 146 makes it necessary to ensure that the word "shares" has the same meaning in those sections as it does in the sections of Part 5 to which they correspond with modifications. Accordingly, *subsections (3)* to *(6)* provide that the application of the definition of "shares" in subsection (1) is subject to the exceptions mentioned in section 576(5) of ICTA, those required for the purposes of sections 137 to 146 of this Act and those required for the purposes of section 147 as a result of the changes described in *Change 26* in Annex 1.

515. *Subsection (8)* is new and clarifies that the date of disposal is the time when the disposal is made or treated as made for the purposes of the capital gains tax legislation. See *Change 35* in Annex 1.

Chapter 7: Losses from miscellaneous transactions

Overview

516. This Chapter gives relief for losses from miscellaneous transactions.

Section 152: Losses from miscellaneous transactions

517. This section provides relief for losses from certain transactions (known as Case VI losses before the enactment of ITTOIA). It is based on section 392 of ICTA.

518. The provisions relating to Case VI income are in Chapter 8 of Part 5 of ITTOIA. That Act amended section 392 of ICTA (which operates by reference to section 836B of ICTA, also inserted by Schedule 1 to ITTOIA). Section 836B of ICTA is rewritten as section 1016 of this Act.

519. A person can make a claim to deduct a loss incurred in a relevant transaction in computing the person's net income of the tax year or of a subsequent tax year, but only from the person's miscellaneous income from relevant transactions. Transactions are relevant if any profits from them would be liable to income tax under a provision listed in section 1016.

Section 153: How relief works

520. This section explains how the deductions are made. It is based on section 392(2) and (5) of ICTA.

Section 154: Transactions in deposit rights

521. This section explains the application of the loss relief against miscellaneous income rules as they apply to transactions in deposit rights. It is based on section 398 of ICTA.

Section 155: Time limit for claiming relief

522. This section sets out the time limits for making claims for loss relief against miscellaneous income. It is based on section 392(6) and (7) of ICTA.

Part 5: Enterprise investment scheme

Overview

523. This Part provides income tax reductions to individuals who subscribe for shares in smaller unquoted trading (and some other) companies with which they are not connected.

524. A tax reduction is available where an individual provides additional full risk equity finance by subscribing money for shares and holds those shares, in most cases, for at least three years and the other conditions of the scheme are met.

525. The structure of the Part is as follows:

- The tax reduction and an overview (Chapter 1);
- Conditions relating to the investor (Chapter 2);
- Conditions relating to money raised and other matters (Chapter 3);
- Conditions relating to the issuing company (Chapter 4);
- Claiming the tax reduction and attributing the reduction to shares (Chapter 5);
- Withdrawing tax reductions that prove to be excessive (Chapter 6);
- Method of withdrawing tax reduction and related matters (Chapter 7); and
- Supplementary provisions (Chapter 8).

526. As set out in section 156(3), this Part has effect only in relation to shares issued on or after 6 April 2007 in accordance with section 1034(3). This is subject to provisions in Schedule 2, in particular the general provisions concerning the continuity of the law in Part 1 and the transitional provisions in Part 7 of that Schedule.

527. For example, the effect of Part 1 of Schedule 2 on section 218 (value received when there is more than one issue of shares) is that the section is read, in relation to shares issued before 6 April 2007, as a reference to the corresponding provision in the source legislation.

528. As a result of the commencement basis applying to Part 5, the minor changes in the law made by this Act will not affect shares issued before 6 April 2007, subject to one exception. This exception is the consequential amendment to section 312(2A) of ICTA, explained in the explanatory note on this section in Schedule 1.

529. Section 1034(3) also provides that consequential amendments and repeals associated with Part 5 have effect only in relation to shares issued on or after 6 April 2007. So enterprise investment scheme (EIS) shares and BES shares (BES is the common name for the business expansion scheme) issued before that date are unaffected.

530. Sections 292, 294, 295, 296 and 395 of ICTA have not been rewritten since these provisions are spent.

Chapter 1: Introduction

Overview

531. This Chapter sets out the conditions for an individual to be entitled to a tax reduction and quantifies the amount of the entitlement. It also gives an overview of the Part, labels certain concepts and provides signposts to other material related to EIS.

Section 156: Meaning of "EIS relief" and commencement

532. This section says the relief is a tax reduction and provides labels for the scheme and the relief. It is based on section 312(1) of ICTA.

533. *Subsection (3)* sets out the commencement basis for Part 5 in accordance with section 1034(3). See the notes in the general overview to this Part.

Section 157: Eligibility for EIS relief

534. This section states the conditions to be satisfied for the relief to be available and indicates where further detail can be found on certain conditions. It is based on sections 289(1), 290(1) and 291(1) of ICTA.

Section 158: Form and amount of EIS relief

535. This section quantifies the amount of the income tax reduction to which an individual is entitled if the individual claims EIS relief for a tax year. It is based on sections 289A(1) to (4) and 290(2) of ICTA.

536. *Subsection (1)* provides that an individual may, if that individual wishes, claim EIS relief in respect of some, but not all, of the shares in relation to which the individual is eligible for relief. See *Change 36* in Annex 1. There are consequential changes in later sections to deal with cases where an individual claims EIS relief in relation to some, but not all, of the shares in relation to which the individual is eligible for relief. The commentary on those later sections refers back to the commentary on this section.

537. Subsection (1) is expressed in terms of the individual's entitlement to a tax reduction. Sections 27 and 29 (within the calculation of income tax liability Chapter in Part 2) contain provisions about how effect is given to the entitlement to a reduction and how the actual reduction is quantified.

538. *Subsection (2)(a)* adds the words "and claims", before "EIS relief", to make explicit a requirement that is implied when sections 289A(1) and 289A(2)(a) of ICTA are considered together.

539. *Subsection (2)(b)* provides that there is an upper limit on the amount of an individual's entitlement to EIS relief rather than an upper limit on the subscriptions in respect of which the relief may be claimed. See *Change 37* in Annex 1.

Section 159: Periods A, B and C

540. This section labels and defines periods (relating to an issue of shares) that are referred to in other sections in this Part. It is based on section 312(1) and (1A) of ICTA.

Section 160: Overview of other Chapters of Part

541. This section indicates the content of Chapters that are not mentioned in section 157. It is new.

Section 161: Other tax reliefs relating to EIS

542. This section signposts other reliefs and material that may be relevant to EIS. It is new.

Chapter 2: The investor

Overview

543. This Chapter sets out the conditions which the investor must meet in order to be a "qualifying investor" in relation to the issue of shares in question.

Section 162: Overview of Chapter

544. This section states the three conditions that must be met by an investor in order to be a qualifying investor and indicates where further detail can be found about them. It is new.

Section 163: The no connection with the issuing company requirement

545. This section provides that the investor must not be connected with the issuing company during the period indicated. It is based on section 291(1) of ICTA.

546. There is a reference to connection before the issuing company is incorporated. This covers for example a former employee of a company which becomes a subsidiary or partner of the issuing company within the prescribed period, see section 167(1)(a).

Section 164: The no linked loans requirement

547. This section denies relief in the cases set out (loans connected with the subscription for the relevant shares). It is based on section 299A of ICTA.

548. The effect of the cross-reference in section 299A(2) of ICTA to section 307(6)(ca) of ICTA is achieved by making reference in section 239(1) of this Act (date from which interest is chargeable) to the meaning of "the making of the loan" in this section.

549. Section 1008(1) notes that "assignation" is the term used in Scotland for "assignment". Both terms are used in section 299A(2)(b) of ICTA.

Section 165: The no tax avoidance requirement

550. This section stops the investor being a qualifying investor if the subscription was not for commercial reasons or if a main purpose was tax avoidance. It is based on section 289(6) of ICTA. There is a complementary requirement in respect of the issue of the shares in Chapter 3 of this Part.

551. Section 289(6) of ICTA has introductory wording about the investor "not being eligible for relief". There is no need for similar introductory words in this section, because section 162 already provides that the investor is not a qualifying investor if the no tax avoidance requirement is not met, and is therefore not eligible for EIS relief (section 157(1)(b)).

552. To be consistent with related legislation, for example paragraph 14 of Schedule 15 to FA 2000 (corporate venturing scheme), this section refers to "commercial reasons" rather than "commercial purposes".

Section 166: Connection with issuing company

553. This section defines, for the purposes of this Chapter, the meaning of an individual being connected with the issuing company and provides signposts to the sections that provide further detail of the way in which such connection can occur. It is based on section 291(2) of ICTA.

554. This section clarifies the application of the definition of connected in section 291(2) of ICTA. See *Change 38* in Annex 1.

Section 167: Employees, directors and partners

555. This section defines how an individual can be connected with the issuing company as a result of a person being "an employee, director or partner". It is based on section 291(2), (3) and (4) of ICTA.

556. *Subsection (3)* is based on section 291(4) of ICTA. It provides that an individual who is both a director and an employee of the issuing company is covered by *subsection (1)(c)* rather than *subsection (1)(a)* and so can benefit from the let-outs in sections 168 and 169. In such a case, references in sections 167 to 169 to an individual in his or her capacity as a director also includes the individual in his or her capacity as an employee. So, for example, in these cases any remuneration received as an employee is taken into account in section 169(2).

Section 168: Directors excluded from connection

557. This section provides that an individual will, in specific circumstances, not be connected with the issuing company. It is based on sections 291(5) and 291A(1), (2), (3) and (6) of ICTA.

558. This section allows, in limited cases, the investor to be eligible for EIS relief in relation to a share issue even if the investor (or an associate) is a director of the issuing company. Such limited cases *broadly* include those where:

- the sole reason for connection would have been the relationship as director; but
- in relation to the period over which connection is tested;
  - — there are no payments to the individual (or to certain other persons), and no entitlement to such payments, from the issuing company (or from certain other persons), or
  - — any such payments fall to be disregarded by virtue of *subsection (2)*.

559. *Subsection (4)(a)(i)* narrows the definition of "related person". See *Change 39* in Annex 1.

560. The meaning of "connected" in *subsection (4)(a)(ii)* is found in section 993. This differs from the other references to "connected" in this Chapter, which take their meaning from section 166.

561. The words "at any time in period A" in *subsection (5)* are needed to convey the full meaning of the expression "51% subsidiary" in section 291A(6) of ICTA. For the source legislation, this expression has a specific definition in section 312(1) of ICTA, but this is not reproduced in the rewritten EIS sections. Instead a "51% subsidiary" in this Part takes its meaning from section 838 of ICTA - see section 989.

Section 169: Directors qualifying for relief despite connection

562. This section provides an exception to the rule that a person is not a qualifying investor if that person is connected with the issuing company. It is based on section 291(5) and section 291A(4) and (5) of ICTA.

563. This exception might apply to certain, otherwise unconnected, business angel investors whose only connection with the issuing company will be as directors. (A business angel is the term used for investors who also make their business expertise available to a company by becoming a director.)

564. In *subsection (3)(a)* the reference to "connected" takes its meaning from section 166, see *Change 38* in Annex 1.

565. In section 291A(5) of ICTA there is a reference to the word "trade" including "any business, profession or vocation". As an incorporated company cannot carry on a

vocation there is now in *subsection (3)(b)* a reference to "the trade, business or profession" carried on by the company or its subsidiary.

Section 170: Persons interested in capital etc of company

566. This section sets out cases in which an individual is treated as connected with the issuing company because of certain interests in that company or a subsidiary of that company. It is based on section 291(5) and section 291B of ICTA other than section 291B(5).

567. In *subsection (1)(a)*, based on section 291B(1)(a) of ICTA, there is a reference to ordinary share capital without the word "issued". This is because the definition of ordinary share capital in section 989 defines ordinary share capital in terms of issued share capital.

568. In *subsections (1)(a), (2)(a)* and *(10)*, it has been made clear that the subsidiary referred to is the subsidiary of the issuing company.

569. *Subsection (6)* refers to "the issuing company". This replaces a reference to "a company" in section 291B(4) of ICTA, on which subsection (6) is based. The clarification is consistent with the context of section 291B of ICTA generally and with the reference in section 291B(5) of ICTA to "another company … assuming it to be an issuing company" in particular.

Section 171: Persons subscribing for shares under certain arrangements

570. This section provides a further instance where an individual is treated as connected with the issuing company. It is based on section 291B(5) of ICTA.

571. The references to "connected" take their meaning from section 166, see *Change 38* in Annex 1.

Chapter 3: General requirements

Overview

572. This Chapter sets out conditions for the general requirements that need to be met in relation to the relevant shares.

Section 172: Overview of Chapter

573. This section lists the various conditions that are contained in this Chapter and where further detail can be found. It is new.

Section 173: The shares requirement

574. This section sets out the conditions that the relevant shares must satisfy. It is based on section 289(1), (7), (8) and (8A) of ICTA.

575. The shares (apart from bonus shares) have to be fully paid up in cash at the time they are issued. Bonus shares are defined in section 257.

576. *Subsection (2)* provides in effect that the shares must also be full-risk ordinary shares throughout period B. The label "eligible shares" which appears in section 289(7) of ICTA is no longer used. Instead of references to "eligible shares", there are now references elsewhere in this Part to shares which meet the requirements of this subsection.

577. There are several instances in ICTA where the reference to *eligible* shares adds nothing to the meaning. The word eligible has been omitted in the Part where this is the case, and if identification of the shares in question is needed, an alternative such as "the relevant shares" has been used.

578. Similarly the term "new ordinary shares" has not been reproduced. As EIS relief depends on subscribing for shares that are issued to the investor, it is not necessary to describe the shares as "new". This approach mirrors that in paragraph 35 of Schedule 15 to FA 2000 (corporate venturing scheme).

Section 174: The purpose of the issue requirement

579. This section sets out the condition concerning the purpose for which the share issue raises money. It is based on section 289(1) of ICTA.

Section 175: The use of the money raised requirement

580. This section sets out the requirements for the employment of the money raised by the issue of relevant shares. It is based on section 289(1), (3) and (3A) of ICTA.

581. *Subsection (1)* contains a reference to bonus shares which are defined in section 257(1). Such shares do not need to meet the tests of this section. This enables for example section 201(4) (attribution of EIS relief to shares) to work. As a result, under section 201(4)(b) this Part applies as if the "original issue" of shares included "corresponding bonus shares".

582. Section 257(5) explains when shares are treated as being of the same class.

Section 176: The minimum period requirement

583. This section requires that the companies mentioned in *subsection (2)* must carry on the qualifying business activity for a certain period of time. It is based on section 289A(6) to (8A) of ICTA.

584. *Subsection (1)* makes the requirements of this section a condition of eligibility for EIS relief instead of, as in section 289A(6) of ICTA, a condition for claiming the relief. See *Change 40* in Annex 1.

585. *Subsections (2)* and *(3)* refer to "at or after the time of the issue" to make more obvious the fact that the period in question may end after the share issue has occurred.

Section 177: The no pre-arranged exits requirement

586. This section denies relief if certain arrangements exist in connection with the issue of shares. It is based on section 299B of ICTA.

587. The words in brackets in *subsection (1)(c)* "in terms of value" are not in section 299B(1)(c), although they do appear in paragraph 37(1) of Schedule 15 to FA 2000 (corporate venturing scheme). Introducing the words here is intended to clarify what is meant by "a substantial amount" in this context.

Section 178: The no tax avoidance requirement

588. This section requires that there be commercial reasons for the issue of the relevant shares and that a main purpose is not tax avoidance. It is based on section 289(6) of ICTA.

589. There is a complementary requirement in respect of the subscription for the shares in Chapter 2.

590. To be consistent with related legislation, for example, in paragraph 14 of Schedule 15 to FA 2000 (corporate venturing scheme), this section refers to "commercial reasons" rather than "commercial purposes".

Section 179: Meaning of "qualifying business activity"

591. This section says what "qualifying business activity" means. It is based on section 289(2), (3A) and (8) of ICTA.

592. For EIS relief to be available, the share issue must raise money for the purpose of a qualifying business activity. (See section 174.)

593. In *subsection (1)* a qualifying business activity is explained by reference to activity A and activity B. The requirement is that these activities are carried out by the company or a qualifying 90% subsidiary.

594. The phrase "or preparing to carry on and then carrying on" in *subsection (2)(b)* is intended to be clearer than the phrase "preparing to carry on, or carrying on," in section 289(2)(a)(ii) of ICTA. Each is concerned with money being raised *both* for the preparations for a trade *and* the subsequent carrying on of that trade.

595. *Subsections (4)* and *(5)* extend the cases in which R&D activities can be treated as a qualifying business activity. See *Change 41* in Annex 1.

596. *Subsection (7)* enables certain requirements to be met in relation to a company that is not a qualifying 90% subsidiary at the time the shares are issued. See *Change 42* in Annex 1.

Chapter 4: The issuing company

Overview

597. This Chapter sets out the conditions to be met if the issuing company is to be a qualifying company in relation to the relevant shares.

Section 180: Overview of Chapter

598. This section summarises the conditions to be met and indicates where further detail can be found. It is based on sections 289(1)(ba) and 293(1) of ICTA but there is no equivalent provision in ICTA that draws these conditions together.

599. Where there are shared provisions, the order matches Chapter 4 of Part 6, "qualifying holdings" in the venture capital trust scheme (VCT), as far as possible.

Section 181: The trading requirement

600. This section sets out the trading requirement which the issuing company must meet throughout period B. It is based on section 293(2), (3A) to (3F) and (8A) of ICTA.

601. The nature of the requirement is set out in *subsection* (2). The requirement can be met in one or other of two ways. Either the issuing company must exist essentially for the purpose of carrying on one or more *qualifying* trades during period B, or it can be a parent company of a group that carries on qualifying activities. It can alternate between these two conditions providing that at all times within period B it meets one or other of them.

602. The meaning of "qualifying trade" is explained in section 189. "Parent company", "group" and "group company" are defined in section 257(1). Only part of section 293(3A) of ICTA appears in this section: it is in *subsection (4)*. The requirements in section 293(3A)(a) and (b) of ICTA are covered respectively by the definition of "parent company" in section 257(1) and by section 187.

603. *Subsections (3)* and *(7)* provide that certain requirements can be met in relation to a company that is not part of the group at the time the shares are issued. See *Change 42* in Annex 1.

604. The provision for property used for R&D in *subsection (6)(d)* has been extended. See *Change 41* in Annex 1.

605. The words "capable of" have been omitted in *subsection (8)*, rewriting the definitions of "incidental purposes" and of "mainly trading subsidiary" in sections 293(2)(a) and 293(3F)(a) of ICTA. The intention is to make the definitions simpler to interpret. In practice the test will not change.

606. The label "non-qualifying activities" in *subsection (2)(b)* is defined in subsection (8). Paragraph (a) of that definition refers to excluded activities. These are listed in section 192. Section 194 provides a let-out for certain leasing of ships from being treated as a non-qualifying activity.

607. The way that subsection (8) interprets non-qualifying activities means that no distinction is made between the let-out in section 194(4), derived from section 297(6)(a) to (d) of ICTA, and the let-out in section 194(7), derived from the final words of section 297(6) of that Act. This contrasts with section 293(3C)(b) of ICTA. See *Change 43* in Annex 1.

Section 182: Ceasing to meet trading requirement because of administration or receivership

608. This section provides an exception to section 181 in the cases specified. It is based on section 293(4A) to (6) and (8A) of ICTA.

609. The cases specified relate to administration or receivership carried out for commercial reasons and which do not have tax avoidance as a main purpose.

610. The meanings of "in administration" and "in receivership" are provided by section 252.

Section 183: The issuing company to carry on the qualifying business activity requirement

611. This section requires that, subject to the rules in the section, during period B it is only the issuing company or a qualifying 90% subsidiary of the issuing company that carries on the qualifying business activity for which money was raised by the share issue. It is based on section 289(1A) to (1E) and (8) and section 312(1) of ICTA.

612. Section 289(1)(ba) of ICTA, stating that the requirements of section 289(1A) of that Act must be met, is not reproduced explicitly. Instead it is implicit in section 180(b), as part of the list of the requirements in relation to the issuing company.

Section 184: The unquoted status requirement

613. This section requires that when the relevant shares are issued:

- the issuing company is unquoted; and
- no arrangements as are mentioned in the section are in existence.

It is based on sections 293(1A), (1B) and (8A) and 312(1), (1B), (1C) and (1E) of ICTA.

614. The words in brackets in section 293(1) of ICTA "whether it is resident in the United Kingdom or elsewhere" have not been rewritten. The words do not add anything to the tests in section 179 (meaning of "qualifying business activity").

615. The definition of unquoted company in section 312 of ICTA is set out in this section, rather than in Chapter 8, since this is the only mention of unquoted status in the EIS provisions.

616. Section 312(1D) of ICTA is not rewritten in this Part. It concerns orders made by the Commissioners for Her Majesty's Revenue and Customs and is covered by section 1014 which is based on section 828 of ICTA.

617. FA 2001 removed the requirement that the issuing company remain unquoted throughout the relevant period. Following that change, section 312(1E) of ICTA has little or no practical significance, but in exceptional circumstances this provision could still apply in relation to the "arrangements" in section 293(1B) of ICTA, (rewritten in *subsection (1)(b)* and *(c)*). Section 312(1E) has therefore been rewritten in *subsection (6)*.

618. "Arrangements" are defined in section 257(1).

Section 185: The control and independence requirement

619. This section is based on section 293(8) and (8A) of ICTA. It *broadly* requires that throughout period B:

- any company that the issuing company (on its own or together with connected persons) controls is a qualifying subsidiary of the issuing company
- the issuing company is not a 51% subsidiary of or controlled by another company (on its own or together with connected persons); and
- there are no arrangements which could lead the issuing company to fail either of these tests.

620. Section 293(3) of ICTA has not been rewritten. The definition of "a qualifying subsidiary of another company" is contained in section 191.

621. In *subsection (1)(a)* the words "of the issuing company" have been added after "a qualifying subsidiary". See *Change 44* in Annex 1.

622. "Control" in *subsection (2)(a)* is defined in section 995. The meaning of "control" in subsection (1)(a) is different and is given by section 257(3).

Section 186: The gross assets requirement

623. This section sets out the limits that apply to the value of a company's gross assets before and after a share issue. It is based on section 293(6A) to (6C) of ICTA.

624. The requirement differentiates between a "single company" and a "parent company". Both these terms are defined in section 257(1).

625. Section 293(6D) of ICTA has not been rewritten as a separate provision. The term the "company's group" and the reference to "in relation to any time" are not needed given the definitions in section 257(1) and the way in which this section as a whole is drafted.

626. *Subsection (3)(b)* sets out more clearly what is meant in relation to a group of companies by the words "aggregate value at that time of the gross assets" in section 293(6B)(b) of ICTA. Similar wording is used in paragraph 12(3) of Schedule 5 to ITEPA (enterprise management incentives).

Section 187: The qualifying subsidiaries requirement

627. This section requires that during period B any subsidiary of the issuing company must be a qualifying subsidiary. It is based on sections 293(3A) and 308(1) and (5A) of ICTA.

Section 188: The property managing subsidiaries requirement

628. This section requires that any property managing subsidiary of the issuing company must also be its qualifying 90% subsidiary. It is based on section 293(6ZA) to (6ZC) and (8A) of ICTA.

629. In section 293(6ZC) of ICTA "land" and "property deriving its value from land" take the meaning in section 776 of ICTA. *Subsection (3)*, applying for the purposes of *subsection (2)* of the rewritten section, provides the definition of "property deriving

its value from land". "Land" itself is not defined in this Act and instead relies on the definition in Schedule 1 to the Interpretation Act 1978. See the commentary on section 772.

Section 189: Meaning of "qualifying trade"

630. This section gives the meaning of "qualifying trade". It is based on sections 297(2) and (8) and 298(3) and (5) of ICTA.

631. The wording of *subsection (1)(b)* is more compact than section 297(2) of ICTA. The comparable wording is that the trade must not "consist of one or more of the following activities if that activity amounts, or those activities when taken together amount, to a substantial part of the trade".

632. Excluded activities referred to in this subsection are set out in section 192.

633. *Subsection (2)* excepts references to a trade in certain sections in this Chapter from the extended meaning of "trade" in section 989, based on the definition in section 832(1) of ICTA.

Section 190: Meaning of "qualifying 90% subsidiary"

634. This section gives the meaning of "qualifying 90% subsidiary". It is based on section 289(9) to (13) of ICTA.

Section 191: Meaning of "qualifying subsidiary"

635. This section defines "qualifying subsidiary". It is based on section 308(2) to (4) and (5B) of ICTA.

636. The term "51% subsidiary" in *subsection (2)(a)*, which is based on section 308(2)(ca) of ICTA, takes its meaning from the definition in section 989. The definition provides a signpost to section 838 of ICTA. Section 308(5B) of ICTA, which applies section 838(2) to (10) to section 308(2)(ca), has not been rewritten as it is unnecessary.

Section 192: Meaning of "excluded activities"

637. This section gives the meaning of "excluded activities". It is based on section 297(2) of ICTA.

638. The meaning of excluded activities is needed to determine whether a trade is a qualifying trade and the extent to which the business of a group includes non-qualifying activities.

639. *Subsection (2)* indicates where further detail can be found on certain of the activities listed in *subsection (1)*.

Section 193: Excluded activities: wholesale and retail distribution

640. This section supplements section 192(1)(b). It is based on section 297(3) of ICTA.

641. *Subsection (2)* makes it clear that there are two sets of determinants, one set establishing what is a trade of wholesale and retail distribution and the other what is an ordinary trade of wholesale and retail distribution.

642. The words "or exposed" before "for sale" have been added in *subsection (4)*. This is intended to reflect the normal description of a trade of retail distribution in United Kingdom statute law.

643. *Subsection (5)(b)* refers to "the trader" rather than "the company" which is referred to in section 297(3)(c)(ii) of ICTA. See *Change 45* in Annex 1.

Section 194: Excluded activities: leasing of ships

644. This section supplements section 192(1)(d). It is based on sections 297(6) and (7) and 298(5) of ICTA.

645. *Subsection (2)* takes paragraph 18(2) of Schedule 5 to ITEPA (enterprise management incentives) as its model. This additional material, which is not in the source legislation, makes it clear that the requirements of *subsection (4)* do not have to be met in relation to offshore installations and pleasure craft.

646. *Change 43* applies for the purposes of *subsection (7)*. See the commentary on section 181.

Section 195: Excluded activities: receipt of royalties and licence fees

647. This section supplements section 192(1)(e). It is based on section 297(4) to (5C) of ICTA.

Section 196: Excluded activities: property development

648. This section supplements section 192(1)(g). It is based on section 298(5), (5B) and (5C) of ICTA.

Section 197: Excluded activities: hotels and comparable establishments

649. This section supplements section 192(1)(j). It is based on sections 297(3A) and 298(5A) of ICTA.

Section 198: Excluded activities: nursing homes and residential care homes

650. This section supplements section 192(1)(k). It is based on sections 297(3A) and 298(5) of ICTA.

Section 199: Excluded activities: provision of services or facilities for another business

651. This section treats the provision of services or facilities as excluded activities if:

- the services or facilities are provided to businesses which themselves consist largely of excluded activities; and
- the specified control requirements exist.

It is based on sections 297(2) and 298(1) to (3) of ICTA.

652. The section is written in terms of a business. As a consequence, the way in which the definition of a trade in section 298(3) of ICTA, governing sections 297 and 298, is applied within those sections has been simplified. See *Change 46* in Annex 1.

Section 200: Power to amend by Treasury order

653. This section allows the Treasury to make orders amending the provisions mentioned in the section. It is based on section 298(4) of ICTA.

Chapter 5: Attribution of and claims for EIS relief

Overview

654. This Chapter deals with attributing EIS relief to shares, claiming the relief and associated matters.

Section 201: Attribution of EIS relief to shares

655. This section attributes EIS relief for a tax year:

- first, to the issues of shares on which relief is claimed; and
- second, to shares included in those issues.

It is based on section 289B(1) to (3A) and (5) and (6) of ICTA.

656. These attributions are needed because the investor may have subscribed to more than one share issue of a single company, or to share issues of more than one company, during the tax year. Each such share issue to the investor may have different periods associated with it for the purpose of recovery or withdrawal of relief. And the question of whether relief is attributable to shares disposed of is also relevant to relief for losses on shares and for capital gains tax purposes.

657. *Subsections (2)* to *(4)* cater for cases where an individual claims EIS relief in respect of all of the shares in relation to which the individual is eligible for relief. They also cater for cases where an individual claims EIS relief in respect of some, but not all, of the shares in relation to which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

Section 202: Time for making claims for EIS relief

658. This section sets out the intervals during which claims for EIS relief can be made for a tax year. It is based on sections 289B(5) and 306(1) of ICTA.

Section 203: Entitlement to claim

659. This section requires the investor to hold a certificate (compliance certificate) from the issuing company before claiming EIS relief. It is based on section 306(2), (7), and (8) of ICTA.

660. *Subsection (2)* omits the words “and admitted” which are in section 306(7) of ICTA. Those words are not needed as there is no separate PAYE admittance procedure.

Section 204: Compliance certificates

661. This section says what compliance certificates are and deals with matters associated with their issue to investors (including the pre-condition that the issuing company gives a compliance statement to HMRC). It is based on section 306(2), (3) and (4) of ICTA.

662. The compliance certificate is commonly known as an EIS 3, the form provided by HMRC for the issuing company to issue to its investors.

663. The reference to requirements for EIS relief being “for the time being met” in *subsection (1)(b)* is new. There is an explanation in *Change 57* in Annex 1.

664. *Subsection (5)* requires an officer of Revenue and Customs to notify the officer’s decision on a request by the issuing company for permission to issue a compliance certificate. See *Change 47* in Annex 1.

Section 205: Compliance statements

665. This section says what compliance statements are and deals with associated matters (including the period during which they can be given). It is based on section 306(3), (3A), (5) and (11) of ICTA.

666. The compliance statement is commonly known as an EIS 1, the form provided by HMRC for completion by the issuing company.

667. The reference to requirements for EIS relief being "for the time being met" in *subsection (1)(a)* is new. There is an explanation in *Change 57* in Annex 1.

Section 206: Appeal against refusal to authorise compliance certificate

668. This section allows an issuing company to appeal, to an independent body, if the officer of Revenue and Customs refuses to authorise the issue of compliance certificates by the company. It is based on section 306(10) of ICTA.

Section 207: Penalties for fraudulent certificate or statement etc

669. This section provides for penalties in the circumstances set out. It is based on section 306(6) of ICTA.

Chapter 6: Withdrawal or reduction of EIS relief

Overview

670. This Chapter deals with cases in which EIS relief, otherwise available to the investor in relation to a share issue, is reduced or withdrawn.

Section 208: Overview of Chapter

671. This section provides a signpost to the various ways in which EIS relief may be withdrawn or reduced. It is new.

Section 209: Disposal of shares

672. This section withdraws or reduces EIS relief if the investor disposes of relevant shares before the end of period A relating to those shares. It is based on sections 299(1), (2) and (8) and 304(1) of ICTA.

673. EIS relief is only reduced to the extent that the relief is attributable to the shares which are the subject of the disposal.

674. *Subsection (4)* provides an exception in the case of certain disposals between spouses or civil partners.

675. Section 299(3) of ICTA is not rewritten. It is not needed because other provisions identify the shares that are disposed of and calculate the appropriate proportion of the relief attributable to those shares.

Section 210: Cases where maximum EIS relief not obtained

676. This section deals with the case where EIS relief on a subscription for shares was effectively obtained for a tax year at a rate that is below the savings rate of tax for the tax year concerned. It is based on sections 289B(5) and 299(4) of ICTA.

677. *Subsection (1)* effectively reduces the rate at which section 209(3)(a) recovers EIS relief on the proceeds from a disposal of the shares concerned. The rate of recovery is reduced, from the savings rate of tax for the year in which the shares were issued, to the rate at which EIS relief was effectively obtained.

678. The subsection also caters for cases where an individual claims EIS relief in respect of some, but not all, of the shares in relation to which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

679. *Subsection (2)* deals with the complication that arises where the investor has obtained relief on some of the shares as if they were issued in the previous tax year. Subsection (1) is then applied as if there were two separate issues. That is necessary because the investor may have obtained EIS relief at different effective rates in the two years

concerned (and one or both of these effective rates could be less than the savings rate for the tax year concerned).

680. *Subsections (3)* and *(4)* are new and correspond to provisions in paragraph 46(5) and (6) of Schedule 15 to FA 2000 (corporate venturing scheme - disposal of shares). See *Change 48* in Annex 1.

Section 211: Call options

681. This section treats the grant of a call option by the investor as if it were a disposal of shares for the purpose of section 209 (disposal of shares). It is based on section 299(8) of ICTA.

Section 212: Put options

682. This section deals with put options granted to the investor during period A relating to the relevant shares concerned. It is based on section 299(5), (5A) and (8) of ICTA.

683. The grant of the put option to the investor leads to the withdrawal of any EIS relief attributable to the shares to which the put option relates.

Section 213: Value received by the investor

684. This section sets out what happens if the investor receives value from the issuing company at any time during period C relating to an issue of shares. It is based on sections 300(1) to (1B), 301(4A), 301A(5) and 312(1) of ICTA.

685. Any EIS relief attributable to the issue of shares is either withdrawn or reduced. The amount of value received by the investor is taken into account in determining whether there is a withdrawal or reduction of relief (and the size of any reduction).

686. Subsection (3) makes explicit the order in which to apply sections 218 to 220.

Section 214: Value received: receipts of insignificant value

687. This section prevents section 213 applying to insignificant amounts of value received by the investor. But such amounts are not ignored if, taken together with certain other receipts of value by the investor, the total amount received is not insignificant. It is based on section 300(1) and (1BC) and section 312(1) of ICTA.

Section 215: Meaning of "receipts of insignificant value"

688. This section gives the meaning of "receipts of insignificant value" for the purpose of section 214. It is based on section 301A(1) to (4) and section 312(1) of ICTA.

Section 216: When value is received

689. This section sets out the time at which, and circumstances in which, the investor is treated as receiving value from the issuing company. It is based on sections 300(1D) to (3), (5) and (6) and 301(3), (4) and (5) of ICTA.

690. *Subsection (3)* refers, for clarity, to "the issuing company" where the source legislation refers to "a company".

Section 217: The amount of value received

691. This section contains a table which sets out the amount of value received by the investor in cases where section 216 treats value as received by the investor. It is based on section 300(4) and (5) of ICTA.

Section 218: Value received where there is more than one issue of shares

692. This section deals with cases where the investor receives value but there is more than one issue of shares from which section 213 reduces or withdraws EIS relief. It is based on section 300(1BA) and (1BB) and section 312(1) of ICTA.

693. *Subsection (2)* apportions the value received between the different share issues before the calculation in section 213(2) takes place. Without such a provision the value received might be counted two, or more, times for reducing or withdrawing EIS relief.

694. By referring to the amount on which the investor obtains relief the subsection also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

Section 219: Value received where part of share issue treated as made in previous tax year

695. This section deals with a complication that can arise where section 213(2) applies to an issue of shares. The complication occurs where the investor has obtained relief on part of that share issue as if that part of the share issue had taken place in the previous tax year. It is based on sections 289B(5), 299(4) and 300(1B*)* of ICTA.

696. If that complication occurs,*subsection (2)* sets out the steps by which to arrive at the amount referred to in section 213(2)(a). Setting out these steps is a change because the source legislation is not explicit on this aspect. See *Change 49* in Annex 1.

697. By referring to the amount on which the investor obtains relief Step 1 also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

698. Step 2 includes a deeming of two separate issues of shares and apportionment of the value received between those two deemed issues. That is necessary because there may be a different savings rate of tax in each of the tax years.

699. Step 2 also requires the application of section 220, where appropriate, to deal with cases where the investor has not obtained EIS relief at the savings rate for one or both of the two years concerned in Step 2.

Section 220: Cases where maximum EIS relief not obtained

700. This section deals with the case where EIS relief on a subscription for shares was obtained for a tax year at a rate which is less than the savings rate of tax for that tax year. It is based on sections 299(4) and 300(1B) of ICTA.

701. *Subsection (1)* effectively lowers the rate at which section 213(2) recovers EIS relief on value received by the investor. The rate of recovery is reduced to the rate at which EIS relief was effectively obtained. The subsection also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

702. *Subsections (2)* and *(3)* are new and correspond to provisions in paragraph 52(2) and (3) of Schedule 15 to FA 2000 (corporate venturing scheme - cases where maximum relief not obtained). See *Change 48* in Annex 1.

Section 221: Receipts of value by and from connected persons etc

703. This section extends the meaning of terms used in some of the preceding sections. It is based on sections 300(1C) and 301(6) and (6A) of ICTA.

704. Without this extension the rules in preceding sections about reduction or withdrawal of EIS relief might be avoided in various ways.

Section 222: Receipt of replacement value

705. This section prevents section 213 reducing or withdrawing EIS relief in certain cases. It is based on sections 300A(1) to (6) and (11), 301(5) and 312(1) of ICTA.

706. This section applies to certain cases where the person who received value effectively repays all of it to the person who gave that value.

Section 223: Section 222: supplementary

707. This section supplements section 222. It is based on section 300A(1), (2) and (7) to (11) and section 312(1) of ICTA.

708. *Subsections (1)* and *(2)* contain limitations on the application of section 222.

709. There is a new reference in *subsection (2)(c)* to "the day" on which the amount of relief is determined. This is in line with the interpretation that the provision disqualifies restitution if it happens on the 61st day after *the day* of the determination.

710. *Subsections (3)* and *(4)* set out, for one particular case, the consequences of section 222 applying. Subsection (4) combines part of the provision in section 300A(10) of ICTA with material from paragraph 13C(4) of Schedule 5B to TCGA. A consequential amendment to that paragraph completes the picture (see the commentary in Part 2 of Schedule 1 to this Act on paragraph 13C of Schedule 5B to TCGA).

Section 224: Repayments etc of share capital to other persons

711. This section reduces or withdraws EIS relief in certain cases where, broadly, the issuing company (group) repays some of its share capital within period C relating to the issue of shares in question. It is based on sections 303(1) to (1C), (9A) and (9B), 303AA(2), 303A(2) and 312(1) of ICTA.

712. *Subsection (2)* sets out the calculation of the withdrawal or reduction in the simplest case where the repayment affects only a single issue of shares and only a single subscriber to that issue.

713. *Subsection (3)* provides a signpost to other sections that, depending on the particular combination of circumstances present, may modify (or remove the need for) the calculation in subsection (2). Subsection (3) makes explicit the order in which to apply sections 226 to 229.

714. *Subsections (4)* and *(5)* prevent this section applying in two cases. First, where the repayment causes a withdrawal or reduction of EIS relief (under other sections) or of relief under Schedule 15 to FA 2000 (the corporate venturing scheme) or precipitates a qualifying chargeable event for the purposes of Schedule 5B to TCGA (enterprise investment scheme: reinvestment). Second, where there would be a withdrawal etc in these cases if the repayment were not treated as insignificant.

715. The references in subsections (4)(b) and (c) to "that person's shares in the issuing company" are more explicit than in the source legislation and are consistent with section 303(IB)(a) of ICTA.

716. *Subsection (6)* is new and corresponds to paragraph 58(1) of Schedule 15 to FA 2000 (corporate venturing scheme - supplementary to value received). See *Change 50* in Annex 1.

Section 225: Insignificant repayments ignored for purposes of section 224

717. This section provides an exception to section 224 in certain cases where the repayment is insignificant. It is based on section 303AA(1) to (5) and section 312(1) of ICTA.

Section 226: Amount of repayments etc where there is more than one issue of shares

718. This section apportions the repayment for cases where that repayment results in relief being reduced or withdrawn, under section 224(2), in relation to two or more issues of shares. It is based on section 303(2) and (2A) of ICTA.

719. By referring to the relief which the individuals obtain *subsection (2)* caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

Section 227: Single issue affecting more than one individual

720. This section apportions the repayment for cases where, in relation to a single issue of shares affected by that repayment, there is more than one individual that has shares to which EIS relief is attributable. It is based on section 303(1C) and (1D) of ICTA.

721. By referring to the relief which the individual obtains, *subsection (2)* caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

Section 228: Single issue treated as made partly in previous tax year

722. This section deals with a complication that can arise where section 224(2) applies to an issue of shares. The investor may obtain relief as if part of that share issue had taken place in the previous tax year; a different savings rate may apply in the previous tax year. It is based on sections 289B(5), 299(4) and 303(1C*)* of ICTA.

723. Setting out steps, involving apportionment of the repayment, in *subsection (2)* is a change because the source legislation is not explicit on how to deal with such a complication. See *Change 49* in Annex 1.

724. By referring to the amount on which the individual obtains relief the subsection also caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

Section 229: Maximum relief not obtained for share issue

725. This section deals with the case where EIS relief on a subscription for shares was obtained for a tax year at a rate that is less than the savings rate for that tax year. It is based on sections 299(4) and 303(1C) of ICTA.

726. *Subsection (1)* caters for the case where an individual claims EIS relief on some, but not all, of the shares in respect of which the individual is eligible for relief. See the commentary on section 158 and *Change 36* in Annex 1.

727. *Subsection (2)* lowers the rate at which section 224(2) recovers EIS relief on the repayment. The rate of recovery is reduced to the rate at which EIS relief was effectively obtained.

728. *Subsections (3)* and *(4)* are new and correspond to provisions in paragraph 56(7) and (8) of Schedule 15 to FA 2000 (corporate venturing scheme - value received by other persons). See *Change 48* in Annex 1.

Section 230: Repayment of authorised minimum within 12 months

729. This section provides an exception to section 224 for certain repayments. It is based on section 303(9) of ICTA.

730. *Subsection (1)(b)* widens the exception in the source legislation and corresponds to paragraph 58(5)(b) of Schedule 15 to FA 2000 (corporate venturing scheme - repayment of authorised minimum within 12 months). See *Change 51* in Annex 1.

Section 231: Restriction on withdrawal of relief under section 224

731. This section provides for section 224 to apply as if the repayment were a reduced, or zero, amount in cases where the repayment has led to a reduction of relief under Schedule 15 to FA 2000 (corporate venturing scheme). It is based on section 303A(1), (3) to (7) and (9) of ICTA.

Section 232: Acquisition of a trade or trading assets

732. This section withdraws relief from an individual in the circumstances set out in the section. It is based on section 302(1), (2) and (4) to (5) of ICTA.

733. The definition of "subsidiary" in section 302(5) of ICTA is not needed in sections 232 and 233 because they refer to "any qualifying subsidiary" and apply to period A.

734. *Subsection (7)* differs from the source legislation by not referring to a vocation. That is on the footing that an incorporated company cannot carry on a vocation.

Section 233: Acquisition of share capital

735. This section withdraws relief from an individual in the circumstances set out in the section. It is based on section 302(3), (4A), (4B) and (5) of ICTA.

Section 234: Relief subsequently found not to have been due

736. This section withdraws EIS relief in cases where the conditions for EIS relief, having been satisfied at the time it was obtained, cease to be satisfied. It is based on section 307(1) and (1A) of ICTA.

Chapter 7: Withdrawal or reduction of EIS relief: procedure

Overview

737. This Chapter deals with the withdrawal or reduction of EIS relief after it has been obtained along with related matters such as information requirements, interest and penalties.

Section 235: Assessments for the withdrawal or reduction of EIS relief

738. This section provides that an assessment must be made to withdraw or reduce EIS relief after it has been obtained. It is based on section 307(1) and (8A) of ICTA.

Section 236: Appeals against section 234(3)(b) notices

739. This section allows the issuing company to appeal to an independent tribunal in cases where the issuing company disagrees with a notice under section 234(3)(b). It is based on section 307(1B) and (1C) of ICTA.

Section 237: Time limits for assessments

740. This section sets out the time limits for making an assessment or giving a notice under section 234(3)(b). It is based on section 307(2), (5) and (8A) of ICTA.

Section 238: Cases where assessment not to be made

741. This section provides for two cases in which EIS relief will not be withdrawn or reduced. It is based on section 307(3), (4) and (8A) of ICTA.

742. *Subsections (2)* and *(3)* cover the case of events occurring after the individual has disposed of all the shares, on which reduction of relief is still possible, by way of bargains at arm's length. An assessment cannot be made in relation to such events unless the individual is connected with the issuing company.

743. Subsection (2) limits, compared to the source legislation, the shares that need consideration in deciding whether an assessment cannot be made. *See Change 52* in Annex 1.

Section 239: Date from which interest is chargeable

744. This section gives the date from which interest runs if EIS relief is withdrawn or reduced by an assessment. It is based on sections 299A(2) and 307(6) and (8A) of ICTA.

745. *Subsection (1)* contains a table setting out the dates that apply. Those dates depend on the provision on which the assessment is based.

746. The table does not include anything derived from section 307(6)(a) and (aa) and (7) of ICTA. Nor is there any material derived from 306(9) of ICTA. Those provisions do not fit with Self Assessment. See *Change 53* in Annex 1.

747. Section 307(8) of ICTA is redundant as it refers to spent legislation and has not been rewritten.

Section 240: Information to be provided by the investor

748. This section requires an investor to provide information to an officer of Revenue and Customs if certain events occur after the investor has obtained EIS relief. It is based on section 310(1), (2A) and (9A) of ICTA.

Section 241: Information to be provided by the issuing company etc

749. This section requires the issuing company, or certain other persons, to provide information to an officer of Revenue and Customs if certain events occur which could withdraw or reduce EIS relief. It is based on section 310(2), (2A) and (9A) of ICTA.

750. *Subsection (1)* differs from section 310 of ICTA as it links the provision of a compliance statement to the requirement to give notice of certain events and it refers to events having an effect "if EIS relief had been obtained". This follows the approach in paragraph 65(1) of Schedule 15 to FA 2000 (corporate venturing scheme). See *Change 54* in Annex 1.

751. *Subsection (4)* also follows the corporate venturing scheme approach and differs from section 310 of ICTA It allows the issuing company to provide notice of one particular event within 60 days of coming to know of that event. See *Change 54* in Annex 1.

752. Section 310(3) of ICTA is redundant as it refers to spent legislation and has not been rewritten.

Section 242: Power to require information where section 240 or 241 applies or could have applied

753. This section allows an officer to require information in certain cases. It is based on section 310(4) of ICTA.

Section 243: Power to require information in other cases

754. This section provides additional circumstances in which an officer can require information for the purposes of this Part. It is based on section 310(5) to (8) of ICTA.

Section 244: Obligations of secrecy

755. This section allows an officer of Revenue and Customs to give certain information to the issuing company. It is based on section 310(9) of ICTA.

Chapter 8: Supplementary and general

Overview

756. This Chapter deals with some special cases and definitions.

Section 245: Transfers between spouses or civil partners

757. This section provides for step in shoes treatment where shares are transferred between spouses or civil partners in specified circumstances. It is based on section 304(2) and (3) of ICTA.

758. *Subsection (2)(b)* and *(d)* and *subsection (3)* contain material, not in the source legislation, making clearer how the step in shoes treatment operates. See *Change 55* in Annex 1.

Section 246: Identification of shares on a disposal

759. This section gives rules identifying which shares are disposed of. It is based on sections 299 (6) to (6D) and 304(4) of ICTA.

Section 247: Continuity of EIS relief where issuing company is acquired by new company

760. This section allows, in limited circumstances, the issuing company to become a wholly-owned subsidiary of another company without jeopardising EIS relief attributable to shares in the issuing company. It is based on section 304A(1), (2) and (6) to (8) of ICTA.

761. When this section applies, the exchange of shares and the issuing company becoming a subsidiary do not cause a reduction or withdrawal of EIS relief.

762. There is effectively step in shoes treatment given to the shares in the new company (which the shareholder receives in exchange for shares in the issuing company). The following two sections deal with that "step in shoes" treatment.

Section 248: Carry over of obligations etc where EIS relief attributed to new shares

763. This section gives the new company the rights and obligations, in relation to EIS relief, of the issuing company that has been acquired. It is based on section 304A(5) of ICTA.

Section 249: Substitution of new shares for old shares

764. This section treats the shareholder in the new company broadly as if actions etc taken in relation to the issuing company had been taken in relation to the new company. It is based on section 304A(3) and (4) of ICTA.

Section 250: Nominees and bare trustees

765. This section deals with the actions of nominees or bare trustees. It is based on section 311(1) to (2A), (4) and (5) of ICTA.

766. *Subsection (2)* adopts a different approach from that in section 311 of ICTA. Section 311 begins with the words "where eligible shares are held on a bare trust" and section 289(7) of ICTA defines "eligible shares" in terms of "new" shares. Subsection (2) begins with the words "if shares have been issued to a bare trust" and thereby makes it clear that these "new" shares are *issued* to bare trustees.

767. Elsewhere in this Part the concept of eligible shares being "new" has been dropped as redundant in the context of a subscription for shares. *Subsection (3)* reproduces the other conditions of "eligible" shares by applying section 173(2).

Section 251: Approved investment fund as nominee

768. This section removes the minimum subscription requirement for shares in a company and allows the investment to be treated as made earlier than was in fact the case where investment is made through an approved investment fund. It is based on section 311(2A) to (6) of ICTA.

769. The use in *subsection (1)* of "at a time when" makes it clear that the conditions in paragraphs (a) to (c) all have to be met but not in any prescribed order.

770. The certificate issued to the investor in an approved fund by the manager (see *subsection (5)*) is commonly known as an EIS 5, the form provided for this purpose by HMRC.

Section 252: Meaning of a company being "in administration" or "in receivership"

771. This section gives the meaning of a company being in administration (or receivership). It is based on section 312(2A) of ICTA.

772. The reference to Northern Ireland legislation in *subsection (2)(a)* takes into account amendments to the Insolvency (Northern Ireland) Order 1989 by the Insolvency (Northern Ireland) Order 2005. The reference in *subsection (2)(b)* to the law of a country or territory outside the United Kingdom accords with the insolvency law in force in Great Britain and in Northern Ireland. See *Change 56* in Appendix 1.

Section 253: Meaning of "associate"

773. This section gives the meaning of "associate" in relation to a person. It is based on sections 312(1) and 417(3) and (4) of ICTA.

Section 254: Meaning of "disposal of shares"

774. This section extends references to a disposal of shares and treats some matters as if they were disposals of shares. It is based on section 312(3) of ICTA.

775. Section 136 of TCGA may treat the investor, in the case of certain reorganisations, as having exchanged "old shares" even though the investor continues to hold the same "old shares" as were held before the reorganisation (together with some "new shares"). This section treats that reorganisation as a disposal of the "old shares".

Section 255: Meaning of "issue of shares"

776. This section gives a meaning to (a) an issue of shares and (b) an issue of shares to an individual. It is based on sections 289B(4) and 312(4A) of ICTA.

777. Section 289B(4)of ICTA, on which *subsection (1)(b)* is based, is subject to the rule in section 289B(5).

778. Section 289B(5) of ICTA has been rewritten in section 201(6) for the purposes of that section and in other sections where that rule is relevant. So *subsection (2)* makes subsection (1)(b) subject to section 201(6) and also to the other sections where that rule is applied.

779. The exception for section 289A(6) and (7) of ICTA was inserted into section 289B(4) of ICTA by FA 2004 to ensure that the wording of those subsections did not invoke the interpretation in section 289B(4) and instead was linked clearly to the interpretation in section 312(4A) of ICTA. To achieve the same end the formulation in section 176(1) is directly linked to the interpretation in section 255(1)(a), (based on section 312(4A) of ICTA).

Section 256: Meaning of "the termination date"

780. This section gives the meaning of "the termination date". It is based on section 312(1) and (1ZA) of ICTA.

Section 257: Minor definitions etc

781. This section contains more definitions. It is based on sections 289(9), 291B(10), 293(3A), (6D) and (8AA), 297(5A), 308(2) and 312(1), (2), (4), (4B), (5) and (6) of ICTA.

782. The definitions of "group", "group company", "parent company" and "single company" are new.

783. These new labels rely on the way "qualifying subsidiary" is defined in this Part. The definitions of "subsidiary" and "51% subsidiary" in section 312(1) of ICTA have not been reproduced. Instead "qualifying subsidiary" is explained in section 191 and "51% subsidiary" in section 989.

784. The definition of "51% subsidiary" in section 312(1) of ICTA adds a condition that the definition applies for a particular period (period A in the sections). The aim has been to reproduce the same effect of this definition without carrying over the same level of complication. (See the commentary on section 168(5).)

785. In some cases the definition of a term included in the Act-wide index of defined expressions in Schedule 4 is distinguished from the particular use of the term in this Part.

786. For example, the definition of "control" in *subsection (3)* sets out the references to control which are explained by section 416(2) to (6) of ICTA. The entry in Schedule 4, which refers to the meaning in section 995 has a signpost to the exceptions in this subsection.

787. The two references to the "reduction" of relief in s*ubsection (7)(b)* are new: section 312(6) of ICTA refers only to the withdrawal of relief.

788. The word "withdrawal" in EIS is used both for the occasions for a clawback of relief (in particular in the provisions in Chapter 6) and for the procedure for withdrawing relief which is set out in Chapter 7.

789. Although the word "withdrawal" can cover both a full and a partial withdrawal of relief, this is made explicit in sections 307 and 310 of ICTA by section 307(8A) and section 310(9A). These subsections note that "references in this section to the withdrawal of relief include its reduction". This has been handled in this Part by spelling out, wherever relevant, that the rules encompass both the reduction and withdrawal of relief.

790. Making reference to the reduction as well as the withdrawal of relief in subsection (7*)* ensures that there is consistency with the language used for the occasion of a clawback and with sections 307 and 310 of ICTA, which are concerned with the procedure for withdrawing relief.

791. *Subsection (8)* is new. Paragraph 102(7)(a) of Schedule 15 to FA 2000 (corporate venturing scheme) contains a similar provision.

792. The subsection interprets the reference to requirements being met "for the time being" in section 204(1) (compliance certificates) and section 205(1) (compliance statements), derived from section 306 of ICTA. At the time the compliance certificate is issued by the issuing company it cannot be known if all the EIS requirements will be met in the relevant period.

793. The interpretation addresses this by treating conditions that must be met over a period of time as met at times before that period has ended (provided the condition then remains capable of being met). See *Change 57* in Annex 1.

Part 6: Venture capital trusts

Overview

794. This Part provides income tax reductions to individuals who subscribe money for full risk shares in certain quoted companies that, in turn, mainly provide additional equity and loan finance to smaller unquoted trading (or certain other) companies with which the quoted company is not connected.

795. The structure of the Part is as follows:

- An overview and a definition of venture capital trust ("VCT") (Chapter 1);
- The tax reduction and related matters (Chapter 2);
- Conditions for approving a company for the purposes of this Part and related matters (Chapter 3);
- The meaning of "qualifying holding" (Chapter 4);
- Powers to make regulations relating to VCT winding up or mergers (Chapter 5); and
- Supplementary provisions (Chapter 6).

796. In contrast to the enterprise investment scheme (EIS), section 1034(1) (commencement) applies to the VCT scheme: see the overview to Part 5. The minor changes made to the law in this Part are the subject of transitional provisions in Part 8 of Schedule 2.

Chapter 1: Introduction

Overview

797. This Chapter gives an overview of the Part, labels certain concepts and gives signposts to material contained elsewhere.

Section 258: Overview of Part

798. This section says that the relief dealt with by this Part ("VCT relief") is a tax reduction and it provides a navigational aid regarding the content of later Chapters. It is based on section 332A of ICTA.

Section 259: Venture capital trusts and VCT approvals

799. This section defines "venture capital trust", "VCT" and "VCT approval". It is based on section 842AA(1) of ICTA and paragraphs 7(4) and 17 of Schedule 33 to FA 2002.

Section 260: Other tax reliefs relating to VCTs

800. This section provides signposts to other tax reliefs relating to VCTs. It is new.

Chapter 2: VCT relief

Overview

801. This Chapter:

- identifies who is eligible for VCT relief and on what amounts;
- identifies the claims to VCT relief that may be made;
- quantifies the entitlement to the tax reduction;
- deals with cases in which VCT relief is not available or will be reduced or withdrawn; and
- deals with other matters (information and powers to make regulations).

Section 261: Eligibility for relief

802. This section identifies cases in which, and amounts in respect of which, an individual is eligible for VCT relief for a tax year. It is based on paragraph 1(1), (2), (4), (9) and (10) of Schedule 15B to ICTA.

Section 262: Entitlement to claim relief

803. This section provides for an individual to claim VCT relief for a tax year. It is based on paragraph 1(1) and (3) of Schedule 15B to ICTA.

804. *Subsection (2)* explicitly provides that a claim by the individual does not have to extend to all the shares by reference to which such eligibility exists for the tax year. This is implied by paragraph 1(3) of Schedule 15B to ICTA which simply sets a limit on a claim for relief.

Section 263: Form and amount of relief

805. This section specifies that a claim for VCT relief gives entitlement to a tax reduction and quantifies the amount of that entitlement. It is based on paragraph 1(5) of Schedule 15B to ICTA.

806. *Subsection (1)* is expressed in terms of the individual's entitlement to a tax reduction. Sections 27 and 29 contain provisions about how effect is given to the entitlement to a reduction and how the actual reduction is quantified.

Section 264: No entitlement to relief if there is a linked loan

807. This section removes an individual's entitlement to VCT relief by reference to shares if certain loans are made, as described in this section, to the individual or an associate of the individual. It is based on paragraph 2 of Schedule 15B to ICTA.

Section 265: No entitlement to relief which would have been lost if it had already been obtained

808. This section removes entitlement to VCT relief by reference to shares if, before the relief is obtained, circumstances have arisen that would cause the relief to be withdrawn or reduced. It is based on paragraph 1(8) of Schedule 15B to ICTA.

809. This and other sections follow the terminology used by other venture capital schemes and refer to relief being "obtained" where paragraph 1(8) refers, and other paragraphs in Schedule 15B to ICTA refer, to relief being "given".

Section 266: Loss of relief if shares disposed of within 5 years

810. This section reduces or withdraws any VCT relief obtained by reference to shares that are disposed of within five years of their issue. It is based on paragraph 3(1) to (4) and (8) of Schedule 15B to ICTA.

Section 267: Transfers of shares between spouses or civil partners

811. This section prevents loss of VCT relief occurring where the shares in question are disposed of between spouses or civil partners who are living together at the time of disposal. It also provides for step-in-shoes treatment, for VCT relief purposes, in respect of shares transferred between those spouses or civil partners. It is based on paragraph 3(5) to (7) of Schedule 15B to ICTA.

Section 268: Loss of relief if VCT approval withdrawn

812. This section treats certain shares in a company as disposed of, for VCT relief purposes, at the time VCT approval is withdrawn from a company. It is based on paragraph 3(9) of Schedule 15B to ICTA.

813. *Subsection (1)* does not apply where section 281(3) treats VCT approval as never having been given to a company. In those cases there never was any entitlement to VCT relief in respect of the company's shares and any relief that was obtained is withdrawn under section 269.

814. *Subsection (2)* has provisions about the timing (immediately before loss of VCT approval) and nature (not arm's length) of any disposal of shares that is treated as taking place. These provisions ensure that any VCT relief recapture (where the shares were issued less than five years before loss of approval) covers all the VCT relief obtained in respect of the shares concerned.

Section 269: Loss of relief which is subsequently found not to have been due

815. This section withdraws any VCT relief that has been obtained but which should not have been obtained. It is based on paragraph 4(1) of Schedule 15B to ICTA.

Section 270: Assessment on withdrawal or reduction of relief

816. This section provides that withdrawal or reduction of VCT relief, under the preceding sections, is by way of assessment for the tax year for which the relief was obtained. It is based on paragraph 4 of Schedule 15B to ICTA.

Section 271: Provision of information

817. This section, in connection with VCT relief, provides for cases where information must be given to an officer of Revenue and Customs and cases where the officer may require information. It is based on paragraphs 1(11) and 5 of Schedule 15B to ICTA.

818. *Subsection (4)* requires a VCT to give notice to an individual if section 261(4) (issue of own shares) prevents the individual from being eligible for relief. Section 261(4) contains a signpost to this requirement.

Section 272: Regulations as to procedure etc

819. This section allows the Treasury to make regulations about certain aspects of VCT relief and other reliefs related to VCTs. It is based on section 73(1) and (2) of FA 1995.

820. This power has been used in relation to the Venture Capital Trust Regulations 1995 (SI 1995/1979).

Section 273: Interpretation of Chapter

821. This section provides definitions of certain terms used in the Chapter. It is based on paragraph 6(1) and (3) of Schedule 15B to ICTA.

822. The section removes a possible doubt as to the effectiveness of the amendment made by section 73(1)(b) of FA 1998 to the definition of "eligible shares" in paragraph 6(1) of Schedule 15B to ICTA. See *Change 58* in Annex 1. Part 8 of Schedule 2 to this Act contains a provision to preserve this possible doubt as to the meaning of eligible shares for shares issued before 6 April 2007.

Chapter 3: VCT approvals

Overview

823. This Chapter:

- lists the conditions relevant to VCT approval;
- sets out alternative bases on which VCT approval may be given and the time from which VCT approval has effect;
- deals with the withdrawal of VCT approval and the time from which withdrawal has effect; and
- deals with related matters (including powers to make regulations for certain matters).

Section 274: Requirements for the giving of approval

824. This section sets out the conditions which must be met before the Commissioners for Her Majesty's Revenue and Customs are able to approve a company as a VCT. It is based on section 842AA(2) and (3) of ICTA.

825. *Subsection (1)* specifies the accounting periods in relation to which the conditions have to be met.

826. *Subsection (2)* gives labels to each of the conditions in section 842AA(2) of ICTA, changes the order in which they appear and uses a tabular layout as an aid to navigation.

827. References in the conditions to qualifying holdings and eligible shares are explained in section 285(1) and (2).

828. *Subsection (3)* provides a signpost to the provisions that contain material supplementing some of the conditions listed in the table.

Section 275: Alternative requirements for the giving of approval

829. This section allows the Commissioners to approve a company as a VCT if they are satisfied that conditions, which are not met in relation to the company's most recent accounting period, will be met in certain other accounting periods. It is based on section 842AA(4) of ICTA.

830. Most approvals are in practice given under this provision.

Section 276: Conditions relating to income

831. This section supplements the nature of income condition and the income retention condition. It is based on section 842(1AB) and (2A) to (2C), section 842AA(11) of ICTA and paragraph 40 of Schedule 26 to FA 2002.

832. Section 842AA(11)(za) and (b) of ICTA relies on the user adapting material that applies to similar conditions in section 842 (investment trusts). This section eliminates the need

to refer to section 842 of ICTA. In addition *subsections (1)*and *(2)* rewrite paragraph 40 of Schedule 26 to FA 2002 which deals with derivative contracts in relation to VCTs.

Section 277: The 15% holding limit condition

833. This section effectively restricts the times at which the 15% holding limit condition is applied in relation to investments in a company and provides supplementary material relating to that condition. It is based on section 842(1A), (2), (3) and (4) and section 842AA(11) of ICTA.

834. Section 842AA(11)(a) and (c) of ICTA applies certain provisions in section 842 (investment trusts) to section 842AA(2)(d). This section eliminates the need to refer to section 842 of ICTA.

835. *Subsection (1)* is based on section 842(3)(b) of ICTA, which provides that if an addition is made to a holding, the holding is treated as acquired at that time. Subsection (1) is also based on section 842(2)(b). The effect is that the 15% holding condition only applies on the occasion or occasions when the holding is acquired or when it is added to.

836. The underlying approach is that the 15% holding limit condition is applied in relation to a company only at times when shares or securities are acquired in that company. This prevents the condition being breached solely as a result of fluctuations in the value of investments.

Section 278: Conditions relating to value of investments: general

837. This section provides rules about the values of holdings of investments of particular descriptions. Those rules are used in applying the 15% holding limit condition, the 70% qualifying holdings condition and the 30% eligible shares condition. It is based on section 842(3) and (4) and section 842AA(5) and (11) of ICTA.

838. The underlying approach is that there is a valuation (or revaluation) of investments of any particular description only when investments of that description are acquired. In that way the three conditions will not cease to be satisfied solely because of later fluctuations in the value of investments.

839. The section makes it clear that the rules about the valuation of a holding in this section apply equally to the 15% holding limit condition, the 70% qualifying holdings condition and the 30% eligible shares condition. See *Change 59* in Annex 1.

Section 279: Conditions relating to value of investments: qualifying holdings

840. This section provides what is to be taken as the value of shares or securities acquired on certain exchanges or conversions if those shares or securities are treated as meeting some of the conditions in Chapter 4 (qualifying holdings). It also provides power to make regulations about the value of shares or securities in certain cases. It is based on section 842AA(5AA) to (5AE) of ICTA.

841. An exchange has to meet the requirements of section 326 (restructuring arrangements) and a conversion has to meet the requirements of section 329 (conversion of convertible shares and securities).

842. The power to treat conditions in Chapter 4 as met under section 330 (power to facilitate company reorganisations etc involving exchange of shares) is extended to encompass the valuation of shares and securities involved in reorganisations.

Section 280: Conditions relating to qualifying holdings and eligible shares

843. This section provides a period of grace during which the proceeds from most further issues of ordinary shares by a VCT are disregarded in determining whether the VCT meets the 70% qualifying holdings condition and the 30% eligible shares condition. It

is based on section 842AA(5A) and (5B) of ICTA and paragraph 11(1), (2) and (4) of Schedule 33 to FA 2002.

844. The underlying rationale is to give the VCT a reasonable amount of time to invest the proceeds of the further share issue in qualifying holdings before taking those proceeds into account for the 70% qualifying holdings condition and the 30% eligible shares condition. Without any period of grace those conditions might deter VCTs from issuing further share capital to raise funds for investment in qualifying holdings.

845. The section also contains powers to make regulations varying the treatment that would otherwise apply under this section. These powers have been used in making the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004 (SI 2004/2199).

Section 281: Withdrawal of VCT approval of a company

846. This section sets out cases in which a company's approval as a VCT may be withdrawn and the time from which the withdrawal has effect, and contains supplementary material concerning the time limits for assessing tax consequent on the withdrawal. It is based on section 842AA(6) to (10) of ICTA.

Section 282: Withdrawal of VCT approval in cases for which provision made under section 280(3)

847. This section gives the Treasury power to make regulations that provide, in certain cases, for withdrawal of VCT approval to have effect before notice of withdrawal is given. It is based on paragraph 12 of Schedule 33 to FA 2002.

848. The cases are limited to those where, but for regulations under section 280(3), section 280(2) (disregard of money raised by further share issue) would have prevented withdrawal of approval.

Section 283: Time as from which VCT approval has effect

849. This section explains when a VCT approval takes effect. It is based on section 842AA(1) of ICTA.

850. Paragraph (a) of section 842AA(1) of ICTA, which refers to an approval given in 1995-96, has not been rewritten.

851. Section 842AA(1) and (4)(b) of ICTA, and regulation 4(2)(b) of SI 1995/1979, make it clear that the date from which approval has effect is not necessarily the date on which approval is given. *Subsection (3)* notes that an approval can be forward-dated as well as back-dated.

Section 284: Power to make regulations as to procedure

852. This section gives the Treasury powers to make regulations regarding VCT approvals, the obligations of VCTs in relation to certain matters and the persons liable to account for tax consequent on withdrawal of VCT approval. It is based on section 73(2) of FA 1995.

853. This power has been used in relation to the Venture Capital Trust Regulations 1995 (SI 1995/1979).

Section 285: Interpretation of Chapter

854. This section provides various definitions for this Chapter. It is based on section 842AA(11A) to (14) of ICTA.

855. *Subsections (4)* to *(6)*, based on section 842AA(11A) to (11C) of ICTA, provide an interpretation of references to a company's investments. Paragraph 8 of Schedule 14 to FA 2006 does not extend this interpretation explicitly to the definitions in section 842(3)

of ICTA. Subsection (4) of this section applies the interpretation to Chapter 3 as a whole. See *Change 59* in Annex 1.

Chapter 4: Qualifying holdings

Overview

856. One of the conditions relating to VCT approval is that the investing company holds at least 70% of its investments in qualifying holdings (the 70% qualifying holdings condition in section 274). This Chapter sets out the requirements that need to be met for an investment to be a qualifying holding.

Section 286: Qualifying holdings: introduction

857. This section describes the ground-rules for what is a qualifying holding. It is based on paragraph 1 of Schedule 28B to ICTA.

858. *Subsection (1)* introduces certain labels. The company invested in is described as "the relevant company", the shares or securities are "the relevant holding" and in this Chapter the company that makes the investments is described as "the investing company".

859. Where there are shared provisions, the order matches that in Part 5 Chapter 4 (EIS: the issuing company) as far as possible.

860. *Subsections (4)* and *(5)* provide that in this Chapter, if only part of the money raised by a relevant holding meets the requirements of section 287, section 293 and section 294, the holding is treated as two separate holdings.

Section 287: The maximum qualifying investment requirement

861. This section requires that the relevant holding does not represent an investment that exceeds "the maximum qualifying investment". It is based on paragraph 7 of Schedule 28B to ICTA.

862. The maximum qualifying investment is £1m, see *subsection (2)*.

863. *Subsection (3)(a)* makes it explicit that if the maximum qualifying investment is exceeded, the £1m can be included as a qualifying holding and the shares or securities which represent the excess over the maximum qualifying investment are not regarded as part of the relevant holding.

864. *Subsection (3)(b)* ensures that there can be no double counting of an amount that represented such an excess. See *Change 60* in Annex 1.

865. *Subsections (4)* and *(5)* provide a rule for attributing shares or securities subsequently disposed of to the part of an investment that is in excess of the maximum qualifying investment.

866. *Subsections (6)* and *(7)* set out the consequences if the trade which meets the requirements of section 291(1) is carried on by the relevant company in a partnership or joint venture. The £1m is divided by the number of the members of the partnership or the parties to the joint venture. In subsection (6)(b) the words "as such" after "the joint venture" in paragraph 7(4)(b) of Schedule 28B to ICTA have not been reproduced, as they do not add anything.

867. In *subsection (8)*, which sets out what the relevant period is, it is made clear that the period ends with the issue of the relevant holding.

Section 288: The no guaranteed loan requirement

868. This section requires that the relevant holding does not include any securities that are backed up by a "guaranteed loan" and explains what is meant by this term. It is based on paragraph 10A of Schedule 28B to ICTA.

Section 289: The proportion of eligible shares requirement

869. This section requires a certain proportion of an investment in a relevant company to be in eligible shares. It is based on paragraph 10B of Schedule 28B to ICTA.

870. *Subsections (2)* and *(3)* set out rules about the value of shares in or securities of a company. The underlying approach is to value shares and securities at their value when acquired so that the requirement will not cease to be satisfied purely because of later fluctuations in the value of those investments.

871. *Subsection (4)* ensures that the value of the investment cannot be less than its initial cost price.

Section 290: The trading requirement

872. This section requires that the relevant company exists essentially for the purpose of carrying on qualifying trades or is a parent company of a group that carries on qualifying activities. It is based on paragraph 3(2) and (6) to (11) of Schedule 28B to ICTA.

873. A parent company, a group and a group company are defined in section 332.

874. Paragraph 3(6)(c) of Schedule 28B to ICTA is rewritten in s*ubsection (1)(b)* and*subsection (3)*. The requirements in paragraph 3(6)(b) and (c) are covered respectively by the definition of "parent company" in section 332 and by section 298.

875. *Subsections (2)* and *(6)* provide that certain requirements can be met in relation to a company that is not part of the group at the time the shares are issued. See *Change 61* in Annex 1. The provision for property used for R&D in *subsection (5)(d)* has been extended. See *Change 41* in Annex 1.

876. The words "capable of" have been omitted in *subsection (7)*, rewriting the definitions of "incidental purposes" and of "mainly trading subsidiary" in paragraph 3(2)(a) and (11) of Schedule 28B to ICTA. The intention is to make the definitions simpler to interpret: in practice the test will not change.

877. The label "non-qualifying activities" in subsection (1)(b) is defined in subsection (7). Paragraph (a) in subsection (7*)* refers to excluded activities. These are listed in section 303. Section 305 provides a let-out for certain leasing of ships from being treated as a non-qualifying activity.

878. The way that subsection (7) interprets non-qualifying activities means that no distinction is made between the let-out in section 305(4), derived from paragraph 4(7)(a) to (d) of Schedule 28B to ICTA, and the let-out in section 305(7), derived from the final words of paragraph 4(7). This contrasts with paragraph 3(8)(b) of Schedule 28B to ICTA. See *Change 43* in Annex 1.

879. There is no reference to R&D in the definition of non-qualifying activities in subsection (7)(b), in contrast to the definition in section 181(8)(b) in Part 5 (Enterprise investment scheme). This is because in VCT the carrying on of R&D is treated as the carrying on of a trade in section 300(2).

Section 291: The carrying on of a qualifying activity requirement

880. This section requires that the relevant company carries on, or certain of its subsidiaries carry on, a qualifying activity at all times from the issue of the relevant holding to the time in question. It is based on paragraph 3(3) to (5B) of Schedule 28B to ICTA.

881. *Subsection (1)* introduces the term "qualifying activity" to cover the activities in paragraph 3(3)(a) and (b) of Schedule 28B to ICTA and these activities are set out in *subsections (2)* and *(3)*. This should make it easier for persons, who are not relying on subsection (3) to meet any of the requirements in this Chapter, to disregard the material in subsections (3) to (6).

882. *Subsection (8)* is new. The change enables the requirement in subsection (3) to be met in relation to a company that is not a qualifying 90% subsidiary at the time the shares are issued. See *Change 61* in Annex 1.

Section 292: Ceasing to meet requirements because of administration or receivership

883. This section provides a disregard from sections 290(1) and 291(1) where a company is in administration or receivership and there is no tax avoidance purpose. It is based on paragraph 11A(1) and (3) of Schedule 28B to ICTA.

884. The meanings of "in administration" and "in receivership" are provided by section 331.

Section 293: The use of the money raised requirement

885. This section sets out the times when, and extent and purpose for which, the money raised by the issue of the relevant holding must be intended to be employed or actually employed. It is based on paragraph 6(1) to (2AA) and (3) of Schedule 28B to ICTA.

Section 294: The relevant company to carry on the relevant qualifying activity requirement

886. This section contains requirements as to the persons who may carry on the relevant qualifying activity by reference to which the conditions in the preceding section have been met. It is based on paragraph 6(2AB) to (2AG) of Schedule 28B to ICTA.

887. *Subsection (1)* links the relevant qualifying activity that it refers to with the use of the money raised from the issue of shares in question. See *Change 62* in Annex 1.

Section 295: The unquoted status requirement

888. This section requires the relevant company to be unquoted and defines an unquoted company. It is based on paragraph 2 of Schedule 28B to ICTA.

889. The words in brackets in paragraph 2(1), "whether or not it is resident in the United Kingdom" are not rewritten. The words do not add anything to the tests in section 291.

890. Paragraph 2(5) of Schedule 28B to ICTA which concerns orders made by the Board is not rewritten in this section. It is instead covered by section 1014 which is based on section 828 of ICTA.

Section 296: The control and independence requirement

891. This section requires that:

- any company that the relevant company controls (on its own or together with connected persons) is a qualifying subsidiary of the relevant company;
- the relevant company is not controlled by another company (on its own or together with connected persons); and
- there are no arrangements which could lead the relevant company to fail either of these tests.

It is based on paragraph 9 of Schedule 28B to ICTA.

Section 297: The gross assets requirement

892. This section sets out the limits that apply to the value of a relevant company's gross assets before and after a share issue. It is based on paragraph 8 of Schedule 28B to ICTA.

893. The requirement differentiates between a "single company" and a "parent company". Both these terms are defined in section 332.

894. *Subsection (3)* sets out more clearly what is meant in relation to a group of companies by the "aggregate value at that time of the gross assets" in paragraph 8(2)(b) of Schedule 28B to ICTA. A similar wording is used in paragraph 12(3) of Schedule 5 to ITEPA (enterprise management incentives).

Section 298: The qualifying subsidiaries requirement

895. This section requires that any subsidiary of the relevant company must be a qualifying subsidiary. It is based on paragraphs 3(6) and 10(1) of Schedule 28B to ICTA.

Section 299: The property managing subsidiaries requirement

896. This section requires that any property managing subsidiary of the relevant company must also be its qualifying 90% subsidiary. It is based on paragraph 10ZA of Schedule 28B to ICTA.

897. In paragraph 10ZA(3) "land" and "property deriving its value from land" take the meaning in section 776 of ICTA. *Subsection (3)*, applying for the purposes of *subsection (2)* of the rewritten section, provides the definition of "property deriving its value from land". "Land" itself is not defined in this Act and instead relies on the definition in Schedule 1 to the Interpretation Act 1978. See the commentary on section 772.

Section 300: Meaning of "qualifying trade"

898. This section explains the term "qualifying trade". It is based on paragraph 4(1), (2) and (9) and on paragraph 5(4) of Schedule 28B to ICTA.

899. In *subsection (1)(b)* there is a reference to excluded activities. Excluded activities are set out in section 303.

900. *Subsection (2)* provides that the carrying on of any R&D activities is treated as the carrying on of a qualifying trade in certain circumstances. Paragraph (b) of subsection (2) now extends the cases in paragraph (a) in which this treatment occurs. See *Change 41* in Annex 1.

901. *Subsection (3)* provides that preparing to carry out R&D does not count as preparing to carry on a qualifying trade. See *Change 63* in Annex 1.

Section 301: Meaning of "qualifying 90% subsidiary"

902. This section gives the meaning of "qualifying 90% subsidiary". It is based on paragraph 5A of Schedule 28B to ICTA.

903. The label "qualifying 90% subsidiary" copies EIS section 190 and replaces "the relevant qualifying subsidiary".

Section 302: Meaning of "qualifying subsidiary"

904. This section says what "qualifying subsidiary" means. It is based on paragraph 10 of Schedule 28B to ICTA.

905. The term "51% subsidiary" in this paragraph and elsewhere takes its meaning from the definition in section 989. This provides a signpost to section 838 of ICTA.

Section 303: Meaning of "excluded activities"

906. This section gives the meaning of "excluded activities". It is based on paragraph 4(2) of Schedule 28B to ICTA.

907. The meaning of excluded activities is needed to determine whether a trade is a qualifying trade and the extent to which the business of a group includes non-qualifying activities.

908. *Subsection (2)* indicates where further detail can be found on certain of the activities listed in *subsection (1).*

Section 304: Excluded activities: wholesale and retail distribution

909. This section supplements section 303(1)(b). It is based on paragraph 4(3) and (4) of Schedule 28B to ICTA.

910. *Subsection (2)* makes it clear that there are two sets of determinants, one set establishing what is a trade of wholesale and retail distribution and the other what is an ordinary trade of wholesale and retail distribution.

911. The words "or exposed" before "for sale" have been added in *subsection (4).* This is intended to reflect the normal description of a trade of retail distribution in United Kingdom statute law.

912. *Subsection (5)(b)* refers to "the trader" rather than "the company" which is referred to in paragraph 4(3)(c)(ii) of Schedule 28B to ICTA. See *Change 45* in Annex 1.

Section 305: Excluded activities: leasing of ships

913. This section supplements section 303(1)(d). It is based on paragraph 4(7) and (8) and paragraph 5(1) of Schedule 28B to ICTA.

914. *Subsection (2)* uses as its model paragraph 18(2) of Schedule 5 to ITEPA (enterprise management incentives). This additional material, which is not in the source legislation, makes it clear that the requirements of *subsection (4)* do not have to be met in relation to offshore installations and pleasure craft.

915. *Change 43* in Annex 1 applies for the purposes of *subsection (7)*. See the commentary on section 290(7).

Section 306: Excluded activities: receipt of royalties and licence fees

916. This section supplements section 303(1)(e). It is based on paragraph 4(5) to (6D) of Schedule 28B to ICTA.

Section 307: Excluded activities: property development

917. This section supplements section 303(1)(g). It is based on paragraph 5(1), (5) and (7) of Schedule 28B to ICTA.

Section 308: Excluded activities: hotels and comparable establishments

918. This section supplements section 303(1)(j). It is based on paragraph 4(3A) and paragraph 5(6) of Schedule 28B to ICTA.

Section 309: Excluded activities: nursing homes and residential care homes

919. This section supplements section 303(1)(k). It is based on paragraph 4(3A) and paragraph 5(1) of Schedule 28B to ICTA.

Section 310: Excluded activities: provision of services or facilities for another business

920. This section treats the provision of services or facilities as excluded activities if:

- the services or facilities are provided to businesses which themselves consist largely of excluded activities; and
- the specified control requirements exist.

It is based on paragraph 4(2) and paragraph 5(2) to (4) of Schedule 28B to ICTA.

921. The section is written in terms of a business. The way the definition of a trade in paragraph 5(4), governing paragraph 4 and 5 of Schedule 28B, is applied within those paragraphs has been simplified. See *Change 64* in Annex 1.

Section 311: Power to amend Chapter

922. This section allows the Treasury to make orders amending the provisions mentioned in the section. It is based on paragraph 12 of Schedule 28B to ICTA.

Section 312: Winding up of the relevant company

923. This section provides that if the requirements of this Chapter would be met but for the winding up of the relevant company, they are treated as met. The winding up must be commercial and not entered into for tax avoidance purposes. It is based on paragraph 11 of Schedule 28B to ICTA.

924. This supplements the provisions on winding up in section 294(4) and (5) in relation to the relevant company or any other company (in this case this extends to a dissolution too) and in section 302(3) in relation to a qualifying subsidiary or any other company.

Section 313: Interpretation of Chapter

925. This section provides an interpretation for certain terms used in this Chapter. It is based on paragraphs 1(1), 5(4) and 13 of Schedule 28B to ICTA.

926. *Subsection (3)* excepts references to a trade in certain sections in this Chapter from the extended meaning of "trade" in section 989, based on the definition in section 832(1) of ICTA. See the commentary on section 310 and *Change 64* in Annex 1.

Chapter 5: Powers: winding up and mergers of VCTs

Overview

927. This Chapter gives the Treasury power to make regulations for cases where a VCT is liquidated or two or more VCTs merge. Any such regulations will mainly ensure that reliefs available to shareholders in a VCT are "protected" in the cases that they cover.

928. These powers have been used in making the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004 (SI 2004/2199).

Section 314: Power to treat VCT-in-liquidation as VCT

929. This section allows regulations to treat a VCT-in-liquidation as if it remained a VCT and withdrawal of its VCT approval as taking place at a time different to when withdrawal actually takes place. It is based on paragraph 2 of Schedule 33 to FA 2002.

Section 315: Power to treat conditions for VCT approval as met with respect to VCT-in-liquidation

930. This section allows regulations to treat a VCT-in-liquidation as if it met conditions in section 274(2). It is based on paragraph 3 of Schedule 33 to FA 2002.

Section 316: Power to make provision about distributions by VCT-in-liquidation

931. This section allows regulations to apply, disapply or modify the way in which tax enactments affect distributions by a VCT-in-liquidation. It is based on paragraph 4 of Schedule 33 to FA 2002.

Section 317: Power to facilitate disposal to VCT by VCT-in-liquidation

932. This section allows regulations to be made that have the effect of treating certain holdings acquired by a VCT, from a VCT-in-liquidation, as if those holdings were qualifying holdings of the acquiring VCT. It is based on paragraph 5 of Schedule 33 to FA 2002.

Section 318: Power in respect of periods before and after winding up

933. This section extends the powers in the preceding sections to periods before and after a company becomes a VCT-in-liquidation. It is based on paragraph 6 of Schedule 33 to FA 2002.

Section 319: Sections 314 to 318: supplementary

934. This section supplements the preceding sections. It is based on paragraph 7(1), (2) and (5) of Schedule 33 to FA 2002.

Section 320: Meaning of "VCT-in-liquidation"

935. This section provides a definition and allows regulations to specify when winding up starts or ends in certain cases. It is based on paragraph 1 of Schedule 33 to FA 2002.

Section 321: Power to facilitate mergers of VCTs

936. This section, in the case of certain mergers of VCTs, allows regulations to be made covering matters set out in section 322. It is based on paragraph 8(1) and (2) of Schedule 33 to FA 2002.

Section 322: Provision that may be made by regulations under section 321

937. This section sets out what regulations under section 321 may provide. It is based on paragraph 9 of Schedule 33 to FA 2002.

Section 323: Meaning of "merger" and "successor company"

938. This section defines certain terms for the purposes of the Chapter. It is based on paragraph 10 of Schedule 33 to FA 2002.

Section 324: Regulations under Chapter

939. This section sets out further matters that may be dealt with by regulations under this Chapter. It is based on paragraph 16 of Schedule 33 to FA 2002.

Section 325: Interpretation of Chapter

940. This section defines some terms used in this Chapter. It is based on paragraph 17 of Schedule 33 to FA 2002.

Chapter 6: Supplementary and general

Overview

941. This Chapter:

- deals with two cases in which a company's holding may be treated as a qualifying holding (where it would not otherwise be);
- gives power to make regulations having a similar effect in other cases; and
- contains supplementary material.

Section 326: Restructuring to which section 327 applies

942. This section sets out the conditions for section 327 to apply (treating some requirements in Chapter 4 (qualifying holdings) as met) where a company is issued with a holding in a new company (Newco) in exchange for a qualifying holding in another company (Oldco). The section also sets out limitations on such application of section 327. It is based on paragraph 10C(1) to (3), (11) and (13) of Schedule 28B to ICTA.

943. These provisions are similar to provisions in Part 5 (Enterprise investment scheme) under which, assuming that EIS relief is attributable to shares in Oldco held by an individual, the EIS relief would carry over to the shares in Newco received by the individual in exchange (see section 247). Companies do not get EIS relief or VCT relief for a holding in Oldco. But the company's holding in Oldco may represent a "qualifying holding" and thus influence the VCT approval of that company. This section may permit the company's holding in Newco (received in exchange for the holding in Oldco) to be treated as a qualifying holding.

Section 327: Certain requirements of Chapter 4 to be treated as met

944. This section sets out the requirements of Chapter 4 (qualifying holdings) that are treated as met, and the periods for which they are so treated, in cases to which this section applies. It is based on paragraph 10C(4) to (10) of Schedule 28B to ICTA.

945. If this section applies, a holding in Newco may be treated as a qualifying holding of a company where that holding has been received in exchange for a qualifying holding in Oldco.

Section 328: Supplementary

946. This section extends the previous two sections so that they apply to securities as well as shares and defines certain terms. It is based on paragraph 10C(12) and (14) to (17) of Schedule 28B to ICTA.

Section 329: Conversion of convertible shares and securities

947. This section sets out cases in which shares in company A, acquired by company B on the conversion of other shares or securities in company A, can be treated as meeting certain requirements in Chapter 4 (qualifying holdings). It is based on paragraph 10D of Schedule 28B to ICTA.

948. If this section applies, the shares in company A acquired on the conversion may be treated as part of company B's qualifying holdings.

Section 330: Power to facilitate company reorganisations etc involving exchange of shares

949. This section allows regulations to be made which treat certain requirements in Chapter 4 (qualifying holdings) as met where company reorganisations involve the replacement

of shares or securities that meet those requirements with shares or securities that do not. It is based on paragraph 11B of Schedule 28B to ICTA.

950. This power has been used in making the Venture Capital Trust (Exchange of Shares and Securities) Regulations 2002 (SI 2002/2661).

Section 331: Meaning of a company being "in administration" or "in receivership"

951. This section explains references to a company being in administration or in receivership. It is based on paragraphs 6(2AH), 10(4C) and 11A(2) of Schedule 28B to ICTA.

952. Paragraph 11A(1) and (3) of Schedule 28B to ICTA is rewritten in section 292.

953. The reference to Northern Ireland legislation in *subsection (2)(a)* takes into account amendments to the Insolvency (Northern Ireland) Order 1989 by the Insolvency (Northern Ireland) Order 2005. The reference in *subsection (2)(b)* to the law of a country or territory outside the United Kingdom accords with the insolvency law in force in Great Britain and in Northern Ireland. See *Change 56* in Appendix 1.

Section 332: Minor definitions etc

954. This section contains various definitions that apply to the whole Part. It is based on sections 842(4) and 842AA(11) of, and paragraph 6(2) of Schedule 15B and paragraph 5(1) and (5) of Schedule 28B to, ICTA and paragraph 17 of Schedule 33 to FA 2002. Other definitions are new.

955. A single definition of "company" and "shares" is applied for the whole Part. That follows their usage for investment trusts (section 842 of ICTA) from which various provisions are applied to VCTs (section 842AA(11) of ICTA). As the general application of these two definitions is not explicit this might represent a change in the law. See *Change 65* in Appendix 1.

956. The definitions of "group", "group company", "parent company" and "single company" are new.

Part 7: Community investment tax relief

Overview

957. This Part provides for community investment tax relief, that is income tax reductions to individuals for investments in community development finance institutions (CDFIs). It is based on Schedule 16 to FA 2002.

958. Schedule 16 to FA 2002 continues in force so far as it relates to relief for companies by way of reduction of corporation tax.

959. Schedule 1 to this Act inserts new sections 151BA, 151BB and 151BC in TCGA, which replace paragraphs 40 and 41 of Schedule 16 to FA 2002 and, so far as they apply for purposes of capital gains tax or corporation tax on chargeable gains, paragraphs 47 and 48(2) of that Schedule. Paragraphs 47(1) to (4), (7) and (8) and 48(2) of Schedule 16 to FA 2002 continue in force for the purposes of corporation tax relief under that Schedule. Sections 377 and 379(2) are based on those paragraphs for the purposes of income tax relief under this Part.

Chapter 1: Introduction

Overview

960. This Chapter quantifies the tax reduction potentially available to an individual, labels certain concepts and provides signposts to material contained elsewhere.

Section 333: Meaning of "CITR"

961. This section sets out a general description of the nature of the relief, an entitlement to tax reductions, and defines it as "CITR". It is based on paragraph 51(1) of Schedule 16 to FA 2002.

Section 334: Eligibility for CITR

962. This section summarises the general conditions which need to be met for an individual ("the investor") to be eligible for CITR. It is based on paragraph 1 of Schedule 16 to FA 2002.

Section 335: Form and amount of CITR

963. This section specifies the amount of the income tax reduction available and the tax years for which it may be claimed. It is based on paragraph 19 of Schedule 16 to FA 2002.

964. The provision in paragraph 19(2) of Schedule 16 to FA 2002 (limiting the tax reduction to the amount which reduces the investor's tax liability to nil) has not been included in this section. *Subsection (2)* is expressed simply in terms that the investor is entitled to a tax reduction for the relevant tax year of 5% of the amount invested. The provision limiting the tax reduction is included in section 29(2) (tax reductions: supplementary).

965. The provisions of paragraph 19(6) of Schedule 16 to FA 2002 are included in section 27(4) (order of deducting tax reductions: individuals). That section sets out the order of priority of all the tax reductions (including CITR) that may be available to an individual.

Section 336: Meaning of "making an investment"

966. This section provides that an investment in a CDFI may take the form of a loan or an issue of securities or shares. It is based on paragraph 2 of Schedule 16 to FA 2002.

Section 337: Determination of "the invested amount"

967. This section sets out rules for determining the amount invested for the purposes of section 335. In particular, it deals with the complications which arise where a loan may be drawn down in tranches, by requiring the average capital balance of the loan in relation to the tax year to be calculated. It is based on paragraph 21 of Schedule 16 to FA 2002.

Section 338: Meaning of "the 5 year period" and "the investment date"

968. This section provides the definitions of two significant terms. It is based on paragraph 3 of Schedule 16 to FA 2002. "The 5 year period", which begins with "the investment date", is the period during which conditions as to the repayment or redemption of the investment are imposed.

Section 339: Overview of other Chapters of Part

969. This section indicates the subject matter of the Chapters of this Part not previously mentioned in Chapter 1. It is new.

Chapter 2: Accredited community development finance institutions

Overview

970. For an investment in a CDFI to qualify for relief, the CDFI must be accredited by the Secretary of State. Part 2 of Schedule 16 to FA 2002 sets out the criteria for accreditation. It also contains powers to determine the manner of making applications and the terms and conditions of accreditation, and authorises delegation of the Secretary

of State's functions. These functions have been assigned to the Secretary of State for Trade and Industry.

971. This Chapter is based on Part 2 of Schedule 16 to FA 2002. So that there is only one set of provisions relating to accreditation, Schedule 1 to this Act substitutes for paragraphs 4 to 7 of Schedule 16 to FA 2002 a new paragraph 4 applying Chapter 2 of this Part for the purposes of corporation tax relief for companies under that Schedule.

Section 340: Application and criteria for accreditation

972. This section sets out the way in which an application for accreditation as a CDFI is to be made and the basis on which it is to be admitted. It is based on paragraph 4 of Schedule 16 to FA 2002.

973. *Subsection (2)(b)* contains powers for the Treasury to make regulations. Under the powers in paragraphs 4 and 5 of Schedule 16 to FA 2002, the Treasury have made the Community Investment Tax Relief (Accreditation of Community Development Finance Institutions) Regulations 2003 (SI 2003/96).

974. Regulations may make different provision for bodies whose principal objective in providing finance is to invest in enterprises whose business does not consist of financing other enterprises or does so only to the extent permitted by the regulations. If such a body is accredited, it is designated as a retail community development finance institution (a "retail CDFI"). See *subsections (6)(b)* to *(8)*.

975. The distinction between a retail CDFI and an accredited CDFI which is not a retail CDFI (a "wholesale CDFI") is relevant to the limits on the total value of investments which a CDFI can make for an accreditation period and which are set out in section 348(4). SI 2003/96 provides different limits on the value of investments which a retail CDFI and a wholesale CDFI may make in any enterprise.

Section 341: Terms and conditions of accreditation

976. This section provides that the terms and conditions for accreditation are to be those set out in regulations and any other terms or requirements the Secretary of State considers appropriate, and specifies what regulations may contain. It is based on paragraph 5 of Schedule 16 to FA 2002. SI 2003/96 contains regulations made under that paragraph.

Section 342: Period of accreditation

977. This section sets out the period for which an accreditation has effect. It is based on paragraph 7 of Schedule 16 to FA 2002.

978. Paragraph 7(2) of Schedule 16 to FA 2002 (relating to applications for accreditation made before 6 April 2003) has been omitted, as it no longer has any relevance.

Section 343: Delegation of Secretary of State's functions

979. This section is based on paragraph 6 of Schedule 16 to FA 2002.

Chapter 3: Qualifying investments

Overview

980. This Chapter sets out the conditions which must be met if an investment is to be a qualifying investment.

Section 344: Qualifying investments: introduction

981. This section introduces:

- the respective conditions which apply to loans (section 345), to securities (section 346) and to shares (section 347); and
- the provisions which apply to all kinds of investment (sections 348 and 349).

It is based on paragraph 8 of Schedule 16 to FA 2002.

Section 345: Conditions to be met in relation to loans

982. This section sets out the three conditions applicable to loans. It is based on paragraph 9 of Schedule 16 to FA 2002.

Section 346: Conditions to be met in relation to securities

983. This section sets out the two conditions applicable to securities. It is based on paragraph 10 of Schedule 16 to FA 2002.

984. Condition A (*subsection (1)*) requires that securities must be subscribed for wholly in cash and fully paid for on the investment date. It is in similar terms to section 347(1) which sets out identical requirements in relation to shares.

985. Section 347(3) (based on paragraph 11(1) of Schedule 16 to FA 2002) provides that shares are not fully paid up for the purposes of section 347(1) if there is any undertaking to pay cash to the CDFI at a future date in connection with the acquisition of the shares. The effect of this is to distinguish the meaning of "paid up" for that purpose from the meaning of those words for the purposes of the Companies Act 1985. Section 738(2) of that Act provides that a share is deemed paid up in cash, or allotted for cash, if the consideration for the allotment or payment up is an undertaking to pay cash to the company at a future date.

986. There is no similar provision in the Companies Act 1985 applicable to the issue of securities, but the position in relation to securities has been made explicit by the inclusion of *subsection (3)*, equivalent to section 347(3). This clarification is not a change in either law or practice.

Section 347: Conditions to be met in relation to shares

987. This section sets out the two conditions applicable to shares. It is based on paragraph 11 of Schedule 16 to FA 2002.

Section 348: Tax relief certificates

988. This section sets limits on the value of investments in respect of which a CDFI may issue tax relief certificates in an accreditation period (as defined in section 342). It is based on paragraph 12 of Schedule 16 to FA 2002. Without a tax relief certificate, an investor may not claim CITR (see section 335(5)(b)).

989. *Subsections (2)* and *(3)* provide that the limit applies to the total value of investments in the CDFI made in the accreditation period by individuals under this Part and by companies under Schedule 16 to FA 2002.

990. *Subsection (4)* provides different limits for retail and wholesale CDFIs. See the commentary on section 340.

991. In *subsection (8)*, the words "wholly or partly", which appear before "in contravention" in paragraph 12(6) of Schedule 16 to FA 2002, have been omitted as being unnecessary.

Section 349: No pre-arranged protection against risks

992. This section is an anti-avoidance provision concerned with ensuring that the investor is subject to all usual investment risks and is not protected from their effect by insurance,

indemnity, guarantee or other means. It is based on paragraph 13 of Schedule 16 to FA 2002.

Chapter 4: General conditions

Overview

993. This Chapter contains various general conditions to be met by the investor. It is based on Part 4 of Schedule 16 to FA 2002, with the exception of paragraph 16 of that Schedule which applies only to investors that are companies.

Section 350: No control of CDFI by investor

994. This section provides that the investor will not qualify for CITR in relation to an investment if the investor or a person connected with the investor controls the CDFI at any time in the 5 year period. It is based on paragraph 14 of Schedule 16 to FA 2002.

995. The legal structure of a CDFI may take a number of forms. It may be a company or some other form of body corporate or it may be a partnership or some other form of unincorporated association. The different meanings of control needed to deal with the possible different forms of a CDFI's constitution are set out in *subsections (3)* to *(6)*.

Section 351: Investor must have beneficial ownership

996. This section provides that the investor must be the sole beneficial owner of the investment. It is based on paragraph 15 of Schedule 16 to FA 2002. Trustees and joint investors are thus precluded from obtaining CITR. But see section 375 which enables investments to be made by a nominee or a bare trustee for an individual.

Section 352: No acquisition of share in partnership

997. This section provides that an investor cannot obtain CITR for capital contributed to a CDFI which is a partnership, including loan capital accounted for as partners' capital. It is based on paragraph 17 of Schedule 16 to FA 2002.

Section 353: No tax avoidance purpose

998. This section denies CITR if the investment is part of a scheme or arrangement the main purpose or one of the main purposes of which is the avoidance of tax. It is based on paragraph 18 of Schedule 16 to FA 2002.

999. Equivalent provisions are to be found in sections 165 and 178 (enterprise investment scheme) and 261 (venture capital trusts).

Chapter 5: Claims for and attribution of CITR

Overview

1000. This Chapter is based on those paragraphs of Part 5 of Schedule 16 to FA 2002 which apply to individual investors other than paragraphs 19 and 21. Sections 335 and 337 in Chapter 1 are based on those two paragraphs.

Section 354: Loans: no claim after disposal or excessive repayments or receipts of value

1001. This section prevents a claim being made for any tax year in respect of an investment by way of loan in certain circumstances. It is based on paragraph 22 of Schedule 16 to FA 2002. This section links to the provisions in sections 360, 362 and 363 which provide for a tax reduction already given to be recaptured in similar circumstances.

Section 355: Securities or shares: no claim after disposal or excessive receipts of value

1002. This section sets out two conditions to be met before a claim can be made for any tax year in respect of a subscription for securities or shares. It is based on paragraph 23 of Schedule 16 to FA 2002.

1003. The first condition (*subsection (1)*) is that the investor has not disposed of the securities or shares before the first anniversary of the investment date which occurs after the end of the tax year.

1004. The second condition (*subsection(2)*) is that the investor has not received or is not treated as having received value from the CDFI in excess of the limits allowed under section 364.

Section 356: No claim after loss of accreditation by the CDFI

1005. This section provides that no claim may be made if the CDFI ceases to be accredited. It is based on paragraph 24 of Schedule 16 to FA 2002. Depending on the investment date and the date upon which the CDFI ceased to be accredited, this section may prevent a claim being made for the tax year before that in which the CDFI ceased to be accredited (see *subsection (2)*).

Section 357: Attribution: general

1006. This section sets out the general rules dealing with the attribution to the loan, securities or shares included in the investment of the reduction in the investor's income tax liability for any tax year made as a result of the investor's entitlement to CITR. It is based on paragraph 26 of Schedule 16 to FA 2002.

1007. Attribution is required for the purpose of determining the amount of the tax reduction which must be withdrawn or reduced in accordance with Chapter 6 of this Part.

Section 358: Attribution: bonus shares

1008. This section sets out additional rules relating to attribution, to deal with the consequences of an issue of "corresponding bonus shares" (see *subsection (4)*) to the investor in respect of the original shares included in the investment. It is based on paragraph 26 of Schedule 16 to FA 2002.

1009. The CITR attributable to the original shares is to be re-attributed across the bonus shares and the original shares proportionately and the bonus shares are to be treated as having been issued at the time the original shares were issued and as having been held by the investor from that date.

Chapter 6: Withdrawal or reduction of CITR

Overview

1010. This Chapter sets out the circumstances in which CITR attributable to an investment for any tax year must be reduced to nil (withdrawn) or reduced proportionately. It is based on Part 6 of Schedule 16 to FA 2002, with the exception of paragraph 27(4) of that Schedule which applies only to investors that are companies.

Section 359: Overview of Chapter

1011. This section provides an overview of the Chapter and contains signposts to its principal provisions. It is new.

1012. *Subsection (3)* defines the term, "the 6 year period". This new term replaces the term "the period of restriction" defined in the same way in paragraph 33 of Schedule 16 to FA

2002. The 6 year period is relevant to sections 363 and 364 which deal with receipts of value. As an anti-avoidance measure, receipts of value in the year before the investment date are taken into account, as well as those in the 5 year period, which begins with the investment date. See the commentary on section 338 for the meaning of "the 5 year period" and "the investment date".

Section 360: Disposal of loan during 5 year period

1013. This section provides that the CITR attributable to a loan must be withdrawn if, within the 5 year period, the investor disposes (otherwise than by receiving repayment) of part of the loan or, unless it is by way of a permitted disposal, of the whole of the loan. It is based on paragraph 28 of Schedule 16 to FA 2002.

1014. A permitted disposal is defined in *subsection (2)*. If the disposal is a permitted disposal, any tax reduction already obtained is not withdrawn, but no further tax reduction may be claimed (see sections 335(6) and 354).

Section 361: Disposal of securities or shares during 5 year period

1015. This section provides for the withdrawal or reduction of CITR attributable to securities or shares, if the investor disposes of the whole or part of the investment in the securities or shares (except upon repayment, redemption or repurchase by the CDFI) within the 5 year period and the CDFI is accredited at the time of the disposal. It is based on paragraph 29 of Schedule 16 to FA 2002.

1016. *Subsections (2)* and *(3)* provide for different consequences depending upon whether the disposal is a qualifying disposal.

1017. *Subsection (4)* defines what is a qualifying disposal. It is based on paragraph 29(4) of Schedule 16 to FA 2002 with the omission of the words "for full consideration" in paragraph (a). See *Change 20* in Annex 1.

1018. *Subsection (5)*provides for circumstances where 5% of the invested amount is greater than the income tax liability of the investor for the tax year.

Section 362: Repayment of loan capital during 5 year period

1019. This section provides for the circumstances in which the CITR attributable to a loan must be withdrawn as a consequence of a repayment other than a "non-standard" repayment (see *subsections (3)* to *(5)*). It is based on paragraph 30 of Schedule 16 to FA 2002.

Section 363: Value received by investor during 6 year period: loans

1020. This section applies if the investment consists of a loan and the investor or a person connected with the investor receives any value, other than an amount of insignificant value (as defined in *subsection (5)*), from the CDFI or a person connected with the CDFI in the 6 year period. It is based on paragraph 31 of Schedule 16 to FA 2002.

1021. *Subsection (2)* provides that, if value is so received, the invested amount (see section 337) is adjusted by the amount treated as repaid and the investor is treated as having received a repayment other than a non-standard repayment for the purposes of section 362(see *subsection (4)*).

Section 364: Value received by investor during 6 year period: securities or shares

1022. This section applies if the investment consists of securities or shares and the investor or a person connected with the investor receives any value, other than an amount of insignificant value (as defined in *subsection (4)*), from the CDFI or a person connected with the CDFI in the 6 year period. It is based on paragraph 32 of Schedule 16 to FA 2002.

1023. *Subsection (2)* provides, that if value is so received and its amount wholly or partly exceeds the permitted level (see *subsection (3)*) by more than an amount of insignificant value, the CITR attributable to the investment must be withdrawn.

Section 365: Receipts of insignificant value to be added together

1024. This section applies at a time when the investor receives value, if the investor has also received value earlier in the 6 year period and the total amount of the value received earlier was of insignificant value. It is based on paragraph 34 of Schedule 16 to FA 2002.

1025. The amount of the receipt in question is to be added to the amounts of value previously received. If the total value of the amounts received is not an amount of insignificant value, the total value is treated as received at that time for the purposes of this Part, including in particular sections 362, 363 and 364.

Section 366: When value is received

1026. This section explains when value is received. It is based on paragraph 35 of Schedule 16 to FA 2002.

Section 367: The amount of value received

1027. This section, which determines the respective values received in relation to the respective transactions listed in section 366(1), is set out in tabular form for clarity. It is based on paragraph 36 of Schedule 16 to FA 2002.

Section 368: Value received if there is more than one investment

1028. This section provides that, if there is more than one investment, any value received is to be apportioned among the investments according to the respective amounts invested and sets out how those amounts are to be calculated. It is based on paragraph 37 of Schedule 16 to FA 2002.

Section 369: Effect of receipt of value on future claims for CITR

1029. This section applies if an investor holding securities or shares receives value (other than an amount of insignificant value) but, because that value is less than the permitted level, the CITR attributable to those securities or shares is not withdrawn under section 364. It is based on paragraph 38 of Schedule 16 to FA 2002.

1030. *Subsection (2)* reduces the amount invested (see section 337) in respect of which CITR may be claimed for the tax years specified in *subsection (3)*.

Section 370: Receipts of value by or from connected persons

1031. This section extends the meaning of "the investor" and "the CDFI" in sections 363 to 369. It is based on paragraph 39 of Schedule 16 to FA 2002.

1032. This section includes the words "if the context permits", which do not appear in paragraph 39 of Schedule 16 to FA 2002. The inclusion of these words does not change the law but makes sections 363 to 369 clearer, by stating explicitly what is implicit in the source legislation.

Section 371: CITR subsequently found not to have been due

1033. This section provides the basis for making an assessment under section 372 in cases where a claim for a tax reduction has been incorrectly allowed. It is based on paragraph 27(1) of Schedule 16 to FA 2002.

Section 372: Manner of withdrawal or reduction of CITR

1034. This section authorises the making of assessments to recapture CITR attributable to an investment which has been withdrawn or reduced, except where the event giving rise to the withdrawal or reduction of the CITR occurs after the death of the investor. It is based on paragraph 27 of Schedule 16 to FA 2002.

Chapter 7: Supplementary and general

Overview

1035. This Chapter contains miscellaneous provisions and definitions applicable to Part 7.

Section 373: Information to be provided by the investor

1036. This section imposes obligations on the investor to notify an officer of Revenue and Customs of events giving rise to the withdrawal or reduction of any CITR attributable to a loan or any securities or shares. It is based on paragraph 42 of Schedule 16 to FA 2002.

Section 374: Disclosure

1037. This section authorises disclosure of information between HMRC and the Secretary of State for the purpose of discharging their respective functions under this Part. It is based on paragraph 43 of Schedule 16 to FA 2002.

1038. Reference to “the Income Tax Acts” has been substituted in *subsection (1)(a)* for the reference to “the Tax Acts” in paragraph 43(1)(a) of Schedule 16 to FA 2002. That paragraph will continue in force for the purposes of corporation tax relief with the substitution of “the Corporation Tax Acts” for “the Tax Acts”.

Section 375: Nominees

1039. This section allows for loans, securities or shares to be acquired, held and disposed of by nominees or bare trustees. It is based on paragraph 44 of Schedule 16 to FA 2002.

Section 376: Application for postponement of tax pending appeal

1040. This section ensures that the investor cannot claim to postpone any payment of tax under section 55 of TMA on the grounds that the investor is eligible for CITR unless a claim has actually been made. It is based on paragraph 45 of Schedule 16 to FA 2002.

Section 377: Identification of securities or shares on a disposal

1041. This section provides rules for the identification of the securities or shares disposed of for the purposes of this Part. It is based on paragraph 47(1) to (4), (7) and (8) of Schedule 16 to FA 2002.

1042. Paragraph 47(1) to (4) of Schedule 16 to FA 2002 provide identification rules not only for the purposes of that Schedule but also for the purposes of capital gains tax and corporation tax on chargeable gains. Paragraph 47(7) and (8) supplement paragraph 47(3) and (4) of that Schedule.

1043. This section is based on paragraph 47(1) to (4), (7) and (8) of Schedule 16 to FA 2002 so far as they apply for the purposes of income tax relief. Paragraph 47(1) to (4), (7) and (8) continue in force so far as they apply for the purposes of corporation tax relief.

1044. Paragraph 47(5) and (6) of Schedule 16 to FA 2002 apply only for the purposes of capital gains tax or corporation tax on chargeable gains. Section 151BA of TCGA, introduced by Schedule 1 to this Act, is based on paragraph 47(5) and (6) and, so far as they apply for those purposes, paragraph 47(1) to (4), (7) and (8) of Schedule 16 to FA 2002.

Section 378: Meaning of "issue of securities or shares"

1045. This section provides definitions, in relation to a body, of an issue of securities or shares by that body and, in relation to a person, of an issue of securities or shares to that person. It is based on paragraph 46 of Schedule 16 to FA 2002.

Section 379: Meaning of "disposal"

1046. This section defines "disposal". It is based on paragraph 48 of Schedule 16 to FA 2002.

1047. Paragraph 48(1) of Schedule 16 to FA 2002 provides that "disposal" and related expressions have the same meanings in that Schedule as in TCGA. This is subject to sub-paragraph (2) which makes modifications, both for the purposes of that Schedule and for the purposes of capital gains tax or corporation tax on chargeable gains, to take account of paragraph 41 of that Schedule.

1048. Section 151BC(5) of TCGA, introduced by Schedule 1 to this Act, is based on paragraph 48(2) of Schedule 16 to FA 2002 so far as that paragraph applies for the purposes of capital gains tax or corporation tax on chargeable gains.

1049. *Subsection (2)* is based on paragraph 48(2) of Schedule 16 to FA 2002 so far as that paragraph applies for the purposes of income tax relief. That paragraph continues in force so far as it applies for the purposes of corporation tax relief.

Section 380: Construction of references to being "held continuously"

1050. This section explains what is meant by "held continuously", for the purposes of those sections of this Part which require the investment to have been "held continuously" by the investor during a specified period (see for example sections 364 and 369). It is based on paragraph 49 of Schedule 16 to FA 2002.

Section 381: Meaning of "associate"

1051. This section provides a definition of associate which is relevant to sections 366 and 367. It is based on paragraph 50 of Schedule 16 to FA 2002.

Section 382: Minor definitions etc

1052. This section explains various terms used in this Part. It is based on paragraph 51 of Schedule 16 to FA 2002.

1053. With the exception of "body", the terms defined in paragraph 51(1) of Schedule 16 to FA 2002 have been omitted, as they are either no longer required or are defined generally for the purposes of this Act.

1054. A definition of "bonus shares" has been added in *subsection (1)*. This term is used in section 358. Section 358 deals with similar issues relating to corresponding bonus shares to those dealt with, for the purposes of the EIS legislation in Part 5, by section 201(4). A definition of "bonus shares" has been in place since 2004 for those purposes (see section 257(1)). Inclusion of the same definition, which does no more than state the normal meaning of the term, ensures consistency between this Part and Part 5.

1055. Paragraph 51(3) of Schedule 16 to FA 2002, which applies section 839 of ICTA (connected persons) for the purposes of that Schedule, has been omitted. Section 993 (connected persons), based on section 839 of ICTA, is applied generally for the purposes of this Act by section 1021(1).

Part 8: Other reliefs

Overview

1056. This Part contains rules about a number of other reliefs.

Chapter 1: Interest payments

Overview

1057. Chapter 1 contains the rules relating to relief for interest paid given by deduction in calculating net income. It is based on sections 353 to 368 of ICTA.

1058. The Mortgage Interest Relief At Source provisions in sections 369 to 379 of ICTA and the related provisions in section 365 of ICTA for relief for interest on a loan to purchase a life annuity are obsolescent. They are not rewritten in this Act, but remain in ICTA.

Section 383: Relief for interest payments

1059. This section is an introduction to the Chapter. It is based on sections 353, 359, 360, 361, 362 and 364 of ICTA.

1060. *Subsection (2)* lists the seven provisions about the purposes for which loans have to be used if the interest on them is to be eligible for relief. Those purposes do not include the generality of purposes for which loans are taken out in the course of a trade or property business, as interest will normally be an allowable deduction in computing the income from that source.

1061. Relief is given as a deduction in computing net income of the year in which payment is made. So if the interest exceeds the income from which it can be deducted, relief for the excess interest is generally lost. The exception from this rule in section 405 is signposted by *subsection (5)(e)*.

Section 384: General restrictions on relief under Chapter

1062. This section sets out two restrictions on relief for interest paid. It is based on section 353(3) of ICTA.

Section 385: General provisions about loans

1063. This section brings together some general rules which apply to the loan itself. It is based on sections 359, 360, 361, 362, 364 and 367 of ICTA.

1064. With the exception of section 367 of ICTA, the source legislation provides a condition in each of the rules that the loan must be to defray money applied for a particular purpose. The rewritten provisions simply refer to a loan being “used”.

1065. *Subsection (1)* expands on what “used” is to be taken to mean. In particular, with the exception of a loan to pay inheritance tax, it covers the case of expenditure already incurred.

1066. The restrictions in *subsections (2)* and *(3)* do not apply to loans to buy plant or machinery (sections 388 and 390 of this Act).

Section 386: Loans partly meeting requirements

1067. This section explains what happens if a loan (“the mixed loan”) is only partly used for a qualifying purpose. It is based on section 367(4) of ICTA.

1068. *Subsection (1)* explains that the qualifying part of the loan is itself treated as a loan within this Chapter.

1069. *Subsection (2)*, read with*subsection (4)*, provides that in respect of a mixed loan within subsection (1) only interest on the part of the loan used for qualifying purposes is eligible for relief. The apportionment is made in a way that reflects the application of the money at the time the loan is used.

1070. *Subsection (3)*, read with*subsection (4)*, provides that if part of the loan is repaid, then the qualifying and non-qualifying parts of the original loan are treated as repaid in the same proportions that the loan was first used. A stricter rule applies in a case where there is a recovery of capital which was the subject of a qualifying investment (see section 406(4)).

1071. The rule dealing with partial repayments is based on section 367(4) of ICTA, but modified so as to apply to all cases. See *Change 66* in Annex 1.

Section 387: Exclusion of double relief etc

1072. This section contains restrictions which ensure that relief is only given once for a particular interest payment, and penalise attempts to switch between claiming relief as a trade etc expense and as a deduction from income under this Chapter. It is based on section 368 of ICTA.

1073. *Subsection (1)* contains the main rule. It denies relief elsewhere for any payment of interest for which relief is given under this Chapter.

1074. *Subsections (2)* to *(6)* contain further rules which prohibit relief under this Chapter in cases where the interest or "connected" interest is claimed as a trading etc expense. They derive from section 368(3) and (5) of ICTA. Section 52 of ITTOIA, based on section 368(4) and (5) of ICTA, makes similar provision in relation to restricting relief for interest in calculating the profits of a trade.

1075. *Subsection (7)* is based on section 368(6) of ICTA but has been adapted to fit better with Self Assessment. See *Change 67* in Annex 1.

1076. Section 368(2) of ICTA is redundant and has not been rewritten. See the commentary on section 404.

Section 388: Loan to buy plant or machinery for partnership use

1077. This section is the first of two dealing with a loan used by a partner in providing plant or machinery for partnership use. It is based on section 359(1) of ICTA.

1078. The reference to a vocation being carried on by a partnership contained in the source legislation has not been included in this section, or elsewhere, because a partnership cannot carry on a vocation.

1079. *Subsection (2)* makes it clear that the plant or machinery must be in use and that the partnership must be entitled to a capital allowance or balancing charge in respect of it for the period of account in which the interest is paid. The "in use" requirement is not explicitly specified in section 359(1) of ICTA, but is clear from section 359(2) and the wording of section 264 of CAA. The requirement in section 359(1) of ICTA that the plant or machinery must belong to the individual partner is not included as it is contained in section 264 of CAA.

1080. It is also made clear that ordinary property businesses (if carried on in partnership) are within the types of partnership business that qualify. See *Change 68* in Annex 1.

1081. *Subsection (3*) ensures that relief remains available where the plant remains within the capital allowances regime, even if no allowance or balancing charge arise in the period of account. See *Change 69* in Annex 1.

1082. *Subsection (4)* makes it explicit that the appropriate definitions of "capital expenditure" and "period of account" are those in sections 4 and 6 of CAA, which apply generally for capital allowances purposes, rather than the definitions in section 989 of this Act.

Section 389: Eligibility requirements for interest on loans within section 388

1083. This section contains two conditions which have to be met if the interest is to be eligible for relief. It is based on section 359(1) and (2) of ICTA.

1084. Both conditions relate to circumstances at the time the interest is paid.

1085. *Subsections (4)* and *(5)* provide an apportionment rule if the plant or machinery is used partly for the purposes of the trade, profession or ordinary property business and partly for other purposes. As regards the inclusion of ordinary property businesses, see *Change 68* in Annex 1 and the commentary on section 388.

Section 390: Loan to buy plant or machinery for employment use

1086. This section is the first of two dealing with a loan used by an individual to provide plant or machinery for use as an employee or office-holder. It is based on section 359(3) of ICTA.

1087. *Subsection (2)* makes it clear that the plant or machinery must be in use, that it must belong to the individual and that the individual must be entitled to a capital allowance or balancing charge in respect of it for the tax year in which the interest is paid. The "in use" requirement is explicitly specified in section 359(3) of ICTA. It is necessary to retain the "belonging to" test here as that is not a requirement of eligibility to capital allowances.

1088. *Subsection (3)* corresponds to section 388(3). See *Change 69* in Annex 1 and the commentary on section 388.

1089. Section 37 of CAA (exclusion where sums payable in respect of depreciation) may operate to deny entitlement to capital allowances in respect of the expenditure met by the employee. In such a case *subsection (4)* preserves entitlement to relief for the interest if a contribution to the expenditure has been made by the individual's employer.

Section 391: Eligibility requirements for interest on loans within section 390

1090. This section contains two conditions which have to be met if the interest is to be eligible for relief. It is based on section 359(3) and (4) of ICTA.

1091. Both conditions relate to circumstances at the time the interest is paid.

Section 392: Loan to buy interest in close company

1092. This section deals with conditions for relief for interest on a loan to buy an interest in a close company. It is based on section 360(1), (3A) and (4) of ICTA.

1093. The section is the first of four dealing with this relief.

1094. S*ubsection (2)* provides that the company in which the investment is made with the borrowed money must be a close company, but must not be a close investment-holding company within section 13A(1) of ICTA. In addition, the investment must either be in the ordinary shares of the company, or in the form of a loan (or a replacement loan) which is used for specified business purposes, or both.

1095. It is clear from section 363(4) of ICTA, under which a replacement loan and the original loan are treated as one, that a replacement loan only qualifies under this section if it replaces an earlier loan for the same qualifying purpose. This point has been made explicit in this section.

1096. *Subsection (3)* contains a further condition that the investment must not be in ordinary shares for which relief is given under the enterprise investment scheme income tax or capital gains tax provisions. See Schedule 2 Part 9 for transitional provisions where the shares were acquired before 6 April 1989.

Section 393: Eligibility requirements for interest on loans within section 392

1097. This section sets out conditions relating to circumstances at the time the interest is paid, or during the period of the loan. It is based on section 360(1), (2) and (3) of ICTA.

1098. The first such condition, in *subsection (1)(a)*, is that at the time the interest is paid, the company must not be a close investment-holding company. It says nothing about whether the company is to be a close company. This accords with Statement of Practice 3/78, which explains that section 360(2)(a) of ICTA does not require the company to be close at the time the interest is paid.

1099. The second condition, in*subsections (1)(b)* and *(2)*, is that during the period of the loan the borrower must not have recovered any capital from the company apart from any amount taken into account under section 406(2) of this Act.

1100. The final condition, in *subsections (1)(b), (3)* and *(4)*, is in two parts, and it is sufficient that either part is satisfied.

1101. The first part is in subsection (3) and requires the borrower to hold some ordinary shares in the company and to have worked full time for the company during the period from the use of the loan to the payment of the interest.

1102. The second part, in subsection (4), requires the borrower to have a material interest in the company and also that, if the company exists for the purposes of holding investments or other property, none of that property is a residence of that individual, unless (broadly speaking) that individual has worked full time for the company. (For the meaning of "material interest" see section 394 and the commentary on that section.)

1103. The source legislation for the material interest condition does not specify over what period the individual has to have worked full-time for the company. The reference to subsection (3)(b) makes it explicit that regard is to be had to the same period as is referred to in the full-time working condition itself.

Section 394: Meaning of "material interest" in section 393

1104. This section defines "material interest" for the purposes of section 393(4)(a). It is based on section 360A(1) of ICTA.

1105. The source legislation does not give the meaning of "control". *Subsection (5)* makes it clear that it is the definition in section 416 of ICTA which applies. The same definition is applied in section 395.

Section 395: Meaning of "associate" in section 394

1106. This section defines the term "associate". It is based on section 360A(2), (4) to (7) and (10) of ICTA.

1107. The reference in section 360A(5) to Schedule 8 to ICTA has been replaced by a reference to the relevant provisions in ITEPA.

1108. Section 360A(8) and (9) of ICTA relate to loans made before 14 November 1986. Those rules are contained in Part 9 of Schedule 2 to this Act.

1109. Section 360A(3) of ICTA is redundant and has not been rewritten.

Section 396: Loan to buy interest in employee-controlled company

1110. This section deals with conditions for relief on interest on a loan to buy an interest in an employee-controlled company. It is based on section 361(3) to (8) of ICTA.

1111. This section deals with the conditions relating to the employee-controlled company and ways of investing in it. Section 397 deals with the conditions that relate to circumstances at the time the interest is paid.

1112. The condition in *subsection (2)* is that the loan is applied in acquiring part of the ordinary share capital of a company that has recently become or becomes an employee-controlled company. As with section 392, relief is available for a loan replacing one that met the conditions in this section.

1113. *Subsection (3)* defines when a company is "employee-controlled". The definition requires more than 50% of the issued ordinary share capital and more than 50% of the voting power to be held by persons who are full-time employees of the company.

1114. *Subsection (4)* provides that, if an individual holds more than 10% of either the ordinary share capital or the voting power, the excess over 10% is regarded as owned by a person who is not a full-time employee of the company and so does not count towards the 50% test in subsection (3).

Section 397: Eligibility requirements for interest on loans within section 396

1115. This section sets out four conditions relating to circumstances at the time the interest is paid, or during the period of the loan. It is based on section 361(3), (4) and (8) of ICTA.

1116. Condition B requires the company to be employee-controlled for at least nine months in the tax year in which the interest is paid (or to become employee-controlled first in that year).

1117. Condition C is that the claimant is a full-time employee of the company throughout the period between the date on which the loan is used ("the use date") and the date the interest is paid. If the individual ceased to be a full-time employee no more than 12 months before the interest payment date, then it is sufficient that the employee worked full time for the company from the use date until that date.

Section 398: Loan to invest in partnership

1118. This section deals with conditions for relief for interest on a loan to invest in a partnership. It is based on section 362(1) of ICTA.

1119. This section deals with the conditions relating to ways of investing in the partnership. Section 399 deals with the conditions that relate to circumstances at the time the interest is paid.

1120. *Subsection (2)* provides that the loan qualifies for relief if the proceeds are used in either buying a share in a partnership or contributing or advancing money to a partnership that is used for a trade or profession carried on by the partnership. As explained in the commentary on section 388, no reference is made to "vocation" as a partnership cannot carry on a vocation. As with section 392, relief is available for a loan replacing one that met the conditions in this section.

Section 399: Eligibility requirements for interest on loans within section 398

1121. This section sets out two conditions relating to circumstances during the period of the loan, both of which must be met. It is based on section 362 of ICTA and, in relation to film partnerships, on section 75(1) of FA 2006.

1122. Condition A is that the individual to whom the loan is made must be a partner in the partnership throughout the period from the making of the investment to the payment of the interest. Relief is not available if the partnership is an investment LLP or a limited partnership in which the individual is a limited partner.

1123. Where the special rules for film partnerships in section 400 apply, *subsection (4)* provides that relief is restricted to 40% of the interest that would otherwise be eligible for relief.

1124. *Subsection (5)* provides that certain senior employees of the partnership may count as partners for the purposes of this section, enacting Statement of Practice SP A33. See *Change 70* in Annex 1.

Section 400: Film partnerships

1125. This section sets out the circumstances in which relief is restricted to 40% of the interest that would otherwise be eligible for relief. It is based on section 75 of FA 2006.

1126. The restriction applies only if the money is invested in a film partnership and secured on an asset or activity of a second partnership, the "investment partnership", of which the individual is or has been a member. The individual must also be entitled to a lower proportion of the profits of the investment partnership than the proportion of capital that he or she contributed to that partnership.

1127. In relation to the calculation of the latter proportion, *subsection (3)* provides rules about what constitutes the partnership capital and *subsection (4)* provides rules for identifying which part of that capital has been contributed by the claimant. In subsection (4) it is made explicit that only amounts that actually form part of the total investment partnership's capital are taken into account.

Section 401: Loan to invest in co-operative

1128. This section deals with conditions for relief for interest on a loan to invest in a co-operative. It is based on section 361(1) and 363(5) of ICTA.

1129. This section is the first of two dealing with this relief and deals with the conditions relating to the co-operative and ways of investing in it. Section 402 deals with the conditions that relate to circumstances at the time the interest is paid.

1130. *Subsection (2)* provides that the loan qualifies for relief if the proceeds are used in either buying shares in a co-operative or lending money to a co-operative or its subsidiary which is used for the business purposes of that body. As with section 392, relief is available for a loan replacing one that met the conditions in this section.

1131. The condition in section 361(2)(a) of ICTA that the loan only qualifies if it was made after 10 March 1981 has not been reproduced. So, if any loans made on or before that date still exist, the interest on them will now be eligible for relief. See *Change 71* in Annex 1.

Section 402: Eligibility requirements for interest on loans within section 401

1132. This section sets out three conditions relating to circumstances at the time the interest is paid or during the period of the loan, all of which must be met. It is based on section 361(2) of ICTA.

Section 403: Loan to pay inheritance tax

1133. This section provides relief for interest on money borrowed by personal representatives to pay certain amounts of inheritance tax. It is based on section 364(1), (3) and (4) of ICTA.

1134. In order for the personal representatives to obtain a grant of representation or confirmation, they have to pay the inheritance tax for which they are liable on delivery of their account under section 226(2) of IHTA. Relief is available for interest on a loan to pay this tax. Relief is not available for interest on a loan to pay inheritance tax that falls due at a later date. The source legislation in section 364(1)(a) of ICTA is written in language relating to estate duty. It has been brought up to date in *subsection (2)*. See *Change 72* in Annex 1.

1135. *Subsection (3)* clarifies that a document from an officer of Revenue and Customs giving details of inheritance tax payable will be accepted in support of a claim under this section. The source legislation refers to a certificate from the Board. See *Change 5* in Annex 1.

Section 404: Eligibility requirements for interest on loans within section 403

1136. This section provides that interest on loans to pay inheritance tax is eligible for relief only if it is paid in respect of a period ending within 12 months of the loan being made. It is based on section 364(1) and (4) of ICTA.

1137. Section 364(4)(b) of ICTA states that “references to interest in respect of a period ending with a given time apply whether or not interest continues to run after that time”. This has been rewritten by using the words “so far as”.

1138. Section 368(2) of ICTA is redundant and has not been rewritten. See *Change 73* in Annex 1.

Section 405: Carry back and forward of relief for interest on loans within section 403

1139. This section provides for the carry back or forward of interest eligible for relief by virtue of section 403. It is based on section 364(2) of ICTA.

1140. Relief for interest on a loan to pay inheritance tax is the only interest relief that may be deducted from income of a tax year other than the year in which it was paid.

Section 406: Effect of recovery of capital in the case of some loans

1141. This section deals with what happens if an individual to whom the loan was made recovers any capital from the business entity in which the investment was made. It is based on section 363(1) of ICTA.

1142. Rules in the particular provisions concerned (eg section 393(2)) disallow relief completely if any capital is recovered unless this section applies. If this section applies, (and it applies to most recoveries), then relief is only reduced in the proportion that the amount of the recovery bears to the amount of the loan (or, where only part of the loan qualified, to the qualifying part of the loan).

1143. The source legislation restricted the application of this rule to cases where the recovered capital was not applied in making a loan repayment. In cases where the recovered capital was so applied relief was, in strictness, lost completely. The rule has been rewritten to ensure that it applies in all cases where capital is recovered. See *Change 74* in Annex 1.

1144. *Subsection (6)* makes it clear that this provision applies only if section 407 treats an amount of capital as having been recovered from the business entity.

Section 407: Events counting as recovery of capital for section 406

1145. This section explains which events count as the recovery of capital for the purposes of section 406. It is based on section 363(2) of ICTA.

1146. *Subsection (1)* identifies the cases relating to an investment in a company (whether a close company or employee-controlled), *subsection (2)* identifies the cases relating to an investment in a partnership and *subsection (3)* identifies the cases relating to an investment in a co-operative.

1147. *Subsection (4)* provides that if there is a sale or assignment that is not at arm's length, market value consideration is used instead of actual proceeds. Section 1008(1) provides that in Scotland "assignment" means "assignation".

Section 408: Replacement loans

1148. This section makes provision for cases where a loan, interest on which would be eligible for relief under some provisions of this Chapter, is used in repaying another qualifying loan. It is based on section 363(4) of ICTA.

1149. *Subsection (3)* ensures that the two loans are treated as a single loan for the purposes of this Chapter. In order that this rule works correctly when looking at how the proceeds are applied, it is subject to *subsection (5)* under which references to the use of a loan are generally taken as referring to the use of the original loan.

1150. *Subsection (4)* makes it clear that any restriction under section 406 (recovery of capital) applies if capital is recovered while the second loan is in place.

Section 409: Business successions between partnerships

1151. This section ensures continuity of relief in certain cases where, in law, a partnership is dissolved. It is based on ESC A43.

1152. Under section 362 of ICTA, relief for interest paid is only available for so long as the individual is a partner in the partnership in which the investment is made. In strictness, the admission or departure of a partner results in a new partnership, but it has never been the practice to refuse relief in these circumstances. Indeed, ESC A43 goes further and allows relief to continue when there is a partnership reconstruction involving a merger or demerger.

1153. *Subsections (1)* and *(2)* of this section gives statutory effect to current practice and ESC A43 to the extent that they relate to partnership changes and reconstructions. See *Change 75* in Annex 1.

1154. *Subsection (3)* builds into the section the extended meaning of "member of a partnership" that is explained in *Change 70* in Annex 1. See also the commentary on section 399.

1155. ESC A43 also deals with other types of business successions including the incorporation of a partnership. These cases are addressed in section 410.

Section 410: Other business successions and reorganisations

1156. This section ensures continuity of relief in certain cases where a partnership is incorporated into another of the business entities covered by this Chapter. It is based on ESC A43.

1157. Under each of the sections in the source legislation dealing with investments in (including loans to) qualifying business entities, relief for interest paid is only available for so long as the shares are held in or the loan is made to the original business entity. In the case where the investment is in a partnership, the individual must remain a partner in the partnership in which the investment is made.

1158. It follows that relief strictly ceases to be available if a partnership is incorporated into one of the other types of qualifying business entity or there is a reconstruction in which the individual's original shares are replaced by shares in a different qualifying business entity. This rule is relaxed by ESC A43 which allows relief to continue if this sort of business succession occurs. This section legislates that part of ESC A43. See *Change 75* in Annex 1 and the commentary on section 409.

1159. This section only applies to genuine business successions. It is not considered to apply if an investment in one entity is replaced by another investment within the same entity. An example is the conversion of convertible loan stock into ordinary shares.

Section 411: Ineligibility of interest where business is occupation of commercial woodlands

1160. This section rules out relief if certain of the business entities covered by this Chapter carry on the business of the commercial occupation of woodlands. It is based on paragraph 3 of Schedule 6 to FA 1988.

1161. The section applies if the loan is invested in a close company, an employee-controlled company or a partnership, and excludes relief for what is in effect an investment into an entity carrying on a tax-exempt activity. This section also provides rules that apply if only part of the business is the exempt activity.

Section 412: Information

1162. This section makes provision for the lender of a loan covered by this Chapter to provide information to the borrower on request. It is based on section 366 of ICTA.

1163. The source legislation requires the person claiming relief to submit to an officer of Revenue and Customs a written certificate from the lender containing details of the debt and interest. Under Self Assessment, such statements are not generally required. Such a certificate will only be required when an officer raises enquiries into the return or the claim. The provision has therefore been recast in terms of the claimant being able to obtain a certificate from the lender if he or she needs or wants to do so. Lenders will no longer need to issue certificates routinely.

Chapter 2: Gift aid

Overview

1164. This Chapter gives relief for some gifts of money by individuals to charities. It is based on section 25 of FA 1990, section 98 of FA 2002 and section 83 of FA 2004.

Section 413: Overview of Chapter

1165. This section provides an overview of the Chapter. It is new.

1166. *Subsection (2)* points to section 414, which sets out how the relief works.

1167. Under section 414(2)(a), the gift is treated as paid after deduction of income tax. If the tax treated as deducted from the gift is greater than the income tax and capital gains tax to which the individual is liable, the excess is recovered. Under these rules, signposted by s*ubsection (3)*:

- the donor may suffer the restriction of certain other reliefs (including personal allowances); and
- if the tax treated as deducted from gifts exceeds the income tax and capital gains tax to which the donor is liable, additional income tax will be charged.

1168. The position of the charity receiving the gift is not addressed in this Chapter. The rules about charitable trusts are in Part 10 of this Act. The rules about charitable companies remain in the source legislation, as indicated by *subsection (5)*.

Section 414: Relief for gifts to charity

1169. This section sets out the relief. It is based on section 25(6) of FA 1990.

1170. *Subsection (1)* sets out the basic requirement for the relief, which is that the gift should be a "qualifying donation" (see section 416).

1171. *Subsection (2)(b)* provides that the individual's basic rate limit is increased by the amount of the gift grossed up at the basic rate of income tax. As a result, an amount of income up to that amount is taxed at either the dividend ordinary rate, the savings rate or the basic rate, rather than at the higher rate or the dividend upper rate.

1172. If "top slicing relief" is claimed on gains under life assurance policies etc (sections 535 to 537 of ITTOIA), relief under this Chapter is ignored for the purposes of the computations required by section 535(1) of ITTOIA. See section 535(7) of ITTOIA, inserted by Schedule 1 to this Act.

Section 415: Meaning of "grossed up amount"

1173. This section provides the meaning of references to "the grossed up amount" of a gift. It is based on section 25(12)(d) of FA 1990.

Section 416: Meaning of "qualifying donation"

1174. This section sets out the meaning of "qualifying donation". It is based on section 25(1) and (2) of FA 1990.

1175. Condition C excludes the possibility of a double claim for relief under these provisions and also under the payroll deduction scheme.

1176. Condition D enacts the principle that, to be a qualifying donation, the payment must not also be deductible in arriving at the individual donor's income from any source. See *Change 76* in Annex 1.

1177. Condition E denies relief if the donor, or any person associated with the donor, disposes of any property to the charity for any consideration. This prevents any overlap between this relief and the relief for gifts of assets in Chapter 3 of this Part.

Section 417: Meaning of "benefits associated with a gift"

1178. This section defines what is meant by one or more benefits being "associated with" a gift. It is based on section 25(2) and (4) of FA 1990.

Section 418: Restrictions on associated benefits

1179. This section sets out two conditions which, if either is met, mean that the restrictions on benefits associated with a gift are breached (condition F of section 416). It is based on section 25(2), (4), (5) and (5A) of FA 1990.

1180. The two conditions are:

- a stepped scale, depending on the amount of each gift (Condition A) – the "benefit per gift" test; and
- an overall monetary limit on benefits associated with the total of any gifts to a single charity in the course of a tax year – the "benefit per year" test (Condition B). This is unrelated to the size of any particular gift.

1181. Both these restrictions apply to any benefit "associated with" a gift. Sections 420 and 421 remove certain benefits consisting of admission rights from the application of both restrictions.

Section 419: Gifts and benefits linked to periods of less than 12 months

1182. This section modifies the application of section 418(2) where gifts or benefits are linked to periods of less than 12 months. It is based on section 25(5B) to (5D) of FA 1990.

1183. The section provides, according to the case, for annualising:

- the actual amount of the gift; or
- both the amount of the gift and the value of the benefit(s) associated with the gift.

1184. Only the annualised amount in each case is to be compared with the cash limits given in section 418(2). This prevents periods of less than 12 months being used to exploit the cash limits.

1185. *Subsection (8)* states the formula for annualising in each case. In the source legislation some of the conditions in the section could overlap, so that more than one condition could apply to the gift(s) and associated benefit(s) concerned. A priority rule is, therefore, provided. See *Change 77* in Annex 1.

Section 420: Disregard of certain admission rights

1186. This section ensures that a benefit consisting of a relevant admission right is ignored for the purposes of the Chapter, so that a donation to a charity with which such a benefit is associated may be a qualifying donation regardless of the value of the benefit. It is based on section 25(5E) to (5I) of FA 1990.

1187. Condition B contains no general qualification relating to the purposes of the recipient charity. But property, as defined in *subsection (6)*, must be preserved, maintained, kept or created by the charity for those charitable purposes.

1188. In Condition C (further provisions about which are in section 421(2) to (4)), the right of admission must apply for at least 12 months whenever admission is available to members of the public who have not made such a gift.

1189. But in Condition D there is no time period. For the meaning of the “same right of admission” see section 421(5).

Section 421: Admission rights: supplementary

1190. This section provides supplementary material about Conditions C and D in section 420. It is based on section 25(5I) and (5J) of FA 1990.

1191. *Subsections (2)* to *(4)* deal with cases when event days could be held to interrupt the availability of a right of admission, reducing it to a period of less than 12 months and thus breaching Condition C. The applicable period is not regarded as broken if there are no more than five event days in it.

Section 422: Disqualified overseas gifts

1192. This section provides the rules for Condition G in section 416(8). It is based on section 25(2) of FA 1990.

1193. In addition to the other conditions for a qualifying donation in sections 416 to 421, this section imposes a specific test that must be met in the case of a gift (an “overseas gift”) made by a donor who is neither UK resident nor in Crown employment.

1194. The source legislation provides that, for the gift to be a qualifying donation, its grossed up amount would, if paid, be “payable out of profits or gains brought into charge to income tax or capital gains tax”. This is rewritten as a reference to the gift being disqualified if it results in the sum of the grossed up amounts of any overseas gifts being more than the individual’s charged amount (see section 427) for the tax year. This is in keeping with the approach adopted towards the parallel rule in the source legislation for charges on income in its application to individuals (see *Change 81* in Annex 1 and the commentary on section 425).

Section 423: Restriction of certain reliefs

1195. This section restricts certain reliefs, where necessary to ensure that the individual pays enough tax to match any tax which might be refunded to the charities receiving the gifts. It is based on section 25(6)(c) of FA 1990.

1196. The section operates if the amount of income tax treated as deducted from an individual's gifts, "amount A" in*subsection (2)*, is greater than "amount B".

1197. The source legislation does not expressly say how "amount B" is to be calculated. This section makes clear that the only difference between "amount B" (from section 25(6)(c) of FA 1990) and "amount C" in section 424 (from section 25(9) of that Act) is that "amount B" is calculated before any restriction of personal reliefs under this section. See *Change 78* in Annex 1 and the commentary on section 425.

1198. So "amount B" is:

- the income tax liability as defined in section 425 but *before* applying any reduction in reliefs under this section; plus
- the capital gains tax liability.

1199. Section 25(6)(b) and (7) of FA 1990 are not rewritten. These provisions relate to certain of the tax reductions listed in section 27(5) of this Act. The effect of the relevant provisions in section 25(6)(b) and (7) of FA 1990 is achieved by the operation of sections 23 and 425(2) of this Act.

1200. The reliefs listed in *subsection (5)* are to be reduced only to the extent necessary. If all such available reliefs are extinguished and the liability still falls short of amount A, a charge to income tax arises under section 424.

Section 424: Charge to tax

1201. This section operates to charge the donor with income tax in the amount of any remaining shortfall after the operation of section 423. It is based on section 25(8) of FA 1990.

1202. Instead of "amount B" as in section 423, the comparison is now with "amount C", which is the tax liability *after* applying section 423. That liability includes the income tax liability as adjusted in accordance with section 425.

1203. The charging provision operates directly in terms of an amount of tax, rather than (as in the source legislation) by way of charging an amount of deemed income.

Section 425: Total amount of income tax to which individual charged for a tax year

1204. This section provides for the adjustments to the individual donor's income tax liability in order to arrive at "amount B" in section 423 and "amount C" in section 424. It is based on section 25(9) of FA 1990.

1205. As part of the clarification of how these amounts are calculated, section 25(9)(c) of FA 1990 has been dropped as anomalous. See *Change 78* in Annex 1 and the commentary on section 423.

1206. Section 25(9)(a) of FA 1990 is not rewritten. That provision dealt with tax charged at the basic rate by virtue of sections 348 or 349 of ICTA. As a result of the new approach to charges on income such tax is no longer dealt with as part of a person's liability. See *Change 81* in Annex 1.

Section 426: Election by donor: gift treated as made in previous tax year

1207. This section provides that an individual may elect that a qualifying donation made in one tax year be treated as having been made in the preceding tax year ("year P"). It is based on section 98 of FA 2002.

1208. A test similar to that in section 422 must be met in year P for an election to be valid. Because of the possibility that other qualifying donations will have been made in year P, and will not themselves have been carried back to "year P minus 1", the language in which the test is expressed differs slightly from that in section 422. Hence the references to the "increased total of gifts".

1209. *Subsection (4)*, concerning the increased total of gifts, also has to take into account the possibility that elections are made when a notice under section 8 of TMA has not been issued and there is no other legal duty to notify liability to tax or file a self-assessment return. In that case, instead of being included in the self-assessment return under section 42(2) of TMA, elections may be made otherwise (under Schedule 1A to TMA), which opens up the possibility of a number of elections being made in respect of separate donations in the same year.

1210. In the case of non-residents to whom section 422 applies, if a donation does not meet the test set out in section 422(3) in the tax year in which the gift is made, it cannot be carried back in this way. In such a case the donation would not be "qualifying" and so would fail the condition in *subsection (1)(a)* of this section.

1211. An election must be made before the actual filing date of the self-assessment tax return for year P (if a self-assessment return is made for that year), and in any case before the normal self-assessment filing date for year P. The requirement in section 98(2) of FA 2002 that the election "be made by notice in writing to an officer of the Inland Revenue" is catered for by paragraph 2(1) of Schedule 1A to TMA.

1212. In all cases the charity is treated as receiving the donation, not in year P, but in the tax year of payment. It is in respect of the year of payment that the charity will, if appropriate, be entitled to an income tax repayment in respect of the donation.

Section 427: Meaning of "charged amount"

1213. This section provides the basic calculation rules to establish the individual's charged amount for the purposes of the tests in sections 422 and 426. It is based on section 25(2) of FA 1990 and section 98(3) of FA 2002.

1214. The detailed rules for establishing the individual's modified net income are contained in section 1025 in Part 17, which defines this term (as used in *subsection (2)* of this section) for this and certain other purposes. See the commentary on that section.

1215. The basic rule is to add together the "modified net income" established under section 1025 and the amount on which the individual is chargeable to capital gains tax. This amount is then compared with the "overseas gifts total" in section 422(4), or the "increased total of the gifts" in section 426(4), as appropriate.

Section 428: Meaning of "gift aid declaration"

1216. This section provides the definition of "gift aid declaration" in section 416(1)(b), and states the powers under which the Commissioners for Her Majesty's Revenue and Customs may make related regulations. It is based on section 25(3) and (3A) of FA 1990.

1217. The regulations currently in force for these provisions are:

- the Donations to Charity by Individuals (Appropriate Declarations) Regulations 2000 (SI 2000/2074); and

- the Donations to Charity by Individuals (Appropriate Declarations) (Amendment) Regulations 2005 (SI 2005/2790), which remove the requirement on charities to send to donors a written record of their oral declarations.

Section 429: Giving through self-assessment return

1218. This section makes provision for individuals to require all or part of any tax repayment arising as a result of a self-assessment return to be paid to a listed charity. It is based on section 83 of FA 2004.

1219. For the effect of this provision where the gift is received by a charitable trust, see section 538(3) and the commentary on that section.

Section 430: "Charity" to include exempt bodies

1220. This section provides that the bodies mentioned in *subsection (1)* are to be treated as charities for the purposes of this Chapter. It is based on section 507(1) of ICTA, section 25(12) of FA 1990 and paragraph 9 of Schedule 18 to FA 2002.

1221. References to the Trustees of the British Museum and of the Natural History Museum appear in section 507(1) of ICTA along with the other three bodies named in subsection (1)(a) to (c) of this section. Section 507 gives exemption to all the bodies named there from corporation tax in line with the exemptions afforded to charities under section 505 of ICTA.

1222. By contrast, the ability to receive gift aid donations is given to any charity if the purposes for which it is established are fully charitable. In the case of the British Museum and the Natural History Museum this is so: see the relevant sections of the British Museum Act 1963. But in the other cases it is more doubtful whether their functions as set out in their foundation Acts are solely charitable. So it is only the names of those bodies which are included in this section. See *Change 79* in Annex 1.

1223. Similar provisions apply in the case of gifts of shares, securities and land to charities: see section 446 in Chapter 3 of this Part.

Chapter 3: Gifts of shares, securities and real property to charities etc

Overview

1224. This Chapter gives relief to individuals making gifts of shares, securities and real property to charities, or disposing of such assets to charities at an undervalue. It is based on sections 587B and 587C of ICTA 1988.

Section 431: Relief for gifts of shares, securities and real property to charities etc

1225. This section sets out the relief. It is based on section 587B(1) and (2) of ICTA.

1226. *Subsection (1)* provides that relief is available if an individual disposes of the whole of the beneficial interest in a qualifying investment to a charity and makes a claim. The rule in section 587B(2) of ICTA that the claim must "be made to an officer of the Inland Revenue" is catered for by paragraph 2(1) of Schedule 1A to TMA.

1227. *Subsection (2)* provides that relief for the "relievable amount" is given as a deduction in calculating net income.

1228. If "top slicing relief" is claimed on gains under life assurance policies etc (sections 535 to 537 of ITTOIA), relief under this Chapter is ignored for the purposes of the computations required by section 535(1) of ITTOIA. See section 535(7) of ITTOIA, inserted by Schedule 1 to this Act.

Section 432: Meaning of "qualifying investment"

1229. This section lists the types of investment that can attract relief. It is based on section 587B(9) of ICTA.

Section 433: Meaning of "qualifying interest in land"

1230. This section defines "qualifying interest in land". It is based on section 587B(9A) to (9E) of ICTA.

1231. *Subsections (2)* and *(3)* clarify the position where an individual with a beneficial interest in an estate in land gives that beneficial interest to a charity along with any easement, servitude or right that benefits the land. For example, A's land may only be accessible by way of an easement over B's land. If A gives the charity both the land and the right over B's land, the disposal of the right is treated as a separate disposal.

1232. If an individual with a freehold or leasehold interest carves out of that interest a lease for the benefit of the charity, the retention of a freehold or leasehold reversion will not prevent the disposal from being "of the whole of the beneficial interest". But an agreement to acquire a freehold, or an agreement for a lease, is not enough to constitute a disposal.

Section 434: The relievable amount

1233. This section sets out how to calculate the relievable amount, firstly in cases where the qualifying investment is transferred to the charity by way of gift (*subsection (1)*), and then where there is consideration for the transfer (*subsection (2)*). It is based on section 587B(4) to (7) of ICTA.

1234. In each case, the computation starts with the value of the net benefit to the charity (V), either directly (as in subsection (1)) or in arriving at E (the excess of V over the consideration for the disposal) in subsection (2).

1235. The detail of how V is calculated is in sections 437 to 440. But it is emphasised in the definition of V in subsection (1) that V must be considered both at, and immediately after, the time of the disposal.

1236. *Subsection (3)* makes it explicit that if the amount given by either formula is negative the relievable amount is nil.

1237. The treatment of incidental costs of disposal depends on whether the transfer is by way of gift or at an undervalue. If it is a gift, all the incidental costs are added in arriving at the relievable amount. But if there is consideration for the disposal, there is an interplay between the capital gains tax treatment and the incidental costs.

1238. Under section 257(2)(a) of TCGA a gift of a qualifying investment to a charity is treated as being for such a consideration as will result in neither a loss nor a gain to the donor. Incidental costs are added only if that deemed consideration is greater than the actual consideration. But the amount added must not be greater than that excess. C is defined (in *subsection (4)*) to achieve this result.

Section 435: Incidental costs of making disposal

1239. This section defines "the incidental costs of making the disposal to the individual making it". It is based on section 587B(9) of ICTA.

1240. The section reproduces the material in section 38(2) of TCGA to which section 587B(9) cross-refers, with the exception of the reference to stamp duty and stamp duty land tax, which do not apply to transactions within this Chapter.

Section 436: Consideration

1241. This section defines “consideration”. It is based on section 587B(7)(b) of ICTA.

1242. The section reproduces the relevant material in section 48 of TCGA (consideration due after time of disposal), to which section 587B(7)(b) cross-refers. The main thrust of section 48 of TCGA is that full value is to be introduced into the computation of the gain. Only on a subsequent claim is the consideration to be reduced, either because the right to receive any amount is contingent or because any part of the consideration proves to be irrecoverable.

Section 437: Value of net benefit to charity

1243. This section is the first of four sections concerned with defining the value of the net benefit to the charity. It is based on section 587B(8A) and (8B) of ICTA.

1244. In the simple case, where there are no disposal-related obligations, the value of the net benefit to the charity is the market value of the qualifying investment. As indicated in section 434, this has to be considered both at, and immediately after, the disposal.

1245. If the charity is, or becomes, subject to an obligation that is connected with the disposal of the qualifying investment to the charity, the market value of the investment is reduced by the amount of the disposal-related liabilities (see section 440) brought about by the obligation. These obligations also must be considered both at, and immediately after, the disposal.

Section 438: Market value of qualifying investments

1246. This section sets out how the market value of qualifying investments is to be determined. It is based on section 587B(10) and (11) of ICTA.

1247. The methods are those laid down in sections 272 to 274 of TCGA. If an offshore fund publishes buy and sell prices, it is in effect subject to the same treatment as a unit trust scheme as laid down by section 272(5) of TCGA. The provisions of that subsection are reproduced here.

Section 439: Meaning of “disposal-related obligation”

1248. This section defines “disposal-related obligation”. It is based on section 587B(8B) to (8D) and (9) of ICTA.

1249. The obligation undertaken by the charity may be any scheme, arrangement or understanding of any kind, regardless of whether it is legally enforceable. The word “obligation” also includes a reference to a series of obligations, whether or not between the same persons. It may also be contingent (see section 440(2)).

Section 440: Meaning and amount of “disposal-related liability”

1250. This section defines “disposal-related liability”. It is based on section 587B(8E) to (8G) of ICTA.

1251. *Subsection (2)* deals with contingent disposal-related obligations.

1252. It is in the nature of a contingency that it may occur after the time of disposal; hence the words “at any time”. If a contingency occurs later than immediately after the disposal, but existed as a possibility at the time of disposal, the value of the net benefit to the charity at the time of, or immediately after, the disposal must be reduced; and all necessary adjustments must be made to give effect to this. Conversely, if the contingency does not occur, to that extent there will be no obligation and no liability.

Section 441: Certificate required from charity

1253. This section, which is the first of four that deal specifically with qualifying interests in land, requires any claim for relief in relation to a qualifying interest in land to be supported by a certificate from the charity. It is based on section 587C(1), (4) and (5) of ICTA.

Section 442: Qualifying interests in land held jointly

1254. This section deals with land held by joint tenants or by tenants in common. It is based on section 587C(1) to (3) of ICTA.

1255. Relief is given only if each joint tenant, or tenant in common, disposes of the whole of that person's beneficial interest in the land. This applies whether the relief is claimed by an individual under this Chapter, or by a company under sections 587B and 587C of ICTA.

1256. It is provided that there must be an agreement between all the tenants eligible for relief (whether individuals or not, and whether joint or in common) as to the share of the relief attributable to each tenant. To the extent that there is no such agreement between the owners entitled to relief, there is no relief under this Chapter, or under sections 587B and 587C of ICTA.

1257. The relief is available to individuals under this Chapter and to companies under sections 587B and 587C of ICTA, but not to other persons. So it is necessary in the case of joint disposals to set out a method to determine whether all beneficial interests have been disposed of. To that end, and to ensure that the total relief given under this Chapter and the corresponding provisions of ICTA is not excessive, it is provided that, for this purpose only, the rules defining "qualifying interest in land" in section 433(2) to (4) are to apply to all owners as if they were individuals. See also *Change 80* in Annex 1 and the commentary on section 443.

Section 443: Calculation of relievable amount where joint disposal of interest in land

1258. This section provides details of the method of calculation of the "relievable amount" in cases where there is a joint disposal of an interest in land. It is new.

1259. The method involves calculating the relievable amount as if there is a disposal by a single person, and then adjusting the amount to take account of only those owners who qualify for relief. See *Change 80* in Annex 1.

Section 444: Disqualifying events

1260. This section provides for the recovery of relief if a "disqualifying event" occurs within the "provisional period". It is based on section 587C(1) and (6) to (10) of ICTA.

1261. In the simplest case, such an event occurs if any of the persons who made the disposal are entitled to buy the land back from the charity at an undervalue.

Section 445: Prohibition against double relief

1262. This section establishes the priority of this Chapter over any other provisions under which relief might be claimed. It is based on section 587B(2)(b) of ICTA.

1263. *Subsection (2)* is a signpost to the effect on the chargeable gains position of the charity of the rules in section 587B(3) of ICTA. See section 257 of TCGA as amended by Schedule 1 to this Act.

Section 446: "Charity" to include exempt bodies

1264. This section extends the relief given by the Chapter to certain bodies set up by Act of Parliament even though they are not charities. It is based on section 587B(9) of ICTA.

1265. The references to the British Museum and the Natural History Museum (originally in section 507(1) of ICTA, to which section 587B(9) of that Act cross-refers) are no longer required, since those bodies are established for charitable purposes. Their omission does not affect the exemption from corporation tax given by section 507 of ICTA. See *Change 79* in Annex 1 and the commentary on section 430.

Chapter 4: Annual payments and patent royalties

Overview

1266. This Chapter provides for relief for certain annual payments and patent royalty payments by deduction in calculating net income. These rules are coupled with those providing for deduction of tax at source from the payments: see Chapter 6 of Part 15 and the related commentary.

1267. The scheme of the source legislation relating to charges on income (which owes its origins to the historic concept of alienation of income) is replaced with a deduction in calculating net income. See *Change 81* in Annex 1.

1268. This Chapter distinguishes between individuals and other persons. One reason for this is that section 347A of ICTA provides that, with certain exceptions, an annual payment made by an individual (or personal representatives) is not to be a charge on the income of the person liable to make it. And there is a similar rule concerning the recipient in section 727 of ITTOIA. But those rules do not apply to payments by other persons. See the commentary on sections 900, 901, and 903.

1269. In addition, the rules about when payments are regarded as being, or not being, made out of profits or gains brought into charge to income tax distinguish between the position of individuals and other persons in the light of the case law.

Section 447: Overview of Chapter

1270. This section provides an overview of the Chapter. It is new.

Section 448: Relief for individuals

1271. This section provides for relief by deduction from income if an individual pays an annual payment for commercial purposes (see section 900) or pays a patent royalty (see section 903). It is based on section 348 of ICTA.

1272. The income tax in respect of the payment is collected as part of the individual's self-assessment by way of Chapter 17 of Part 15. See *Change 81* in Annex 1 and the overview commentary on this Chapter.

1273. The term "gross amount of the payment" is defined in section 452.

1274. In the source legislation a number of types of income are treated as not brought into charge to income tax and so are not available to cover charges on income. To preserve the effect of the source legislation, it is necessary to prevent the deduction being given against such "non-qualifying income". *Subsection (3)* introduces these by referring to *subsection (4)* and to section 451.

1275. Subsection (4) gives a signpost to section 1025 which, together with section 1026, provides that such income cannot form part of "modified net income". So it cannot give occasion for relief. See the commentary on section 1025.

Section 449: Relief for other persons

1276. This section provides for relief by deduction from income in the case of persons other than individuals. It is based on section 348 of ICTA.

1277. *Subsection (1)(c)* works together with the repeal of section 51 of ITTOIA to align the approach to patent royalties with that for annual payments. See *Change 81* in Annex 1.

1278. *Subsection (5)* mirrors the rule about "modified net income" in the previous section.

Section 450: Other persons: payments ineligible for relief

1279. This section rewrites the rule in the source legislation about when payments are regarded as being, or not being, made out of profits or gains brought into charge to income tax. It is new.

1280. In the case of an individual one need go no further than ask whether the individual has income, as noted in *Change 82* in Annex 1. But the position is more complex in the case of persons other than individuals.

1281. *Subsection (2)* provides that if a payment can lawfully only be made out of capital, or out of exempt income, relief will not be given: see *Change 82* in Annex 1 in connection with Sugden v Leeds Corporation (1913), 6 TC 211 HL.

1282. *Subsection (3)* provides that, if a person other than an individual makes a payment within this Chapter that is charged to capital, it is to that extent denied relief. This principle appears in Chancery Lane Safe Deposit and Offices Co Ltd v CIR (1965), 43 TC 83 HL and related cases: see *Change 82* in Annex 1.

1283. *Subsection (4)* provides for cases where the taxpayer has treated a payment as having been made out of exempt income, and this has had an effect on the actual or contingent rights or obligations of any person. Relief in such cases is denied on the authority of CIR v Ayr Town Council (1938), 22 TC 381 CS: see *Change 82* in Annex 1 concerning that and related cases.

1284. *Subsection (5)* deals with subsidy cases, where payment is made but the payer is reimbursed for the gross amount in a form that is not taxable in the payer's hands. To permit such cases would in effect give double relief: see *Change 82* in Annex 1 as regards Corporation of Birmingham v CIR (1930), 15 TC 172 HL and related cases.

Section 451: Special rule for persons affected by section 733 of ICTA

1285. This section is based on section 733(2) of ICTA.

1286. Sections 731 to 735 of ICTA are anti-avoidance provisions. They are concerned with cases where:

- a person ("the first buyer") buys securities and subsequently sells them to someone else; and
- the first buyer becomes entitled to receive any interest payable on them.

1287. Section 733(2) addresses the case where:

- interest (the "affected income") is payable to the first buyer;
- that interest, or some part of it, would be exempt, but is not so, because section 733(1) cancels the exemption; and
- the first buyer makes an annual payment in the same tax year as that in which the interest arises.

1288. The source legislation provides that an annual payment is to be treated as paid out of profits or gains not brought into charge. It follows that, even though the exemption is cancelled by section 733(1), leaving interest in charge to income tax, the annual payment must not be treated as paid out of that interest.

1289. This is rewritten so that relief is only given if, and to the extent that, the person has "non-affected income" equal to the annual payment. Non-affected income is defined as modified net income less affected income. On modified net income, see the commentary on sections 448 and 1025.

1290. Because this is a rule relating to a very specific type of income, it is necessary to apply it before applying the provisions referred to in *subsection (4)*.

Section 452: The gross amount of a payment

1291. This section provides, for the purposes of this Chapter, that the gross amount of a payment is the amount of the payment before deduction of income tax. It is new.

Chapter 5: Qualifying maintenance payments

Overview

1292. This Chapter provides relief as a tax reduction at Step 6 of the tax calculation (see section 23) for individuals who make qualifying maintenance payments. It is based on section 347B of ICTA.

1293. Maintenance payments have been exempt from income tax since 6 April 2000. And in general no relief is available for those who pay them. But a measure of relief remained available if at least one party to a marriage was 65 or over before 6 April 2000, in line with corresponding changes made at the same time to married couple's allowance.

1294. Since 5 December 2005, when the Tax and Civil Partnership Regulations 2005 came into force, relief has been extended to civil partners. And, in relation to payments for children, it was also extended to cover payments between parents who were never married and payments between any two individuals if the child was treated as a child of their family.

1295. The transitional arrangements in section 38 of FA 1988 for maintenance paid under obligations that existed in 1988 came to an end on 5 April 2000 (see section 36 of FA 1999) and are spent. Accordingly, they are repealed by this Act.

Section 453: Tax reduction for qualifying maintenance payments

1296. This section provides for a tax reduction if an individual makes qualifying maintenance payments. It is based on section 347B(2), (3) and (5A) of ICTA.

1297. Relief has to be claimed and is given for the year in which the payments are due. The relief is 10% of the amount of the payments, but is capped by reference to the minimum amount of married couple's allowance for the year. For 2006-07 that amount is £2,350 so the maximum tax reduction is £235.

1298. The rules in section 347(5A) and (5B) of ICTA giving the priority between this relief and other tax reductions, and providing that relief cannot reduce liability below nil, are not set out here. They are contained in the general rules applying to all tax reductions in Chapter 3 of Part 2.

Section 454: Meaning of "qualifying maintenance payment"

1299. This section sets out the conditions that must be satisfied for relief to be due. It is based on section 347B(1), (1A), (7), (8) and (11) of ICTA.

1300. Condition A requires that the payment be paid either for the maintenance of a party to the marriage or civil partnership or for the maintenance of a child.

1301. In relation to payments for the maintenance of the other party to the marriage or civil partnership, they must be made to the other party.

1302. In relation to payments for the maintenance of a child, they must be made by one parent to the child's other parent or be between any two persons for the maintenance of a relevant child of theirs. "Relevant child" is defined in *subsection (9)*. Relief is not due if the order or agreement provides for payments direct to a child.

1303. Condition C requires the payment to be made under certain types of court order or written agreement that apply in member States. Later subsections provide that payments under child support legislation are also included.

1304. Condition D specifies that, in relation to a payment for the other spouse or civil partner, the parties must not be a married couple living together or civil partners living together. If the marriage or civil partnership has formally ceased, the recipient must not have remarried or entered into a new civil partnership (whether or not that new marriage or civil partnership has since come to an end). If the payment is for a child, the condition is that the payer and the recipient are not living together.

1305. Condition E specifies that relief must not be due for the payment under any other provision. This caters for the possibility that the payment of interest on a loan to buy an annuity for the other party (and for which relief is due under section 365 of ICTA) may constitute maintenance.

1306. *Subsections (7)* and *(8)* provide that maintenance calculations made under the Child Support Act 1991 and maintenance assessments made under the Child Support (Northern Ireland) Order 1991 (SI 1991/2628(NI 23)) are treated as made under a court order. The transitional provision in Part 9 of Schedule 2 ensures that maintenance assessments in the rest of the United Kingdom which have not yet been replaced by maintenance calculations are treated in the same way.

1307. In the source legislation for subsection (7) the reference was to an order made by a court in the United Kingdom. It is here replaced by a reference to a court in a member state to tie in with the wording in subsection (4). This is not a change in the law.

Section 455: Child support maintenance payments

1308. This section ensures that condition A in section 454 is treated as satisfied in certain cases where the maintenance payment for a child is not made to the other party. It is based on section 347B(9) and (10) of ICTA.

1309. In certain circumstances, the maintenance for a child may be paid instead to the Secretary of State or the Department of Health, Social Services and Public Safety for Northern Ireland. This section treats condition A as satisfied in those cases.

Section 456: Payments under orders for recovery of benefit etc

1310. This section treats condition A in section 454 as satisfied in relation to certain maintenance payments under "recovery of benefit orders". It is based on section 347B(12) and (13) of ICTA.

1311. In certain circumstances, the party entitled to the maintenance may receive income support or jobseeker's allowance which is recovered from the party liable to pay the maintenance under a "recovery of benefit order" (see *subsection (2)*). Such payments are treated as satisfying condition A.

Chapter 6: Miscellaneous other reliefs

Overview

1312. The first three sections of this Chapter concern relief for certain payments of an insurance-related nature, either by deduction in calculating net income or as a tax reduction. They are based on sections 266(7), 273, 274 and 278 of ICTA.

1313. Relief is given for parts of certain payments made to trade unions or police service organisations that go to provide life insurance, superannuation or funeral benefits. This relief is given by deduction in calculating net income.

1314. Relief is given for certain payments an individual is required to make to secure an annuity for a spouse or to provide for children after the individual's death. This relief is given as a tax reduction.

1315. The fourth section is the residence condition relating to those reliefs.

1316. The final section in this Chapter is a relief that may be claimed by the recipient of patent royalties. It is based on section 527 of ICTA.

1317. Section 266(6) and (6A) of ICTA provided relief for premiums paid under certain policies issued by friendly societies. These provisions are obsolete. Accordingly they are repealed by this Act.

1318. The remaining provisions of sections 266 to 274 of, and Schedule 14 to, ICTA are obsolescent. They have not been rewritten, and remain in ICTA.

Section 457: Payments to trade unions

1319. This section provides a deduction in calculating net income if an individual makes a payment to a trade union of which part is attributable to the provision of superannuation, life insurance or funeral benefits. It is based on section 266(7) of ICTA.

1320. *Subsection (1)(c)* requires a claim to be made. The general rule in section 266(1), in the context of the relief given at source, is that claims are not required. This section brings the position in relation to section 266(7) of ICTA, which is administered through the self-assessment return, into line with practice. See *Change 83* in Annex 1.

1321. *Subsections (2)* and *(3)* provide that the amount of relief is one half of the qualifying part of the payment, subject to a maximum of £100. This simplifies many of the complexities of the existing limits provided by section 274(1) and (2) of ICTA. See *Change 84* in Annex 1.

1322. *Subsection (5)* defines a trade union. The 1974 Act referred to in section 266(7) of ICTA was repealed in 1992.

Section 458: Payments to police organisations

1323. This section is based on section 266(7) of ICTA.

1324. The section is similar to section 457. But there is an additional requirement that the qualifying part of all the payments made in a particular tax year must be at least £20.

1325. *Changes 83* and *84* also apply to this section. See the commentary on section 457.

Section 459: Payments for benefit of family members

1326. This section provides relief as a tax reduction for certain payments an individual is required to make to provide benefits for a surviving spouse, civil partner or children after the individual's death. It is based on section 273 of ICTA.

1327. *Subsection (1)* explains that a tax reduction may be claimed if an individual is required under an Act or the conditions of employment to pay a sum or suffer a deduction from earnings to secure an annuity for a surviving spouse or civil partner or make provision for the individual's surviving children.

1328. The residence requirement from section 278 of ICTA is contained in subsection (1)(c) without any special provision for claims by non-residents to be made to the Commissioners for Her Majesty's Revenue and Customs. Claims may be made to any officer and appeals are not reserved to the Special Commissioners. This is achieved here by not specifying to whom claims are to be made. See *Change 5* in Annex 1.

1329. *Subsections (2)* to *(4)* specify that the relief operates as a tax reduction of an amount equal to income tax at the basic rate on the amount of all of the payments (or sums deducted) in the tax year, subject to a maximum of £100. The limit provided by section 274(1) and (2) of ICTA requires account to be taken of other qualifying insurance related payments in the year. That requirement has been removed. See *Change 84* in Annex 1 and the commentary on section 457.

1330. *Subsection (7)* defines the term "earnings" in subsection (1). The term "stipend" in the source legislation is interpreted in the context of the terms "salary" and "employment" and is therefore covered by the term "earnings". "Stipend" does not embrace income in the nature of a pension.

Section 460: Residence etc of claimants

1331. This section sets out the residence-related requirement referred to in each of the previous three sections. It is based on section 278 of ICTA. S*ubsections (2)* and *(3)* are the same as in section 56.

1332. Individuals who, under the source legislation, were able to claim the reliefs only by virtue of meeting the condition in section 278(2)(a) of ICTA are catered for by provisions remaining in ICTA, as amended by this Act. See the overview commentary on Part 3.

Section 461: Spreading of patent royalty receipts

1333. This section allows the recipient of a lump sum patent royalty to claim a tax reduction if the royalty was for the use of the patent over a period of two years or more. It is based on section 527 of ICTA.

1334. The amount of the royalty is notionally spread equally over the number of complete years for which the use of the patent extended (up to a maximum of six). The total additional tax that would have been due on that basis is compared to the tax attributable to the whole royalty in the year of receipt. If it is less, a tax reduction equal to the difference is given.

Part 9: Special rules about settlements and trustees

Overview

1335. This Part is about special rules that apply to settlements and trustees.

1336. Most income tax rules apply to persons in general, which includes trustees. This Part contains additional rules specific to trustees. Some of these rules apply generally. Others apply more specifically, to particular types of settlement, to certain types of settlement income or to the treatment of income of beneficiaries.

1337. Except for the special position of unauthorised unit trusts, the provisions in this Part do not apply to bare trusts, ie those where the beneficiary is absolutely entitled to both the income and capital.

1338. The provisions in this Part do not apply to personal representatives. Accordingly, the rates at which their income is taxed (the savings, dividend ordinary or basic rates depending on the income concerned) are the rates provided for in Chapter 2 of Part 2.

1339. Rules specific to charitable trusts are in Part 10.

Chapter 1: Introduction

Overview

1340. This Chapter contains an introduction to the Part and some basic definitions.

1341. There is no attempt to define a settlement or particular types of settlement, although Chapter 2 defines "settled property" and "settlor".

1342. While it is often useful in practice to categorise a settlement either as an interest in possession settlement (under which the beneficiaries are entitled to the settlement income as it arises) or as an accumulation or discretionary settlement (under which income can be accumulated or paid to beneficiaries at the trustees' discretion), some settlements are mixed (in that there are both sorts of beneficiary).

1343. The rules in this Part are written so that they apply having regard to the treatment of the income rather than the type of settlement.

Section 462: Overview of Part

1344. This section introduces the Part. It is new.

Section 463: Interpretation of Part

1345. This section provides definitions for the purpose of the Part. It is based on sections 686(6) and 687(4) of ICTA.

Section 464: Scottish trusts

1346. This section concerns beneficiaries of Scottish trusts. It is based on section 118(1) of FA 1993.

1347. For certain income tax purposes, trusts under which the beneficiaries have an equitable right in possession are treated differently to discretionary trusts. Scottish law does not recognise the concept of an equitable right in possession. So this section provides for the law of England and Wales to be applied for the purpose of determining whether beneficiaries under a Scottish trust have an equitable right in possession for income tax purposes.

Chapter 2: General provision about settlements and trustees

Overview

1348. This Chapter provides definitions for income tax purposes that are, as far as possible, aligned with those which apply for the purposes of capital gains tax (see sections 68A to 69 of TCGA). It is based on provisions inserted into ICTA by Schedule 13 to FA 2006.

1349. The definitions in the ICTA provisions apply for the purpose of the Tax Acts and thus extend beyond income tax to provisions of the Corporation Tax Acts. But the extent of their application for the purposes of the Corporation Tax Acts is in fact fairly limited. Accordingly, the ICTA provisions are repealed in favour of a new section 832(2A) in ICTA applying this Chapter for those purposes (see Schedule 1).

Section 465: Overview of Chapter and interpretation

1350. This section introduces the Chapter.*Subsections (1)* to *(6)* are new. *Subsections (7)* and *(8)* are based on section 685B(7) and (8) of ICTA.

Section 466: Meaning of "settled property" etc

1351. This section defines "settled property". It is based on section 685A of ICTA.

1352. The definition corresponds to that in section 68 of TCGA. It also mirrors the effect of section 60 of TCGA in relation to bare trustees and nominees.

1353. In subsection (3), the expression "under a disability" in section 685A(1) of ICTA has been rewritten as "lacking legal capacity". This does not change the substance.

Section 467: Meaning of "settlor" etc

1354. This section defines "settlor". It is based on section 685B of ICTA.

1355. The definition corresponds to that in section 68A of TCGA.

1356. The section introduces a new term "disposable property", defined in section 468.

1357. *Subsection (6)* is concerned with the case where one person makes or enters into a settlement in accordance with reciprocal arrangements with another person.

1358. As *subsection (8)* makes clear, a wider definition of "settlor" applies to the anti-avoidance provisions in Chapter 5 of Part 5 of ITTOIA.

Section 468: Meaning of "disposable property"

1359. This section defines the new term "disposable property". It is based on section 685B(5) of ICTA.

1360. The definition covers the same ground as section 62(10) of TCGA.

Section 469: Person ceasing to be a settlor

1361. This section explains when a person ceases to be a settlor for income tax purposes. It is based on section 685B(6) of ICTA.

Section 470: Transfers between settlements

1362. This section and section 471 provide rules for identifying the settlor(s) of property in a settlement where property is transferred from one settlement to another for less than full consideration. The rules are the same as those that apply in section 68B of TCGA.

1363. This section explains when a relevant transfer occurs. It is based on section 685C of ICTA.

Section 471: Identification of settlor following transfer covered by section 470

1364. This section identifies the settlor(s) in circumstances where a transfer of property within section 470 takes place. It is based on section 685C of ICTA.

Section 472: Settlor where property becomes settled because of variation of will etc

1365. This section identifies the settlor in certain cases where a will is varied after a person dies. It is based on section 685D of ICTA.

1366. The rules are the same as those that apply in section 68C of TCGA.

1367. *Subsection (2)* applies when property becomes settled property in consequence of the variation, but would not otherwise have become settled property. In that case a person specified in *subsection (3)* is treated as the settlor.

1368. In subsection (3), the expression "under a disability" in section 685D(3) of ICTA has been rewritten as "lacking legal capacity". This does not change the substance.

1369. In *subsection (4)*, the expression "donatio mortis causa" has been retained, in the absence of any simple English expression that adequately summarises its meaning.

Section 473: Deceased person as settlor where variation of will etc

1370. This section deems the deceased person to be the settlor in certain cases where a will is varied after a person dies or that person dies intestate. It is based on section 685D of ICTA.

1371. The rules are the same as those that apply in section 68C of TCGA.

Section 474: Trustees of settlement to be treated as a single and distinct person

1372. This section provides that the trustees of a settlement are collectively regarded as a single person distinct from the persons who are the trustees from time to time. It is based on section 685E(1) and (8) of ICTA.

1373. The rule is the same rule as in section 69 of TCGA.

1374. This rule is of particular significance in relation to the determination of the trustees' residence for income tax purposes.

Section 475: Residence of trustees

1375. This section sets out rules for determining whether trustees (treated as a single person under section 474) are resident and ordinarily resident in the United Kingdom. It is based on section 685E(2), (3), (4), (6) and (7) of ICTA.

1376. If all the persons who are trustees are UK resident then the single person is UK resident and ordinarily UK resident. If all those persons are non-UK resident then the single person is non-UK resident and not ordinarily UK resident. If the trustees have mixed residence then a tie-breaker applies and the residence of the single person is determined by reference to whether there is a settlor who meets condition C (see *subsection (5)(b)* and section 476).

Section 476: How to work out whether settlor meets condition C

1377. This section applies for the purposes of working out whether a settlor in relation to the settlement meets condition C. It is based on section 685E(4) and (5) of ICTA.

1378. *Subsections (2)* and *(3)* each provide that a person who is a settlor in relation to a settlement meets condition C if the person was UK resident, ordinarily UK resident or domiciled in the United Kingdom at the time specified in the subsection.

1379. Subsection (2) applies if the settlement arose on the death of the settlor and requires the settlor's residence and domicile to be determined immediately before the settlor's death.

1380. Subsection (3) applies in all other cases and requires the settlor's residence and domicile to be determined at every time when a settlor makes, or is treated as making, the settlement (see, in particular, section 467(3)).

1381. Subsections (2) and (3) also each provide that a person who meets condition C in relation to a settlement at the time specified in the subsection continues to meet condition C at all subsequent times until the person ceases to be a settlor in relation to the settlement.

1382. Accordingly, the single person mentioned in section 474(1) will be treated as UK resident and ordinarily UK resident for as long as the settlement has mixed residence trustees and there continues to be a settlor who meets condition C in relation to the settlement.

Section 477: Sub-fund elections under Schedule 4ZA to TCGA 1992

1383. This section sets out the income tax position where the trustees of a settlement have made a sub-fund election under Schedule 4ZA to TCGA. It is based on section 685G of ICTA.

1384. The broad effect is that each sub-fund is treated as a separate settlement distinct from the principal settlement and with its own deemed single person trustees.

Section 478: References to settled property etc in regulations

1385. This section provides rules for interpreting terms in regulations. It is based on paragraph 37(1) of Schedule 13 to FA 2006.

Chapter 3: Special rates for trustees' income

Overview

1386. This Chapter provides the main rules about which income is to be charged at either the trust rate or the dividend trust rate.

1387. The main category is "accumulated or discretionary income" which, broadly, is income which is income of trustees under trust law and which is not assessable as income of any beneficiary.

1388. The Chapter also deals with other specific types of receipt to which one or other of the special trust rates apply.

Section 479: Trustees' accumulated or discretionary income to be charged at special rates

1389. This section applies one of two special trust rates to trustees' accumulated or discretionary income. It is based on section 686(1), (1AA), (2) and (5A) of ICTA.

1390. The special rates apply to the trustees even where the receipt will be taxed as the income of the settlor. The settlor will receive credit for the full amount of tax paid by the trustees.

1391. *Subsection (1)* introduces the term "accumulated or discretionary income" which is defined in section 480. The fact that this section does not apply to charitable trusts is given greater prominence than in the source legislation.

1392. *Subsections (2)* to *(4)* provide that accumulated or discretionary income is charged at either the dividend trust rate or the trust rate instead of the rates that would otherwise apply to that income.

Section 480: Meaning of "accumulated or discretionary income"

1393. This section defines "accumulated or discretionary income". It is based on section 686(2), (6ZA), (6ZB) and (6A) of ICTA.

1394. "Accumulated or discretionary income" is a single concept rather than the sum of two separate elements.

1395. *Subsection (2)* is based on section 686(2)(a) of ICTA. This provision spells out the nature and extent of the discretion concerned in more detail than in the source legislation.

1396. Income is not included within "accumulated or discretionary income" simply because trustees have discretion over what expenses to incur or how those expenses are to be charged.

1397. *Subsection (3)(a)* excludes from the meaning of "accumulated or discretionary income" any income to which a beneficiary is entitled as it arises. This is the case where a beneficiary has an interest in possession.

1398. *Subsection (3)(b)* and *subsection (4)* exclude income that arises to certain pension funds, provided that the property giving rise to the income is not held as a member of a property investment LLP (see the definition in section 1004).

1399. *Subsection (3)(c)* and *subsections (5)* and *(6)* exclude income from service charges held on trust by certain bodies.

Section 481: Other amounts to be charged at special rates for trustees

1400. This section applies one of the special trust rates to certain receipts of trustees that are taxed as income. It is based on sections 686 and 686A of ICTA.

1401. The special rates apply to the trustees even where the receipt will be taxed as the income of the settlor. The settlor will receive credit for the full amount of tax paid by the trustees.

1402. *Subsection (1)* sets out the circumstances in which the section applies. The exemption for charitable trusts, which was in section 686A(4)(c) of ICTA before it was amended by FA 2006, has been reinstated. See *Change 85* in Annex 1.

1403. *Subsections (2)* to *(4)* apply the trust rate or dividend trust rate to the receipt arising to the trustees instead of the rate that would otherwise apply to that income. The only receipt to which the dividend trust rate applies is Type 1 within section 482.

1404. *Subsection (5)(a)* and *(b)* ensure that receipts are not caught by this section if they are accumulated or discretionary income (and so within section 480) or would be but for the exceptions in section 480(3)(a) or (c). This exemption, which was in section 686A(4)(a) before it was amended by FA 2006, has been reinstated. See *Change 85* in Annex 1.

1405. *Subsection (5)(c)* and *subsection (6)* correspond to the exception in section 480(4)(a). That exemption, which was in section 686A(4)(d) before it was amended by FA 2006, has been reinstated. See *Change 85* in Annex 1.

Section 482: Types of amount to be charged at special rates for trustees

1406. This section lists the types of receipts arising to trustees that are taxed at one of the special trust rates under section 481. It is based on section 686A(2) of ICTA.

1407. Section 686A(2) did not include amounts taxed on trustees under the accrued income scheme and liable at the trust rate by virtue of section 720(5) of ICTA. As it is intended that all amounts that are always liable at the trust rate are treated in the same way, those amounts are included here as Type 2 income. See *Change 86* in Annex 1.

Section 483: Sums paid by personal representatives to trustees

1408. This section concerns the treatment of sums paid by personal representatives to trustees. It is based on section 686(6) of ICTA.

1409. The section applies if personal representatives have received income or other amounts which would have been liable at the special trust rates had they been trustees, and they pay a sum to trustees representing income. In such a case, the sum is treated as income of the trustees and as having borne tax at the rate referred to in section 663(1) of ITTOIA.

1410. Following its substitution by FA 2006, section 686A of ICTA no longer includes the provision that specifically applied this rule to receipts within section 686A. But the reference in section 686(6) of ICTA to income to which section 686 applies includes receipts deemed to be such income as a result of section 686A. Accordingly, it is made explicit that this rule applies to all receipts within this Chapter.

Chapter 4: Trustees' expenses and special rates for trustees

Overview

1411. This Chapter provides for expenses incurred by trustees to reduce the amount of income chargeable at the special trust rates.

1412. Beyond a few basic rules, it is left to trust law to determine what expenses may be taken into account. Generally, it is only expenses incurred in the course of exercising the trustees' duties and powers and solely in managing the trust assets to produce or maintain an income flow which are allowable.

1413. The label "management expenses" has not been used. It does not carry any weight and omitting it avoids giving the impression that all expenses incurred in the course of managing a trust will necessarily be allowable.

Section 484: Trustees' expenses to be set against trustees' trust rate income

1414. This section concerns the trustees' expenses which are to be taken into account in calculating the extent of the income chargeable at the special trust rates. It is based on sections 686(2AA) and 689B(1) of ICTA.

1415. *Subsection (1)* provides that the section applies where the trustees incur allowable expenses. This is in contrast to the source legislation which requires the expenses to have been defrayed. See *Change 87* in Annex 1.

1416. *Subsection (4)* provides that where allowable expenses are set against income chargeable at the special rates, the income is instead charged at the rate that would normally apply to that type of income.

1417. *Subsection (5)* provides basic rules regarding what constitute allowable expenses.

1418. *Subsection (6)* makes it explicit that expenses are not allowable if they are taken into account (otherwise than under this section) in calculating the trustees' liability for any tax year.

Section 485: Carry forward of unused expenses

1419. This section specifies how expenses are relieved if the amount paid exceeds the income of the year taxable at the special trust rates. It is new.

1420. In essence, if expenses incurred exceed income they are carried forward and allowed as soon as there is sufficient trust rate income. See *Change 87* in Annex 1.

Section 486: How allowable expenses are to be set against trust rate income

1421. This section explains in step terms how allowable expenses are to be set against the trust rate income. It is based on sections 686(2AA) and 689B of ICTA.

1422. The section makes it explicit that it is the grossed up amount of expenses that is set against income charged at the special rates. (The meaning of "grossing up" is given in section 998.) See *Change 88* in Annex 1.

1423. Before the grossing up process, *Step 1* eliminates a proportion of expenses in the case of non-UK resident trustees in receipt of untaxed income (see section 487).

1424. *Steps 2* to*6* require dividend, savings and other income to be considered in turn.

1425. Dividend income not within *subsection (2)* corresponds to foreign income within section 689B(2A) of ICTA.

Section 487: Non-UK resident trustees

1426. This section specifies that a proportion of the allowable expenses of the trustees is ignored if a proportion of their income is not liable to income tax ("untaxed income"). It is based on section 686(2A) and (2B) of ICTA.

Chapter 5: Share incentive plans

Overview

1427. This Chapter is based on sections 686B and 686C of ICTA.

1428. Under a share incentive plan, shares which are not "plan shares" (see paragraph 99(1) of Schedule 2 to ITEPA) are held on accumulation or discretionary trusts. So the trustees' dividend income arising from such shares is potentially chargeable at the dividend trust rate under section 479. But this Chapter provides that such a charge on approved plans does not arise if the shares are awarded to participants in the plan within an "applicable period" (defined in section 489).

Section 488: Application of section 479 to trustees of approved share incentive plans

1429. This section sets out the circumstances in which section 479 applies to approved share incentive plans. It is based on sections 686B(1), (2) and (6) and 686C(3) of ICTA.

1430. *Subsection (1)* gives the basic condition that the section applies to dividends or other distributions received by the trustees of approved share incentive plans.

1431. *Subsections (2)* to *(4)* provide that the charge at the dividend trust rate under section 479 arises only if and when the shares are disposed of or the "applicable period" comes to an end without the shares having been awarded to participants in accordance with the plan.

1432. *Subsection (5)* provides that, if shares of the same class are acquired by the trustees at different times, they are treated as awarding shares acquired earlier before shares acquired later.

1433. *Subsection (6)* explains that, for the purposes of this section, shares are also treated as awarded when they are acquired on behalf of a participant as dividend shares.

Section 489: "The applicable period" in relation to shares

1434. This section explains the meaning of "the applicable period". It is based on sections 686B(3) to (5) and 686C(4) and (5) of ICTA.

1435. *Subsections (2)* to *(4)* state the basic rule that the applicable period ends at the earliest of:

- five years from the acquisition of the shares;
- two years from the acquisition of the shares if any shares in the company were readily convertible assets at that time; and
- two years from the date that any shares in the company became readily convertible assets.

1436. *Subsections (5)* and *(6)* provide that the basic rule is varied in a case where the shares were acquired in consequence of a contribution to the plan by the company for which it is allowed a deduction under paragraph 9 of Schedule 4AA to ICTA. In such a case the applicable period ends ten years after the shares were acquired.

Section 490: Interpretation of Chapter

1437. This section makes provision about the interpretation of the Chapter. It is based on sections 686B(7) and 686C(1) and (2) of ICTA.

Chapter 6: Trustees' first slice of trust rate income

Overview

1438. This Chapter is based on sections 686D and 686E of ICTA.

Section 491: Special rates not to apply to first slice of trustees' trust rate income

1439. This section provides for the first £1,000 of any trustees' income that would otherwise be chargeable at one of the special trust rates to be taxed instead at the rate or rates that normally apply to the income. It is based on section 686D of ICTA.

1440. *Subsections (3) and (4)* set out the steps to be taken in identifying the first slice of income (if it exceeds £1,000) and in determining the rate of tax to apply to income within that slice.

1441. The order is established by reference to the rules regarding ordering of income in section 16. The effect is that, so far as possible, the first slice consists first of income for which the normal rate is the basic rate, then, of income for which the normal rate is the savings rate and finally, of income for which the normal rate is the dividend ordinary rate. The first slice is then taxed at the normal rates appropriate to the types of income of which it consists.

Section 492: Cases where settlor has made more than one settlement

1442. This section reduces the band of income charged at normal rates if a settlor of that settlement has made other settlements. It is based on section 686E of ICTA.

1443. The £1,000 band is divided by the total number of existing settlements made by the settlor, but not so as reduce the band below £200. If there is more than one settlor for the settlement in question then the lowest threshold arrived at by this calculation is used.

Chapter 7: Discretionary payments

Overview

1444. This Chapter concerns the tax treatment of a payment made by trustees to a beneficiary in the exercise of a discretion. It is mainly concerned with the taxation of the trustees, but contains some provisions affecting the beneficiary.

1445. The discretionary payment is treated as a net amount corresponding to a gross amount from which the trustees have deducted income tax at the trust rate.

1446. That gross amount is chargeable to income tax on the beneficiary as an annual payment within Chapter 7 of Part 5 of ITTOIA, and the beneficiary is treated as having paid the income tax deducted. The deduction of income tax at source provisions that normally apply to annual payments are disapplied by section 899(5)(d) and (e) of this Act.

1447. The trustees, who will be charged to tax on the income of the trust at either the dividend trust rate or the trust rate, with the total tax paid going into a "tax pool", have to account for the tax deemed to have been deducted only to the extent that there is insufficient tax in the tax pool.

Section 493: Discretionary payments by trustees

1448. This section sets out what payments come within this Chapter. It is based on section 687(1) and (5) of ICTA.

1449. *Subsection (1)* provides that an annual payment is within this Chapter if it is made by trustees in the exercise of a discretion (exercised by the trustees or any other person) and provided that condition A or B is met. And it is made explicit that the trustees must be UK resident. See *Change 89* in Annex 1.

1450. Condition A is that the payment is income of the beneficiary for either income tax or corporation tax purposes. "Beneficiary" is used instead of the phrase "person to whom [the payment] is made" in section 687(1)(a) of ICTA. The reference to corporation tax provides a link to section 687A of ICTA.

1451. A discretionary payment from an employment-related settlement may be taxed on a beneficiary as employment income. Such a payment is excluded from this section. But the income arising to the trustees out of which the payment is made is taxable at the special trust rates. In such circumstances there is effectively double taxation and the trustees may be able to claim a payment from HMRC. See ESC A68.

1452. Condition B is that the payment is treated as income of a settlor under section 629 of ITTOIA.

Section 494: Grossing up of discretionary payment and payment of income tax

1453. This section provides for the grossing up of discretionary payments and sets out the treatment of the tax deemed to have been deducted. It is based on section 687(2) of ICTA.

1454. *Subsections (1)* and *(2)* provide for the amount of the actual payment to the beneficiary to be grossed up by reference to the trust rate for the year in which the discretionary payment is made.

1455. The amount by which a payment is grossed up represents income tax. *Subsections (3)* and *(4)* provide that the beneficiary or the settlor (in a case where the discretionary payment is treated as income of the settlor), is treated as having paid the tax deemed to have been deducted.

Section 495: Statement about deduction of income tax

1456. This section provides for the recipient of the discretionary payment to be able to obtain a statement from the trustees giving details of the payment and tax treated as deducted. It is based on section 352 of ICTA as it applies to payments under section 687 of ICTA.

1457. In a case where the income is treated as that of the settlor, it is the settlor rather than the recipient who will need these details. Accordingly, this section gives authority to the appropriate person to require a statement from the trustees. See *Change 90* in Annex 1.

Section 496: Income tax charged on trustees

1458. This section sets out the tax effect on the trustees of making a discretionary payment. It is based on section 687(2) of ICTA.

1459. The source legislation provides for all the tax deemed to have been deducted to be assessed on the trustees, subject to set-off under section 687(3) of ICTA (the "tax pool"). But the charge under this section is only on the amount of tax by which the amount treated as deducted exceeds the amount of the tax pool for that year. This is similar to the approach adopted in section 424 (gift aid).

Section 497: Calculation of trustees' tax pool

1460. This section sets out the calculation of the trustees' tax pool available for a tax year, in order to determine whether a charge on the trustees arises under section 496. It is based on section 687(3) of ICTA.

1461. To make the comparison in section 496, the amount of the tax pool available for a tax year is the amount at the end of the tax year (including tax going into the pool in that year) before reduction in respect of amounts of tax deemed to have been deducted from payments in the tax year. It follows that the amount of the pool available for the previous year has to be adjusted at *Step 1* for the amount of tax deemed to have been deducted in the previous year in order to arrive at the correct brought forward figure. See also the transitional provision in Part 10 of Schedule 2.

1462. *Subsections (2)* and *(3)* ensure that tax only goes into the pool if it is tax paid at a time when the trustees were UK resident. This is a corollary to trustees having to account for tax only on discretionary payments made while UK resident, See *Change 89* in Annex 1 and the commentary on section 493. It is also provided that the opening pool is nil if the settlement is established during the year.

Section 498: Types of income tax for the purposes of section 497

1463. This section sets out the types of income the tax on which goes into the tax pool. It is based on section 687(3) and (3A) of ICTA.

1464. The section streamlines many of the references to other provisions made by section 687(3) of ICTA. For example, following the amendments made by ITTOIA, section 687(3)(a2) and (aa) of ICTA are unnecessary because the sections mentioned there are within Chapter 3 of Part 4 of ITTOIA and so are already covered by section 687(3)(a1) of ICTA.

1465. Following its substitution by FA 2006, section 686A of ICTA brings together the charges on items that were previously charged at the trust rate under various separate provisions. This means that there may have been overlap between paragraph (bc) and other paragraphs of section 687(3) of ICTA and uncertainty about the amount of tax to go into the pool. That uncertainty is removed by this section.

Chapter 8: Trustees' expenses and beneficiary's income

Overview

1466. This Chapter is concerned with how trustees' expenses affect the income of a beneficiary. It has no application to discretionary payments by trustees, but relates to circumstances in which a beneficiary (and no-one else) is entitled to the whole of or a share in the income of a settlement. Such a beneficiary is often described as having an interest in possession.

1467. Much of this Chapter is new, as there is very little statutory guidance about how trustees' expenses affect the measure of a beneficiary's income. The principles set out in this Chapter are mainly derived from trust and tax law, but are well understood and have been the subject of guidance issued by HMRC. See *Change 91* in Annex 1.

Section 499: Application of Chapter

1468. This section sets out the circumstances in which the Chapter applies. It is new.

1469. The key factor is that there is a beneficiary who is entitled to some or all of the income of the trust before it is distributed.

Section 500: Restrictions on use of trustees' expenses to reduce the beneficiary's income

1470. This section sets out restrictions which apply in arriving at the amount of the trustees' expenses which are to be taken into account in measuring a beneficiary's income. It is new.

1471. *Subsection (1)* provides that expenses may be taken into account if they are incurred in the current tax year or an earlier tax year and are chargeable to a beneficiary's income in accordance with the following subsections. The critical issue is not in which year the expense is incurred, but in which year the beneficiary's income is reduced by reference to the expense. See *Change 91* in Annex 1.

1472. *Subsections (2)* and *(3)* provide that the expenses must either be chargeable to income under a term of the settlement (subject to any overriding law) or, if the deed contains no such term, they must be chargeable to income under trust law (subject to any overriding term of the settlement). See *Change 91* in Annex 1.

1473. *Subsection (4)* makes it explicit that expenses cannot be used to reduce the beneficiary's income if they have been or will be taken into account in calculating the trustees' liability to income tax for any tax year.

Section 501: Non-UK resident beneficiaries

1474. This section performs a similar function to section 487 (which applies to expenses taken into account in taxing *trustees* in receipt of accumulated or discretionary income) in providing that a proportion of expenses is to be disregarded if part of the *beneficiary's* income is untaxed income. It is based on section 689A of ICTA.

Section 502: Meaning of "untaxed income" in section 501

1475. This section defines "untaxed income" for the purposes of section 501. It is based on section 698A(1) and (5) of ICTA.

1476. The definition is the same as that in section 487(4) and (5) with beneficiary substituted for trustees.

Section 503: How beneficiary's income is reduced

1477. This section explains how trustees' expenses are taken into account in measuring a beneficiary's income. It is based on section 689B of ICTA.

1478. Trustees are liable at the normal rates on the income of the trust. The beneficiary receives income net of tax and expenses, but is entitled to the gross income after expenses. So to calculate the true measure of the beneficiary's income, the net income of each type is calculated, expenses are allowed against that income and what is left is grossed up at the normal rate for that type of income.

1479. *Subsections (1*) and *(2)* provide that, when trustees' expenses are taken into account, they reduce different types of income of the beneficiary in a particular order.

1480. *Subsection (5)*sets out the calculation in step form. See *Change 91* in Annex 1 and the overview commentary on this Chapter.

Chapter 9: Unauthorised unit trusts

Overview

1481. This Chapter provides rules about unauthorised unit trusts (UUTs).

1482. There are related sections about UUTs in Chapter 13 of Part 15. Those sections provide for the trustees to be treated as making deemed payments representing the gross amount of the income they receive. They also provide for the trustees to be treated as deducting income tax from those payments at the basic rate, and for the collection of that income tax.

Section 504: Treatment of income of unauthorised unit trust

1483. This section sets out the basis of the taxation of the trustees of a UUT. It is based on section 469(1), (2) to (2B) and (9) of ICTA.

1484. The taxable income of the trustees of a UUT is treated as that of the trustees rather than the unit holders (*subsection (2)*).

1485. All income of the trustees is to be charged at the basic rate (*subsection (3)*). The special trust rates do not apply (see *subsection (4)(a)* and section 481(1)(b)).

1486. Accordingly, certain sums that would ordinarily be treated as carrying a tax credit, or where the recipient is treated as having paid income tax, are not so treated if received by UUT trustees (*subsection (4)(b)* to *(d)*).

1487. *Subsection (5)* provides that annual payments to unit holders do not come within the special discretionary payments regime in section 494. The general provision for trustees to provide statements of tax deducted, in section 352 of ICTA, is rewritten in section 495. But the provisions concerning such statements by UUT trustees are in section 975 in Chapter 19 of Part 15, where they more naturally belong. So section 495 is also excluded by subsection (5).

Section 505: Relief for trustees of unauthorised unit trust

1488. This section gives relief to the trustees of a UUT for the payments to unit holders treated as made under Chapter 13 of Part 15. It is based on sections 348(1) and 835(6) of ICTA.

1489. The relief is given by deduction in calculating net income. This is in line with the approach adopted generally to rewriting the provisions about charges on income. See *Change 81* in Annex 1 and the overview commentary on Chapter 4 of Part 8.

1490. The relief is limited by reference to two factors:

- the case law enacted in section 450 (see the commentary on that section and *Change 82* in Annex 1); and
- the trustees' modified net income for the tax year.

Section 506: Special rules for trustees affected by section 733 of ICTA

1491. This section is based on section 733(2) of ICTA.

1492. Sections 731 to 735 of ICTA are anti-avoidance provisions. They are concerned with cases where:

- a person ("the first buyer") buys securities and subsequently sells them to someone else; and
- the first buyer becomes entitled to receive any interest payable on them.

1493. Section 733(2) of ICTA addresses the case where:

- interest is payable to the UUT trustees as the first buyer;
- that interest, or some part of it, would be exempt, but is not so, because section 733(1) of ICTA cancels the exemption; and
- the trustees of the UUT are treated as making one or more deemed payments in the same tax year as that in which the interest arises.

1494. The source legislation provides that an annual payment is to be treated as "paid out of profits or gains not brought into charge". It follows that, even though the exemption is cancelled by section 733(1) of ICTA, leaving interest in charge to income tax, the payment must not be treated as paid out of that interest.

1495. This is rewritten so that relief is only given if, and to the extent that, the trustees have "non-affected income" equal to the payment treated as made. Non-affected income is defined as modified net income less affected income. On modified net income, see the commentary on sections 448 and 1025.

1496. Because this is a rule relating to a very specific type of income, it is necessary to apply it before applying section 505(7).

Chapter 10: Heritage maintenance settlements

Overview

1497. A heritage maintenance settlement (an HMS) is a settlement that holds property ("heritage maintenance property") solely for the maintenance of, or for making provision of public access to, "qualifying property" designated under section 31 of IHTA. And the heritage maintenance property itself must be the subject of a direction under paragraph 1 of Schedule 4 to that Act.

1498. The provisions of this Chapter grant income tax benefits to complement inheritance tax benefits granted under IHTA provisions. So many of the definitions in section 507 cross-refer to IHTA provisions.

1499. "Qualifying property" is defined in paragraph 3(2) of Schedule 4 to IHTA, and includes:

- land of outstanding scenic, historic or scientific interest;
- buildings of such outstanding historical or architectural interest that special steps should be taken to preserve them, and land essential to protect the character and amenities of such buildings; and
- objects historically associated with such buildings.

1500. An HMS does not usually own the qualifying property itself. Its role is to hold the heritage maintenance property that has been settled for the purpose of maintaining the qualifying property and providing access to it. The IHTA rules specify that the heritage maintenance property must be subject to the terms of the trust for at least six years from the time it goes into the trust.

1501. An HMS may also have subsidiary purposes, such as the maintenance of property held under the trust for maintenance of the qualifying property. During the six-year period the trust must provide that any other application or devolution of income or capital outside these main and subsidiary purposes must be for the benefit of a charity with heritage purposes or a body listed in Schedule 3 to IHTA.

1502. In the absence of the rules in this Chapter, the ordinary income tax rules would apply for charging the settlors of certain settlements under Chapter 5 of Part 5 of ITTOIA. In such cases all income, and certain capital sums paid to the settlor, are charged on the settlor as income. (The nature of an HMS means that any settlor of any HMS will fall within both the definition of settlor in section 467 of this Act and the definition in section 620 of ITTOIA.)

1503. By contrast, sections 508 and 509 make it possible for the trustees of an HMS to elect, for a tax year, that:

- the income not be treated as that of the settlor; and
- any sum applied out of the heritage maintenance property not be treated as the income of an owner or occupier of the qualifying property.

1504. But the trustees may not consider it appropriate to make such an election. In such cases section 510 ensures that, if in a tax year any sum applied for a property maintenance purpose is greater than the trustees' income for that year, the settlor is not charged to tax on the excess.

1505. And, in the absence of an election, section 511 protects the settlor from double taxation if the trustees' income is applied for a property maintenance purpose through a trade carried on by the settlor and would therefore ordinarily be a receipt of that trade. The settlor is only charged under Chapter 5 of Part 5 of ITTOIA, not also on the trading receipt.

1506. The Chapter also charges the trustees to tax in cases where the conditions for property to be qualifying property, or the rules concerning the purposes of the HMS, are breached (sections 512 to 517).

Section 507: Overview of Chapter

1507. This section draws together a number of important definitions. It is based on sections 690, 691(1), 692(1), 693 and 694(1) of ICTA.

1508. "Heritage maintenance property" is defined as property to which a direction (a "heritage direction") under paragraph 1 of Schedule 4 to IHTA has effect. The property here is not the qualifying property mentioned in paragraph 3(2) of Schedule 3 to IHTA, but the property in the trust set up for the maintenance of that qualifying property.

1509. A "heritage maintenance settlement" is defined as a settlement that comprises heritage maintenance property.

1510. If there is in the settlement some property that is heritage maintenance property and some that is not, the two blocks of property are treated for the purposes of this Chapter, and for three other purposes, as being comprised in separate settlements – the "separate settlements rule".

1511. The first of those purposes relates to certain trade losses under Chapter 2 of Part 4. The source legislation refers only to sections 380 to 387 of ICTA, thus excluding sections 388 and 389 of that Act (terminal loss relief) from the operation of the rule.

1512. The second purpose of the separate settlements rule relates to sections 686 to 689B of ICTA, now rewritten in Chapters 2 to 8 of this Part.

1513. The third purpose of the separate settlements rule concerns amounts assessed on the settlor of a settlement under Chapter 5 of Part 5 of ITTOIA. The right to make an election under section 508 can therefore only apply to that part of the settlement that comprises heritage maintenance property. And the special rules about capital sums paid to the settlor (see section 633 of ITTOIA) will also apply only to that part.

Section 508: Election by trustees

1514. This section provides that the trustees of an HMS may make an election for this section to have effect for a tax year. It is based on section 691(1), (2) and (4) of ICTA.

1515. The first effect of an election is that income of the HMS is not to be treated as income of the settlor, as it otherwise would be under Chapter 5 of Part 5 of ITTOIA. So such income will be taxed on the trustees and at trust rates.

1516. The second effect is that certain sums applied from the trust are not to be treated as income of the recipients.

1517. *Subsection (4)(a)* is concerned with any person who has an interest in, or occupies, the qualifying property in respect of which the sum is applied. One example is a sum applied in repairing qualifying property when the occupier is an employee not wholly exempted from the benefit of such expenditure by section 315 of ITEPA. Another example is a sum applied in reimbursing an expense of an owner or occupier (other than the settlor, see section 511) who is carrying on a trade in respect of the qualifying property.

1518. *Subsection (4)(b)* is concerned with section 633 of ITTOIA. Under that provision a capital sum paid to the settlor is taxable on the settlor as income. But if the sum is applied for a property maintenance purpose, the effect of the election is that the sum does not form part of the settlor's income.

1519. The election is to be made to an officer of Revenue and Customs, rather than to the Commissioners for Her Majesty's Revenue and Customs. See *Change 5* in Annex 1.

1520. Accordingly, parts of section 691(4) of ICTA are no longer not necessary and are omitted. The election is one to which Schedule 1A to TMA applies, as it is not made on the trustees' self-assessment tax return. So paragraph 2(1) of that Schedule is sufficient to ensure that the election is to be made to an officer of Revenue and Customs. And paragraph 2(3) of that Schedule is sufficient to ensure that it "shall be in such form as the Commissioners may require".

Section 509: Change of circumstances during a tax year

1521. This section provides for the splitting of a tax year if there is a change of circumstances, eg if a heritage direction takes effect, or ceases to have effect, during the year. It is based on section 691(5) of ICTA.

1522. Without this provision, if a heritage direction were not in force for the full tax year, no election could be made for that year. The effect of the section is to treat each of the parts of the tax year (before and after the change of circumstances) as a separate tax year, in respect of which an election may be made.

1523. For this section to apply it must be the case, in one of the two parts of the tax year, that a heritage direction applies and the HMS income is taxable on the settlor under Chapter 5 of Part 5 of ITTOIA. In the other part of the tax year, either or both of these statements will not be true.

Section 510: Sums applied for property maintenance purposes

1524. This section addresses a particular issue where an election under section 508 has not been made, and so the income for the year is taxable on the settlor. It is based on section 691(3) of ICTA.

1525. The issue is the treatment of any sum applied for a property maintenance purpose that exceeds the income for the year. Such a sum may already have been taxed on the trustees or the settlor in past years, but it may also be subject to a charge to income tax for one or other of the reasons referred to in *subsection (2)*.

1526. This section cancels such a charge to tax on the excess. The result is that all the income of the HMS for the year is taxable on the settlor solely under Chapter 5 of Part 5 of ITTOIA. There is no other charge on any sum in excess of that income to the extent that the excess is applied for a property maintenance purpose.

Section 511: Prevention of double taxation: reimbursement of settlor

1527. This section prevents a double charge to income tax that may arise if the settlor is carrying on a trade. It is based on section 692 of ICTA.

1528. The source legislation (section 692(1) of ICTA) refers to expenditure that "is (or would apart from the reimbursement be) deductible in computing … profits". The bracketed words have been omitted from *subsection (1)(c)* because the amount reimbursed is, strictly, income of the business that is ignored in computing profits. It does not cancel the real expenditure, which in principle remains allowable.

Section 512: Charge to tax on some settlements

1529. This section makes provision for a charge to income tax on income arising to the trustees in a number of circumstances. It is based on section 694(1) and (5) of ICTA.

1530. Most of the circumstances involved (cases A to C) involve a breach of the main IHTA conditions.

1531. But no charge will arise under this section if the settlor has already been charged on the income as trust income: see section 517. This charge can, therefore, only arise if an election under section 508 has been made.

1532. Case D is an anti-avoidance provision to guard against loss of tax if a non-heritage beneficiary with a reversionary interest in property comprised in the HMS sells that interest to another heritage body (H1).

1533. The charge under this Chapter would not ordinarily arise when the property leaves the HMS on reversion, because the recipient is a heritage body or a charity. But the non-heritage person would have effectively obtained money from the heritage property.

1534. So it is provided that if, earlier or at the time, H1 (or any other heritage body) has paid monetary consideration for any interest under the settlement, a charge on the trustees will arise. But if H1 has acquired the interest from another heritage body, there is no charge.

Section 513: Income charged

1535. This section sets out the measure of the income to be charged to tax under section 512. It is based on section 694(2) and (4) of ICTA.

1536. Other than income applied for a property maintenance purpose or for the benefit of a heritage body, the charge is on all the income that has arisen from the time the HMS came into being to the occasion of charge. But if there has been a previous charge to tax under section 512, the period over which income is measured starts from the date of that previous occasion of charge. There is no credit for any other tax charge on any part of the income that has arisen over the relevant period.

Section 514: Persons liable

1537. This section provides that the persons liable for the tax under section 512 are the trustees of the HMS. It is based on section 694(4) of ICTA.

Section 515: Rate of tax

1538. This section sets out the rate at which the income charged under section 512 is to be taxed. It is based on section 694(2A) of ICTA.

1539. That rate of tax is arrived at by subtracting the trust rate from the higher rate of income tax. This applies to income of all types, including dividend income.

1540. In the particular case of dividend income, the provision does not seek to reinstate the effect of charging the settlor instead of the trustee. (Dividend income would generally be charged on an individual at the dividend upper rate, and on the trustees of the HMS at the dividend trust rate. But the difference between these rates is not necessarily the same as that between the rates referred to by this section.)

1541. From the tax year 2004-05 onwards, the trust rate has been aligned with the higher rate. So, at present, there can be no charge under section 512. But the situation could change in the future.

Section 516: Transfer of property between settlements

1542. This section addresses occasions when heritage maintenance property leaves the HMS and becomes comprised in another settlement either:

- without a charge to inheritance tax arising on the transfer; or
- when the property does not cease to be heritage property on the transfer.

It is based on section 694(6) and (7) of ICTA.

1543. The "default rule" is that inheritance tax is charged when property leaves an HMS (paragraph 8 of Schedule 4 to IHTA).

1544. But no such charge arises if, within 30 days of the property leaving the HMS, it becomes comprised in another HMS. This is because the exemption for transfers into an HMS overrules the charge when the property leaves an HMS (paragraph 9(1) and (2) of Schedule 4 to IHTA). The only exception to this is when the value of the property leaving the first HMS is greater than its value on entering the second. In that case, inheritance tax is charged on the excess (paragraph 9(4) of Schedule 4 to IHTA). But that charge is ignored in considering the effect of this section (see the words in brackets in *subsection (4)(a)*).

1545. In some circumstances, a charge to income tax under section 512 could still arise, there being, for example, no 30-day permitted period in Case B set out in section 512 to match the "permitted period" in the inheritance tax provision.

1546. *Subsection (2)* ensures that no charge to income tax arises at the time of the transfer of the property if the transfer is also exempt for inheritance tax purposes, or if the property transferred remains heritage property throughout. Instead, the amount chargeable to income tax is deferred and added to any income taxable on the trustees of the later HMS if an occasion of charge occurs.

1547. Accordingly, *subsection (3)* determines the period over which the income to be charged is measured, applying the following modifications to the provisions in section 513:

- the date of the last occasion of charge of the earlier HMS (see section 513(2)(a)) is attributed to the later HMS; and
- the date on which the earlier HMS took effect (see section 513(2)(b)) is likewise attributed to the later one.

1548. The result is that any income of any earlier HMS (however many tax-free transfers have occurred) will be charged on the chargeable settlement to the extent that it has not been subject to this charge already.

Section 517: Exemption for income treated as income of settlor

1549. This section excludes from the charge to income tax under section 512 income of the trustees that is treated as income of the settlor. It is based on section 694(3) of ICTA.

Part 10: Special rules about charitable trusts etc

Overview

1550. This Part contains rules specific to charitable trusts. It is based mainly on sections 505 to 506C of, and Schedule 20 to, ICTA, section 25 of FA 1990 and section 46 of FA 2000.

Section 518: Overview of Part

1551. This section sets out the scope of the Part and provides signposts to rules about the tax treatment of gifts made to charitable trusts, exemptions from charges to tax under ICTA or ITTOIA, and the restrictions on when exemptions can apply. It is new.

1552. The exemptions for various types of income received by charitable trusts are set out following (so far as relevant) the order in which the types of income concerned are set out in ITTOIA. This order is also followed in Part 4 of this Act (loss relief).

1553. The exemptions are effected by saying that the "income is not taken into account in calculating total income". The expression "no liability to income tax arises" (used in Part 6 of ITTOIA, where it is supported by section 783(1) of that Act) would go too far in relation to the exemptions provided in this Part as it may be necessary to have regard to the income for certain income tax purposes.

Section 519: Meaning of "charitable trust"

1554. This section defines "charitable trust" for the purposes of this Part. It is based on section 506(1) of ICTA.

1555. The effect of splitting the source legislation between income tax and corporation tax is that the income tax rules apply only to charities constituted in the form of trusts. Schedule 1 to this Act accordingly makes appropriate consequential amendments to the rules (eg in ICTA) relating to charitable companies.

1556. The definition of charitable trust does not include anything coming within the definition of "company" in section 832(1) of ICTA, so charities constituted as unincorporated associations and charities incorporated by Royal Charter are excluded from the definition of "charitable trust".

Section 520: Gifts entitling donor to gift aid relief: income tax treated as paid

1557. This section specifies that charitable trusts receiving gift aid donations from individuals are treated as receiving a grossed up amount, and that the tax treated as deducted from the gift is treated as paid by the charitable trust. It is based on section 25(10) and (12) of FA 1990.

1558. This paves the way for section 521. In particular, it is what enables charitable trusts to recover income tax treated as deducted by individual donors in cases where the gift is chargeable but exempt (which is normally the case). It also means that, in a case where the gift is chargeable and not exempt, that this income tax is available to be set against any liability.

Section 521: Gifts entitling donor to gift aid relief: income tax liability and exemption

1559. This section sets out the charge to tax that can arise on gift aid payments received by a charitable trust. It is based on section 505(1) of ICTA and section 25(10) and (12) of FA 1990.

1560. This section imposes a freestanding charge to income tax on gift aid payments, unlike the source legislation which operates by treating the gifts as annual payments. It also sets out the exemption which will normally apply if the charitable trust uses the gifts for charitable purposes.

Section 522: Gifts of money from companies: income tax liability and exemption

1561. This section sets out the charge to tax that can arise on gifts made by companies to a charitable trust. It is based on section 339(4) of ICTA.

1562. This section imposes a freestanding charge to income tax on gifts, unlike the source legislation which operates by treating the gifts as annual payments. It also sets out the exemption which will normally apply if the charitable trust uses the gifts for charitable purposes.

1563. Companies have no obligation to deduct income tax from qualifying donations (as defined in section 339 of ICTA), which are treated as charges on income. This section, like the source legislation, is silent about the consequences of the payment of a gift which is not a qualifying donation by a company to a charitable trust.

Section 523: Payments from other charities: income tax liability and exemption

1564. This section imposes a charge to tax on certain payments made by a charity to a charitable trust, to prevent charities avoiding the operation of the restrictions on exemptions by routeing non-charitable expenditure through other charities. It is based on section 505(1) to (2) of ICTA.

1565. This section imposes a freestanding charge to income tax on payments, unlike the source legislation which operates by treating the payments as annual payments. It also sets out the exemption which will normally apply if the charitable trust uses the payments for charitable purposes.

1566. *Subsection (6)* makes it clear that section 494, which is based on section 687 of ICTA and deals with the grossing up of discretionary payments from trusts, takes precedence over this section where applicable.

Section 524: Exemption for profits etc of charitable trades

1567. This section sets out the exemption for trading profits of charitable trusts. It is based on section 505(1) of ICTA.

1568. The exemption applies only if the trade is a charitable trade. This is defined in section 525.

1569. This section makes it clear that adjustment income (arising from a charitable trade) is exempt, in line with practice. Adjustment income is defined by reference to ITTOIA. See *Change 92* in Annex 1.

1570. This section also makes it clear that post-cessation receipts (arising from what was a charitable trade) are exempt, in line with practice. Post-cessation receipt is defined by reference to ITTOIA. See *Change 92* in Annex 1.

1571. *Change 92* also affects sections 525, 526, 531 and 539.

1572. Exemptions for small-scale trades are dealt with separately in section 526.

Section 525: Meaning of "charitable trade"

1573. This section defines the meaning of "charitable trade" for the purposes of the previous section. It is based on section 505(1) and (1B) of ICTA.

1574. The main rule, in *subsection (1)*, is that the trade must be exercised in the course of carrying out a primary purpose trade of the charitable trust, ie that it must form part of the primary purposes of the trust, as set out in the trust deed or other governing document. Or that the work in connection with the trade must be mainly carried on by beneficiaries of the charitable trust.

1575. The source legislation in section 505(1)(e) of ICTA refers to the trade being carried on "in the United Kingdom or elsewhere", and section 505(1)(e)(i) refers to it being exercised in the "actual" carrying out of a primary purpose. The words in inverted commas have been omitted as they add nothing.

1576. S*ubsection (4)*, about making apportionments where different parts of a trade are treated as separate trades, makes specific mention of adjustment income and post-cessation receipts. See *Change 92* in Annex 1 and the commentary on section 524.

1577. Any apportionments must be "just" as well as "reasonable", as in the source legislation. See *Change 93* in Annex 1.

Section 526: Exemption for profits etc of small-scale trades

1578. This section provides an exemption for trading income, adjustment income and post-cessation receipts in circumstances where the amount of income which can be exempted under this section and the next is small, and provided the income is applied to the purposes of the charitable trust. It is based on section 46 of FA 2000.

1579. The exemption provided by this section applies only if the income is not otherwise exempt. So profits from primary purpose trading (including related adjustment income and post-cessation receipts) are exempt under section 524, whereas profits from a non-primary purpose trading activity (including related adjustment income and post-cessation receipts) may be exempt under this section.

1580. The section provides a statutory exemption for adjustment income. See *Change 92* in Annex 1 and the commentary on section 524.

1581. The source legislation restricts the exemption to income from trades carried on wholly or partly in the United Kingdom. This restriction has been dropped. See *Change 94* in Annex 1.

1582. The condition about the level of the income is in section 528.

Section 527: Exemption from charges under provisions to which section 1016 applies

1583. This section provides an exemption for certain miscellaneous income and gains arising to a charitable trust and applied to the purposes of the charitable trust. It is based on section 46 of FA 2000.

1584. The types of miscellaneous income and gains which can come within the terms of this exemption are defined by reference to section 1016. They are broadly those items which were Schedule D Case VI income before the enactment of ITTOIA.

1585. *Subsection (2)* specifies particular types of income and gains which cannot benefit from the exemption.

1586. The exemption provided by this section only applies if the income or gains are not otherwise exempt. So, for example, post-cessation primary purpose trading receipts and interest are exempt under sections 524 and 532 respectively and post-cessation trading receipts from a non-primary purpose trading activity are exempt under section 526. But profits from the disposal of know-how or the sale of patent rights may be exempt under this section.

1587. The condition about the level of the income and gains is in section 528.

Section 528: Condition as to trading and miscellaneous incoming resources

1588. This section sets out the condition about the level of trading and miscellaneous incoming resources that has to be met if the exemptions in sections 526 or 527 are to be available. It is based on section 46 of FA 2000.

1589. The condition operates by reference to the incoming resources associated with the trading activity and miscellaneous transactions whose profits are not exempt under sections 524, 529, 530, 531 or 536. The expression "incoming resources" is used instead of "gross income" because this accounting term is a more direct and accessible way of capturing the meaning of the income labelled "gross income" in the source legislation. There are also related points of clarification. See *Change 94* in Annex 1.

1590. Trading incoming resources and miscellaneous incoming resources are defined in *subsections (2)* and *(4)* respectively. Incoming resources relating to trading activities are determined for a basis period for a tax year, since the profits (or losses) of the trade are taxable by reference to basis periods. Incoming resources relating to miscellaneous transactions, and to other non-trading items or activities, are determined by reference to tax years.

1591. The requisite limit is given in *subsection (6)*.

1592. Where basis periods or tax years do not correspond to periods of account, incoming resources are to be apportioned on a time basis, or on any other basis that is reasonable in the circumstances. For the purpose of the comparison required in *subsection (6)(a)*, the total incoming resources for a tax year comprise the incoming resources from trading activities for the relevant basis period for the tax year and the incoming resources from all other sources for the tax year.

Section 529: Exemption for profits from fund-raising events

1593. This section gives statutory effect to ESC C4 as it applies to charitable trusts and provided the profits are applied to the purposes of the charitable trust. It is new.

1594. The ESC deals with fund-raising events arranged by voluntary organisations or charities and applies if the profits are transferred to charities or otherwise applied for charitable purposes. In the context of charitable trusts, any such transfer or application would have to fall within the scope of the overall purposes of the trust.

1595. The fund-raising event has to fall within the exemption from VAT under Group 12 of Schedule 9 to the Value Added Tax Act 1994. That Schedule provides an exemption from VAT for the supply by a charity of goods and services in connection with an event that is organised primarily to raise money for itself or other charities. The Schedule defines "event" and places certain limits on the number of events that a charity can hold in the same location in any given year.

1596. See *Change 95* in Annex 1. This change also affects section 539.

Section 530: Exemption for profits from lotteries

1597. This section provides an exemption for lottery income provided the income is applied to the purposes of the charitable trust. It is based on section 505(1) of ICTA.

Section 531: Exemption for property income etc

1598. This section sets out the exemption from income tax for property income and certain trading income arising from land, provided the income is applied to charitable purposes. It is based on section 505(1) of ICTA.

1599. The exemption applies where income is chargeable to tax under Part 2 of ITTOIA as a result of section 261 of that Act, and provided the income is applied to charitable purposes.

1600. Income chargeable to tax under Part 2 of ITTOIA means profits of a trade, adjustment income and post-cessation receipts. This means that the section includes an exemption for adjustment income, and for post-cessation receipts, in line with practice. See *Change 92* in Annex 1 and the commentary on section 524.

1601. There is no requirement for the trade to be exercised in the course of carrying on a primary purpose of the charitable trust. But *subsection (1)* specifies that the income must be chargeable under Part 2 of ITTOIA, rather than Part 3, as a result of section 261 of that Act.

1602. This makes the effect of the source legislation in section 505(1)(a) of ICTA, as amended by ITTOIA, explicit. There is no other income arising from land and chargeable to tax under Part 2 of ITTOIA which is exempt under that provision.

1603. The exemption also refers to Part 3 of ITTOIA, rather than referring to profits or gains arising in respect of rents or other receipts from an estate, interest or right in or over land, to reflect the fact that such income is charged by ITTOIA as the profits of a property business.

1604. The reference to Part 3 of ITTOIA means that the section provides an exemption from income tax for adjustment income of UK property businesses, provided the income is applied to charitable purposes. See *Change 92* in Annex 1. See also the commentary on section 524.

1605. The reference to Part 3 of ITTOIA also makes it explicit that the section provides an exemption from income tax for post-cessation receipts of UK property businesses, provided the income is applied to charitable purposes.

1606. *Subsection (2)(b)* requires that the estate, interest or right in or over land is vested in a person in trust for a charitable trust or for charitable purposes. A charitable trust has no legal personality and cannot hold land itself, so the land belonging to a charitable trust must be vested in the names of the trustees, or of another person (eg a nominee for the trustees). Hence the reference to the estate, interest or right being vested in any person.

1607. The exemption applies where the income derives from land vested in trust for a charitable trust or for charitable purposes. But if some of the land is vested in trust for charitable purposes and some vested or held for other purposes (for example, as an investment to generate income for non-charitable purposes) it is necessary to allocate the profits of the single property business between the two parts. This reflects the approach of the exemption in the source legislation that looks to particular interests in land, rather than to one overall property business.

Section 532: Exemption for savings and investment income

1608. This section sets out the various categories of savings and investment income that qualify for exemption from income tax, provided the income is applied to charitable purposes. It is based on section 505(1) of ICTA.

1609. The precise terms of the section draw significantly on the consequential amendments made to section 505 of ICTA by ITTOIA.

1610. In s*ubsection (1)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

Section 533: Exemption for public revenue dividends

1611. This section provides an exemption for public revenue dividends used for the repair of certain places of worship. It is based on section 505(1) and (1A) of ICTA.

Section 534: Exemption for transactions in deposits

1612. This section provides an exemption for profits arising from transactions in certificates of deposit, and for transactions in deposit rights where there is no certificate but the person entitled to the right can call for the issue of a certificate. It is based on sections 56(3) and 56A(1), (3) and (4) of ICTA.

1613. The Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003 (SI 2003/1633) provides for "eligible debt securities", which are securities held in a dematerialised system. A paper certificate cannot be issued in respect of these securities. The statutory instrument assimilates these, in the Tax Acts, to certificates of deposit. This section makes explicit the treatment of these eligible debt securities.

1614. *Subsection (2)* specifies that the exemption applies to the extent that profits or gains are applied to charitable purposes.

Section 535: Exemption for offshore income gains

1615. This section provides an exemption for a gain on the disposal of a material interest in a non-qualifying offshore fund, provided the gain is applied to charitable purposes. It is based on section 761(6) of ICTA.

1616. Details of offshore funds can be found in Chapter 5 of Part 17 of ICTA. Section 761(6B) of ICTA is inserted by Schedule 1 to this Act.

Section 536: Exemption for certain miscellaneous income

1617. This section provides an exemption for certain categories of miscellaneous income from income tax, provided the income is applied to charitable purposes. It is based on section 505(1) and (1AA) of ICTA.

1618. The precise terms of the section draw significantly on the consequential amendments made by ITTOIA.

1619. In s*ubsection (1)(b)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

1620. *Subsection (3)(a)* and *(b)* specify that royalties and other income from intellectual property and income from relevant telecommunication rights, where such income is not taxable as profits of a trade, are eligible for exemption. This is a change from the source legislation in that such income was only exempt if it came within the definition of annual payments. See *Change 96* in Annex 1.

Section 537: Exemption for income from estates in administration

1621. This section provides an exemption for estate income received by the trustees of a charitable trust provided the income is applied to the purposes of the charitable trust. It is new.

1622. Estate income is income from property held by the personal representatives of the estate of a deceased person on behalf of the beneficiaries of the estate. The personal representatives are liable to income tax on the income. The exemption provided by this section allows the trustees of a charitable trust to recover any income tax suffered by the personal representatives. See *Change 97* in Annex 1.

Section 538: Requirement to make claim

1623. This section provides that in general a claim is necessary for an exemption. It is based on sections 56(3), 505(1) and 761(6) of ICTA, section 46(1) of FA 2000 and section 83(4) of FA 2004.

1624. Claims are made either as required during the tax year, eg to secure repayments of income tax treated as paid in relation to gift aid payments, or in a self-assessment return. The need to make a claim ensures that there is a mechanism for appeals in the event of any dispute about the availability or amount of any exemption.

1625. The self-assessment procedure means that a charitable trust only needs to complete a tax return, and make the associated claims, if the charitable trust is chargeable to tax or is required to do so by HMRC.

1626. The reference in section 505(1) of ICTA to claims being to the Board of Inland Revenue has been changed. Claims will simply be to an officer of Revenue and Customs. See *Change 5* in Annex 1, which also affects sections 542, 551, 554, 557, 558 and 561. One effect of a claim being made to the Board is that appeals are to the Special Commissioners. This is maintained by means of an amendment to section 46C of TMA.

1627. *Subsection (3)* provides that where an individual makes a direction in a self-assessment return for a tax repayment to be paid as a gift to a charitable trust, the trustees are treated as having made a claim. See section 429 and the commentary on that section.

Section 539: Restrictions on exemptions

1628. This section restricts exemptions where income of a charitable trust is attributed to non-charitable expenditure. It is based on section 505(4) of ICTA.

1629. A number of the exemptions have been extended to treat adjustment income and post-cessation receipts as exempt. As a result the restrictions apply to the extended exemptions. See *Change 92* in Annex 1 and the commentary on section 524.

1630. A statutory exemption has been introduced for profits of fund-raising events. The restrictions apply to this exemption. See *Change 95* in Annex 1 and the commentary on section 529.

1631. A statutory exemption has also been introduced for income from estates in administration. The restrictions apply to this exemption. See *Change 97* in Annex 1 and the commentary on section 537.

Section 540: The non-exempt amount

1632. This section specifies how the non-exempt amount is calculated. It is based on section 505(3) and (4) of ICTA.

1633. The term “attributable income and gains” is defined in *subsection (3)*. This label replaces “relievable income and gains” as defined in section 505(3) of ICTA.

1634. *Subsection (5)* specifies that section 256(4) of TCGA is to be ignored in applying subsection (3)(b). Section 256 of TCGA provides the exemption from capital gains tax for certain gains accruing to a charity. Schedule 1 to this Act amends section 256, adding subsections (3) to (5). Schedule 1 also inserts sections 256A and 256B, to deal with the interaction between income tax and capital gains tax as regards attributing income and gains to the non-exempt amount.

Section 541: Attributing income to the non-exempt amount

1635. This section specifies how income is attributed to the non-exempt amount. It is based on section 505(4) and (7) of ICTA.

1636. It specifies that the non-exempt amount is to have attributed to it amounts of attributable income or amounts of attributable gains or a combination of both, until it is used up.

Section 542: How income is attributed to the non-exempt amount

1637. This section specifies that the charitable trust can decide the attribution of attributable (exempt) income or chargeable gains to the non-exempt amount, to determine which items of otherwise exempt income or chargeable gains should be treated as taxable. It is based on section 505(7) of ICTA.

1638. Where the restrictions apply, an amount of income (or chargeable gains) equal to the non-exempt amount (of expenditure) must be identified (as calculated in accordance with the previous section) in order to enable the charitable trust to complete its tax return and self-assess its tax liability. This section provides the mechanism for the charitable trust to specify the items or elements of income (such as trading income or investment income) which lose the benefit of exemption.

1639. But if the charitable trust has not provided the attribution within a period of 30 days from the day of a request for a specification of the attribution, an officer of Revenue and Customs can decide the attribution. References to "the Board" have been replaced with "an officer of Revenue and Customs". See *Change 5* in Annex 1 and the commentary on section 538.

Section 543: Meaning of "non-charitable expenditure"

1640. This section defines "non-charitable expenditure". It is based on sections 506 and 506A of ICTA.

1641. Section 506(1) of ICTA contains a definition of "charitable expenditure". But neither expenditure itself nor "non-charitable expenditure" are defined explicitly. This section sets out the definition in some detail, to reflect practice and HMRC guidance. See *Change 98* in Annex 1, which also affects sections 544 and 545.

Section 544: Section 543: supplementary

1642. This section applies relevant material located elsewhere (eg rules for computing trading losses and about basis periods) and provides interpretative material. It is new. See *Change 98* in Annex 1.

Section 545: Section 543(1)(f): meaning of expenditure

1643. This section provides interpretative material about the meaning of "expenditure". It is new. See *Change 98* in Annex 1.

1644. *Subsection (1)* makes it clear that "expenditure" includes expenditure on the acquisition of capital assets. But expenditure on assets qualifying for capital allowances is taken account of in determining, for example, a trading loss and so is not included in expenditure within section 543(1)(f).

Section 546: Section 543(1)(f): tax year in which certain expenditure treated as incurred

1645. This section specifies the tax year to which expenditure relating to commitments (whether or not contractual in nature) that have been entered into is to be allocated for the purpose of operating the restrictions. It is based on section 506(2) of ICTA.

1646. This rule has been rewritten in terms which make explicit reference to United Kingdom generally accepted accounting practice. See *Change 99* in Annex 1.

Section 547: Section 543(1)(f): payment to body outside the UK

1647. This section provides interpretative material about payments to a body situated outside the United Kingdom. It is based on section 506(3) of ICTA.

1648. The section makes it clear that the onus is on the trustees of the charitable trust to ensure that any payments to a body outside the United Kingdom are applied for charitable purposes. Otherwise the charitable trust must classify the payments as "non-charitable expenditure".

Section 548: Section 543(1)(i) and (j): investments and loans

1649. This section provides interpretative material about the making of investments or loans. It is based on section 506(5) of ICTA.

1650. The section makes it clear that it is only the expenditure in the tax year on making new investments and loans, or expenditure to fund net increases in such investments or loans, that is included in the calculation of non-charitable expenditure.

Section 549: Transactions with substantial donors

1651. This section defines "substantial donor transaction" and explains when a person is a substantial donor to a charitable trust. It is based on sections 506A(1) and (2) and 506C(3) of ICTA.

1652. Under *subsection (2)(a)* a person giving £25,000 or more in a period of 12 months will be a substantial donor for up to three consecutive tax years.

1653. Under *subsection (2)(b)* a person giving £100,000 or more in a period of six years will be a substantial donor for up to 13 consecutive tax years.

1654. In either case,*subsection (3)* means that the person is also a substantial donor for the five tax years following the last of those consecutive tax years.

1655. It should be noted that references to a charitable trust include connected charities (see section 556) and that references to a substantial donor include persons connected with the donor (see section 557(1)(a)).

Section 550: Meaning of "relievable gift"

1656. This section includes details of the sources of gifts that are "relievable gifts" for the purposes of the preceding section. It is based on section 506C(1) of ICTA.

Section 551: Non-charitable expenditure in substantial donor transactions

1657. This section specifies that certain amounts relating to substantial donor transactions are to be treated as non-charitable expenditure. It is based on sections 506A(3) to (5) and 506C(2) and (6) of ICTA.

1658. The source legislation specifies that certain matters are to be determined by the Commissioners for Her Majesty's Revenue and Customs. References to "the Commissioners for Her Majesty's Revenue and Customs" have been replaced with references to "an officer of Revenue and Customs". See *Change 5* in Annex 1, which also affects sections 554 and 557. The source legislation specifies that, on an appeal against an assessment, the Special Commissioners may review a decision of the Commissioners, so section 557 specifies that the Special Commissioners may affirm or replace a decision of an officer.

Section 552: Adjustment if section 551(1) and (2) applied to single transaction

1659. This section makes it clear that there can be no double counting. It is based on section 506C(4) of ICTA.

Section 553: Section 551: certain payments and benefits to be ignored

1660. This section provides that payments or benefits arising from transactions, relating to gift aid donations made by individuals or qualifying donations by companies, are to be ignored if they do not disqualify the donations concerned from relief. It is based on section 506B(7) of ICTA.

Section 554: Transactions: exceptions

1661. This section specifies exceptions to the transactions caught by section 549. It is based on section 505B of ICTA.

1662. In particular, the section carves out of the substantial donor provisions transactions of an ordinary commercial nature.

1663. References to "the Commissioners for Her Majesty's Revenue and Customs" and "the Commissioners" have been replaced with references to "an officer of Revenue and Customs". See *Change 5* in Annex 1 and the commentary on section 551.

Section 555: Donors: exceptions

1664. This section specifies exceptions to the donors caught by section 549. It is based on section 506B(8) and (9) of ICTA.

1665. *Subsection (1)* concerns companies set up by charitable trusts, for example to carry on trading activities as a means of generating funds.

1666. *Subsection (2)* concerns registered social landlords and housing associations, which often share services and accommodation with charities as a means of meeting charitable and non-charitable objectives, through complex group structures.

Section 556: Connected charities

1667. This section extends, for the purposes of sections 549 to 555, the meaning of "charitable trust" to include charities connected with the charitable trust. It is based on section 506C(5) of ICTA.

Section 557: Substantial donor transactions: supplementary

1668. This section provides interpretative material for sections 549 to 555. It is based on section 506C(7) to (9) of ICTA.

1669. References to "the Commissioners" have been replaced with references to "an officer of Revenue and Customs". See *Change 5* in Annex 1 and the commentary on section 551.

Section 558: Approved charitable investments

1670. This section sets out which investments, including loans made by way of investment, count as approved charitable investments for the purposes of the rules restricting exemptions. It is based on Schedule 20 to ICTA.

1671. The label "approved charitable investments" replaces the label "qualifying investments" in section 506(4) of ICTA.

1672. Paragraph 2 of Schedule 20 to ICTA specifies investments falling within Schedule 1 to the Trustee Investment Act 1961 (TIA 1961) as approved, with a small exception. For trust law purposes TIA 1961 has been largely superseded by the Trustee Act 2000 (TA 2000). So the detail of investments covered by Schedule 1 to TIA 1961 has been incorporated into the sections in a more succinct and updated form, removing the need to refer to a Schedule to an Act (TIA 1961) that trustees no longer need to refer to for investment purposes. See *Change 100* in Annex 1. This affects this section, section 559 and section 560.

1673. The reference to securities traded on the Unlisted Securities Market has been deleted as obsolete, because the Unlisted Securities Market ceased trading in December 1996.

1674. Investments can qualify as approved charitable investments if, despite not falling into any of the specified types not requiring a claim, a claim is made and it is accepted by HMRC. In order to be accepted, the claimant must show that the investment has been made for the benefit of the charitable trust and has not been made for the avoidance of tax.

1675. Investments include loans made by way of investment. And although not explicitly stated, such a loan would include a loan secured by a mortgage over land.

1676. The source legislation includes a reference in paragraph 7(2) of Schedule 20 to ICTA to an "authorised institution" – which in the context of that paragraph clearly means a "bank". In fact "authorised institution" was amended to read "bank" in paragraph 7(1) by Schedule 37 to FA 1996, but was not amended in paragraph 7(2). This was an oversight and is corrected here.

1677. In *Type 4*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

1678. References to "the Board" have been replaced with "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 559: Securities which are approved charitable investments

1679. This section sets out details of which investments in securities count as approved charitable investments for the purposes of the rules restricting exemptions. It is based on Schedule 20 to ICTA and Schedule 1 to TIA 1961.

1680. The detail of investments covered by Schedule 1 to TIA 1961 have been incorporated into these sections in a more succinct and updated form. See *Change 100* in Annex 1 and the commentary on section 558.

Section 560: Conditions to be met for some securities

1681. This section sets out details of certain conditions which some of the securities specified in the previous section have to meet to count as approved charitable investments for the purposes of the rules restricting exemptions. It is based on Schedule 1 to TIA 1961.

1682. The detail of the investments covered by Schedule 1 to TIA 1961 is incorporated into these sections in a more succinct and updated form. See *Change 100* in Annex 1 and the commentary on section 558.

1683. *Subsection (8)* specifies (among other things) that a company acquiring control of another company or other companies is treated as having paid a dividend or dividends paid by the other company or companies. The effect of including this provision (rather than cross-referring to a provision in TIA 1961) is that "control" needs to be defined. Consequently the definition of "control" in section 995 applies for the purposes of this subsection. See *Change 100* in Annex 1.

Section 561: Approved charitable loans

1684. This section sets out which loans (not being made by way of investment) count as approved charitable loans for the purposes of the rules restricting exemptions. It is based on Schedule 20 to ICTA.

1685. The label "approved charitable loans" replaces the label "qualifying loans" in section 506(4) of ICTA.

1686. References to "the Board" have been replaced with references to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 562: Excess expenditure treated as non-charitable expenditure of earlier years

1687. This section treats "excess expenditure" in a tax year as non-charitable expenditure for earlier tax years. It is based on section 505(3) and (5) of ICTA.

1688. The "excess expenditure" is the amount of the non-charitable expenditure of the year in excess of the available income and gains of the tax year.

1689. The term "available income and gains" is defined in *subsection (4)*. This label replaces "total income and gains" as defined in section 505(3) of ICTA.

Section 563: Rules for attributing excess expenditure to earlier years

1690. This section specifies the earlier tax years to which the excess expenditure is to be attributed, later years taking priority to earlier ones. It is based on section 505(5) and (6) of ICTA.

1691. The amount of excess expenditure that can be attributed to the year 2005-06 or earlier years cannot exceed the amount that would have been attributed if the change in the method of calculating excess expenditure resulting from section 55 of FA 2006 had not been introduced. See the transitional provision in Part 11 of Schedule 2.

Section 564: Adjustments in consequence of section 562

1692. This section then specifies that any necessary adjustments (eg to tax, interest etc) for earlier years may be made. It is based on section 505(5) of ICTA.

Part 11: Manufactured payments and repos

Overview

1693. This Part contains provisions about sale and repurchase arrangements, stock lending and other transactions in the financial markets giving rise to manufactured payments. It is based on sections 231AA, 231AB, 730A, 730B and 736B to 737E of, and Schedule 23A to, ICTA.

Chapter 1: Introduction

Section 565: Overview of Part

1694. This section gives an overview of the Part. It is new.

1695. The remaining sections of this Chapter explain some important terms which are used in the same sense throughout this Part.

Section 566: Meaning of "UK shares" and "UK securities"

1696. This section defines "UK shares" and "UK securities". It is based on sections 737B and 737C of, and paragraph 1 of Schedule 23A to, ICTA.

1697. This Part uses the label "UK shares" for income tax purposes instead of the label "United Kingdom equities" given in paragraph 1 of Schedule 23A to ICTA, as the definition includes preference shares. The label "United Kingdom equities" is retained in Schedule 23A for corporation tax purposes.

Section 567: Meaning of "overseas securities" and "overseas dividend"

1698. This section defines "overseas securities" and "overseas dividend". It is based on sections 737B and 737C of, and paragraph 1 of Schedule 23A to, ICTA.

Section 568: Meaning of "stock lending arrangement"

1699. This section defines "stock lending arrangement". It is based on sections 231AA and 736B of ICTA and sections 263B and 263C of TCGA.

Section 569: Meaning of "repo"

1700. This section defines "repo". It is based on sections 231AA, 231AB, 730A, 730B, 737B and 737E of, and paragraph 1 of Schedule 23A to, ICTA.

Section 570: Meaning of "buying back" securities etc.

1701. This section provides the meaning of the expression "buying back" securities. It is based on sections 730B, 737B and 737E of ICTA.

Section 571: Meaning of "related" agreements

1702. This section explains when agreements are "related". It is based on sections 730B, 737B and 737E of ICTA.

Chapter 2: Manufactured payments

Overview

1703. This Chapter is concerned with the treatment of manufactured payments, in particular:

- the taxability of manufactured payments in the hands of the recipient (or, if different, the owner);
- tax relief for the payer of manufactured payments; and
- taxes management.

1704. The detailed structure of the Chapter is as follows:

- Section 572 - overview of the Chapter;
- Sections 573 to 577 - manufactured dividends on UK shares;
- Sections 578 to 580 - manufactured interest on UK securities;
- Sections 581 and 582 - manufactured overseas dividends (MODs);
- Sections 583 to 585 - special cases;
- Sections 586 to 588 - general regulation-making powers;
- Sections 589 to 591 - minor definitions which apply to this Chapter.

1705. Manufactured payments will normally arise under stock loan and repo agreements, but they may also occur if there has been a short sale of securities. A short sale is a sale of securities by someone who does not own the securities at the time of selling them, so is required to acquire them at a time between the date of the bargain and the date when the seller has to deliver them to the purchaser. Dealers may sell short for a variety of reasons. For example, dealers may expect the market price of the securities to fall between the time of the sale bargain and the time at which they expect to buy and so may choose to delay acquiring securities.

1706. A consequence of short selling can be that the dealer sells the securities cum-div (with dividend) but buys them ex-div (without dividend – leaving the right to the next dividend with the seller). The dealer pays the buyer a sum as compensation for the dividend that the buyer expected to receive, but did not. This sum is a manufactured payment.

1707. Many of the detailed rules, especially as regards MODs, are laid down in regulations. The Act does not rewrite any of these regulations.

Section 572: Overview of Chapter

1708. This section provides an overview of the Chapter. It is new.

Section 573: Manufactured dividends on UK shares

1709. This section defines "manufactured dividend" and states how the Income Tax Acts apply in the circumstances set out in the section. It is based on paragraphs 2(1) to (3) and 2A(1) of Schedule 23A to ICTA.

1710. For income tax purposes, *subsection (2)* treats the manufactured dividend in the hands of the recipient (or, if different, the owner of the manufactured dividend) as if it was a real dividend on the UK shares.

1711. *Subsections (1)* and (2) together ensure that if an income tax payer claims title to the manufactured dividend through or under a recipient (such as a nominee), the manufactured dividend is still treated for income tax purposes as if it was a real dividend even if the recipient is not an income tax payer.

1712. *Subsections (3)* and *(4)* deal with the position of the payer. Subsection (4) is subject to sections 574 and 575 (allowable deductions).

Section 574: Allowable deductions: matching

1713. This section details the special rules on deductibility of manufactured dividends for the payer which are referred to in section 573(4). It is based on paragraphs 2A(1) to (1A) and (4) of Schedule 23A to ICTA.

1714. The effect of the full-out words at the end of *subsection (2)* and *subsection (3)(a)* is that the general rules on income tax relief take priority. To the extent that the manufactured dividend is deductible as a trading expense, for example, it is not deductible under sections 574 and 575.

1715. *Subsection (3)(b)* restricts the extent to which a deduction is allowable under subsection (2). The amount mentioned in subsection (2) is allowable to the extent that it is matched with a dividend-type receipt or with deemed interest on a repo under *subsection (4)* or *(7)* respectively.

Section 575: Allowable deductions: restriction on double-counting

1716. This section prevents double relief. It is based on paragraph 2A(1B) of Schedule 23A to ICTA.

Section 576: Manufactured dividends on UK shares: Real Estate Investment Trusts

1717. This section deals with manufactured dividends (manufactured property income dividends or MPIDs) which are representative of dividends (property income dividends or PIDs) paid by Real Estate Investment Trust companies or by principal companies of Real Estate Investment Trust groups. It is based on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

1718. This section treats the MPID in the hands of the recipient (or, if different, the owner of the MPID) as if it was a real property income dividend. And it ensures that if an income tax payer claims title to the MPID through or under a recipient (such as a nominee), the MPID is still treated for income tax purposes as if it was a real PID even if the recipient is not an income tax payer.

1719. A dividend may be partly but not wholly a PID. *Subsection (2)* therefore provides that the section applies only so far as the manufactured dividend is representative of a PID.

Section 577: Statements about manufactured dividends

1720. This section imposes an obligation on the payer of a manufactured dividend to give the recipient a statement setting out information which may be relevant for tax purposes. It is based on paragraph 2(6) to (8) of Schedule 23A to ICTA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

1721. The application of section 577 will depend on the tax status of the payer of a manufactured dividend, rather than that of the recipient. Under *subsection (1)*, section 577 will apply only if the payer is within the charge to income tax. If the payer is within the charge to corporation tax, corresponding obligations will be imposed by paragraph 2(6) to (8) of Schedule 23A to ICTA or (by virtue of paragraph 2(2) of that Schedule) section 234A of that Act. These provisions are signposted in *subsection (8)*.

1722. *Subsection (2)* disapplies the provisions of this section so far as the manufactured dividend is an MPID. *Subsection (9)* gives a signpost to the power to make regulations concerning statements about MPIDs.

Section 578: Manufactured interest on UK securities

1723. This section deals with the income tax treatment of persons receiving or paying manufactured interest on UK securities. It is based on paragraph 3(1), (2) and (3) of Schedule 23A to ICTA.

1724. *Subsection (1)* defines "manufactured interest" and states when the section applies.

1725. For income tax purposes, *subsection (2)* treats the manufactured interest in the hands of the recipient (or, if different, the owner of the manufactured interest) as if it was a real payment of interest on the UK securities.

1726. Subsections (1) and (2) together ensure that if an income tax payer claims title to the manufactured interest through or under a recipient (such as a nominee), the manufactured interest is still treated for income tax purposes as if it was a real payment of interest even if the recipient is not an income tax payer.

1727. *Subsection (3)* deals with the position of the payer. It is subject to sections 579 and 580 (allowable deductions).

Section 579: Allowable deductions: matching

1728. This section details the special rules on deductibility of manufactured interest for the payer which are referred to in section 578. It is based on paragraph 3(2), (2A) and (10) of Schedule 23A to ICTA.

1729. The effect of the closing words of *subsection (2)* and *subsection (3)(a)* is that the general rules on income tax relief take priority. To the extent that the manufactured interest is deductible as a trading expense, for example, it is not deductible under this section.

1730. *Subsection (3)(b)* restricts the extent to which a deduction is allowable under subsection (2). The amount mentioned in subsection (2) is allowable to the extent that it is matched with an interest-type receipt, with a taxable amount under Chapter 2 of Part 12 (accrued income profits), or with deemed interest under a repo under *subsection (4)*, *(6)* or *(7)* respectively.

1731. Paragraph 3(2) of Schedule 23A to ICTA, so far as relevant, provides that "the manufactured interest shall be treated, *except in determining whether it is deductible*, as if it were an annual payment". As explained in the commentary on section 919, this Act does not continue the annual payment pretence and the italicised words have therefore not been rewritten.

1732. *Subsections (6)* and *(10)* include by implication a minor change in the law on accrued income profits; see *Change 101* in Annex 1.

Section 580: Allowable deductions: restriction on double counting

1733. This section prevents double relief. It is based on paragraph 3(2B) of Schedule 23A to ICTA.

Section 581: Manufactured overseas dividends

1734. This section deals with the income tax treatment of MODs in the hands of the recipient (or, if different, the owner). It is based on paragraph 4(1), (2), (3) and (4) of Schedule 23A to ICTA.

1735. *Subsections (1)* and *(3)* together ensure that if an income tax payer claims title to the MOD through or under a recipient (such as a nominee), the MOD is still treated for income tax purposes as if it was a real overseas dividend even if the recipient is not an income tax payer.

1736. *Subsection (6)* identifies the provisions of the Income Tax Acts in relation to which the deeming provisions in *subsections (4)* and *(5)* have effect: namely, those applicable to UK residents or persons carrying on business through a UK branch or agency.

Section 582: Powers about manufactured overseas dividends

1737. This section is concerned with double taxation relief. It is based on paragraph 8(1A) of Schedule 23A to ICTA.

Section 583: Manufactured payments exceeding underlying payments

1738. This section deals with special cases, as do sections 584 and 585. It is based on paragraph 7(1) of Schedule 23A to ICTA.

1739. Unlike sections 573 to 577 (manufactured dividends on UK shares), sections 578 to 580 (manufactured interest on UK securities) and sections 581 and 582 (MODs), sections 583 to 585 are not restricted to a single type of manufactured payment.

1740. This section overrides sections 573 to 582 (main rules about manufactured payments) and Chapter 9 of Part 15 (deduction of income tax at source: manufactured payments). If it applies, the excess is taken out of the rules about manufactured payments and is treated as a separate fee. This may affect relief for the payer or taxability for the recipient (or, if different, the owner) or both, if the person concerned is an income tax payer; it may also affect the amount of income tax which has to be deducted or accounted for and paid under Chapter 9 of Part 15.

Section 584: Manufactured payments less than underlying payments

1741. This section overrides sections 578 to 582 (main rules about manufactured interest and MODs) and 589(3) (meaning of gross amount of MOD). It is based on paragraph 7 of Schedule 23A to ICTA.

1742. If it applies, the gross amount of the manufactured interest or MOD is adjusted for the purposes of giving income tax relief to the payer.

Section 585: Power to deal with other special cases

1743. This section is a general power to modify the rules about manufactured payments contained in sections 572 to 582 and Chapter 9 of Part 15. It is based on paragraph 8(1) of Schedule 23A to ICTA.

Section 586: Powers about administrative provisions

1744. This section is the first of a group of sections (sections 586 to 588) which are about general regulation-making powers. It is based on paragraph 8(2) to (3) of Schedule 23A to ICTA.

Section 587: Power for manufactured payments to be eligible for relief

1745. This section enables the Treasury to make exceptions to the main rules in this Chapter on the taxability of manufactured payments. More specifically, it enables manufactured payments to be exempt from income tax in the hands of pension funds if the actual dividends or interest which the manufactured payments represent would have been exempt from income tax in their hands. It is based on section 737D of ICTA and not, like the rest of this Chapter, on Schedule 23A to that Act.

Section 588: Regulation-making powers: general

1746. This section is based on paragraph 8(4) of Schedule 23A to ICTA.

Section 589: Meaning of "gross amount": interest and manufactured overseas dividends

1747. This section defines "gross amount" for the purposes of the rules in this Chapter about interest and manufactured overseas dividends. It is based on paragraphs 3(13), 4(5) and 7(1) of Schedule 23A to ICTA.

Section 590: Meaning of "relevant withholding tax"

1748. This section defines "relevant withholding tax" for the purposes of this Chapter. It is based on paragraph 4(5) and (6) of Schedule 23A to ICTA.

Section 591: Interpretation of other terms used in Chapter

1749. This section gathers up minor definitions for the purposes of this Chapter. It is based on paragraphs 1(1), 2(1), 3(1), 4(1) and 7(1) of Schedule 23A to ICTA, section 153(2) of FA 2003. and on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

Chapter 3: Tax credits: stock lending arrangements and repos

Overview

1750. This Chapter denies the recipient of a manufactured dividend the benefit of a tax credit on it. It is based on sections 231AA and 231AB of ICTA.

1751. Sections 231AA and 231AB of ICTA are potentially relevant to the shadow ACT regime, and this Act therefore includes consequential amendments which will confine them to corporation tax.

Section 592: No tax credits for borrower under stock lending arrangement

1752. This section prevents the borrower under a stock lending arrangement from claiming a tax credit when that person in economic terms does not retain a dividend on the securities, but passes it on to the lender, by way of a manufactured dividend or other means. It is based on section 231AA of ICTA and section 263B of TCGA.

Section 593: No tax credits for interim holder under repo

1753. This section prevents the interim holder under a repo from claiming a tax credit when that person in economic terms does not retain a dividend on the securities, but passes it on to the counterparty, by way of a manufactured dividend or other means. It is based on section 231AA of ICTA.

Section 594: No tax credits for original owner under repo

1754. This section counters unusual repo arrangements where the original owner does not pass entitlement to the dividends to the interim holder under the repo but the interim holder nonetheless pays the lender a manufactured dividend. It prevents shareholders using these arrangements to generate multiple tax credits in respect of the same dividend. It is based on section 231AB of ICTA.

Section 595: Meaning of "manufactured dividend"

1755. This section gives "manufactured dividend" the same meaning in this Chapter as in Chapter 2. It is based on sections 231AA(4) and 231AB(3) of ICTA.

Chapter 4: Deemed manufactured payments

Overview

1756. This Chapter extends the scope of Chapter 2 (manufactured payments) to certain arrangements under which there is no actual manufactured payment.

Section 596: Deemed manufactured payments: stock lending arrangements

1757. This section, which is the first of a group of sections (sections 596 to 600) concerned with stock lending arrangements, deems the borrower in a stock lending arrangement to make a manufactured payment in certain circumstances. It is based on sections 736B, 736D and 231AA of ICTA.

1758. Usually, a stock lending arrangement will require the borrower to make a manufactured payment to the lender, in which case Chapter 2 (or, as the case may be, Schedule 23A to ICTA) will apply.

1759. Exceptionally, a stock lending arrangement may be structured in such a way that the lender is not entitled to receive a manufactured payment, even though the lender has forgone interest or dividends on the securities transferred. In such a case, this section deems the borrower to make a manufactured payment. In consequence, Chapter 2 applies and, in particular, if the securities are UK securities or overseas securities, then potentially either the borrower is subject to the main charge or the lender is subject to the reverse charge. But the borrower is denied any tax relief for the deemed manufactured payment.

1760. *Subsection (5)* provides that for the purposes of this section a quasi-stock lending arrangement is treated as if it were a stock lending arrangement.

Section 597: Deemed interest: cash collateral under stock lending arrangements

1761. This section is a targeted anti-avoidance rule, deeming interest to arise to the borrower on collateral provided under certain stock lending arrangements. It is based on section 736C(1) to (7) and (11) of ICTA.

Section 598: Cash collateral under stock lending arrangements: supplementary

1762. This section supplements section 597. It is based on section 736C(8), (10) and (12) to (14) of ICTA.

1763. Section 736C(11) of ICTA provides that money includes money expressed in a currency other than sterling. This section omits it.

Section 599: Sections 597 and 598: quasi-stock lending arrangements and quasi-cash collateral

1764. This section extends the ambit of sections 597 and 598 to cover arrangements which, although achieving the same economic effect as a stock lending arrangement with cash collateral, fall outside either or both of the detailed definitions of "stock lending arrangement" and "cash collateral". It is based on section 736D(4), (5), (7), (8) and (10) of ICTA.

Section 600: Meaning of "quasi-stock lending arrangements" and "quasi-cash collateral"

1765. This section defines the expressions "quasi-stock lending arrangements" and "quasi-cash collateral". It is based on section 736D(1) to (3), (6) and (10) of ICTA.

Section 601: Repo cases in which deeming rules apply

1766. This section defines circumstances under which sale and repurchase arrangements (repos) are deemed, under section 602, to give rise to manufactured payments to which Chapter 2 applies. It is based on sections 231AA, 231AB, 737A, and 737B, of ICTA.

1767. If, as a matter of legal analysis, a transaction includes an amount which is a manufactured payment within Chapter 2 or, as the case may be, Schedule 23A to ICTA, then Chapter 2 (or, as the case may be, Schedule 23A) will apply to that amount. But if there is no separately identifiable amount then, as a matter of legal analysis, there may be no manufactured payment within Chapter 2 or Schedule 23A.

1768. Sale and repurchase arrangements could therefore be made under which no manufactured payment was payable and, instead, the pricing of the transaction reflected the fact that a payment of interest or dividend on the securities was receivable otherwise than by the seller. Such arrangements would be outside Chapter 2 and Schedule 23A. Chapter 4 plugs this gap by deeming the arrangement to include the making of a manufactured payment.

Section 602: Deemed manufactured payments: repos

1769. This section activates the rules about manufactured payments in a case in which section 601 is satisfied. It is based on sections 231AA, 231AB, 737A and 737C of ICTA.

1770. *Subsection (2)(b)* ensures that, in a repo of Real Estate Investment Trust shares, the deemed manufactured payment will in appropriate circumstances be an MPID.

1771. *Subsections (3)* and *(4)* prevent the holder of securities acquired under a repo from obtaining a tax deduction for a deemed payment representing interest or dividends unless that person is also the person to whom the securities were first transferred.

Section 603: Deemed deductions of tax

1772. This section treats deductions of tax as having been made in the circumstances specified in the section. It covers payments representative of PIDs, periodical payments of interest on UK securities and overseas dividends on overseas securities. It is based on section 737C of ICTA.

1773. This section is the first of a group of sections (sections 603 to 605) all of which are based on section 737C of ICTA (deemed manufactured payments: further provisions). Section 737A of ICTA (sale and repurchase of securities: deemed manufactured payments) interacts not only with Schedule 23A to ICTA (manufactured dividends and interest) but also with section 730A of ICTA (treatment of price differential on sale and repurchase of securities). Section 737C of ICTA ensures that the interaction does not give rise to anomalies.

Section 604: Deemed increase in repurchase price: price differences under repos

1774. This section ensures that, if this Chapter deems a manufactured payment to be made, this is factored into the calculation of the price difference under Chapter 5. It is based on section 737C of ICTA.

Section 605: Deemed increase in repurchase price: other income tax purposes

1775. This section extends the circumstances in which the deemed increase in the repurchase price made by section 604 has effect. It is based on section 737C(11A) of ICTA.

Section 606: Interpretation of Chapter

1776. This section defines various terms. It is based on sections 231AA, 231AB and 737A to 737C of ICTA and section 139 of, and paragraph 4 of Schedule 17 to, FA 2006.

Chapter 5: Price differences under repos

Overview

1777. This Chapter contains provisions about the treatment of the difference between the sale price and the repurchase price in relation to sale and repurchase agreements. It is based on sections 730A and 730B of ICTA, with supplementary provisions based on section 737E of ICTA.

1778. Section 737A of ICTA deals with repos which straddle an ex-dividend date; if it applies, there is a deemed manufactured payment to which Schedule 23A to ICTA applies. Section 737A is rewritten in Chapter 4 of this Part.

1779. For the purposes of section 730A of ICTA, by contrast, it does not make any difference whether the repo straddles an ex-dividend date, and section 730A does not have a direct connection with Schedule 23A. If a sale and repurchase agreement is within section 730A, the difference between the sale price and the repurchase price is deemed to be a payment of interest on a deemed loan. If the other conditions are met, this deemed interest may come within the withholding obligation of section 349(2) of ICTA. Section 349(2) is rewritten in Chapter 3 of Part 15 (deduction of income tax at source: deduction from certain payments of yearly interest).

Section 607: Treatment of price differences under repos

1780. This section deals with the treatment of price differences under repos. It is based on sections 730A(1), (2), (3) and (8A), 730B and 737B of, and paragraph 1(1) of Schedule 23A to, ICTA.

Section 608: Exceptions to section 607

1781. This section disapplies section 607 in certain cases. It is based on section 730A(8) of ICTA.

1782. It disapplies section 607 in cases where:

- the agreement or agreements for sale and repurchase are not what one would expect of persons dealing at arm’s length; or
- the interim holder has all the benefits and risks from fluctuations in the market value of the securities between their sale and repurchase.

Section 609: Additional income tax consequences of price differences

1783. This section deals with some additional consequences of section 607. It is based on section 730A(4), (4A) and.(7) of ICTA.

Section 610: Repurchase price in deemed manufactured payment case

1784. This section deals with the interaction between Chapters 4 and 5 of this Part. It is based on sections 730A of ICTA.

Section 611: Power to modify Chapter in non-arm's length case

1785. This section enables the Treasury to make regulations modifying the provisions of this Chapter in cases where agreements for sale and repurchase are not what one would expect of persons dealing at arm's length. It is based on section 737E of ICTA.

1786. Section 737E(3) of ICTA does not mention section 730B of ICTA. But section 611(1), in rewriting section 737E(3), includes within its scope section 610, which rewrites section 730B. This does not mean that section 611(1) changes the law.

1787. Since section 737E(3) refers to section 730A and section 730B has the sidenote "interpretation of section 730A", the omission of "section 730B" from section 737E(3) is not significant. Section 737E(3) enables the Treasury to modify section 730B indirectly (for example, by making a regulation saying that, despite anything in section 730B, section 730A applies as if it said …).

Chapter 6: Powers to modify repo provisions

Overview

1788. This Chapter contains powers to modify some of the provisions of Chapters 4 and 5 of this Part.

Section 612: Non-standard repo cases

1789. This section is a power to make regulations dealing with certain non-standard repo cases. It is based on section 737E(1), (8) and (9) of ICTA.

Section 613: Redemption arrangements

1790. This section is a power to make regulations dealing with certain cases involving repos and the redemption of securities. It is based on sections 737B(1) and 737E(2), (8) and (9) of ICTA.

Section 614: Sections 612 and 613: supplementary

1791. This section contains provisions which supplement sections 612 and 613. It is based on section 737E(5), (6) and (7) of ICTA.

Part 12: Accrued Income Profits

Overview

1792. This Part is based on sections 710 to 727A in Chapter 2 of Part 17 of ICTA. These provisions are commonly known as the "accrued income scheme". The Part has therefore been named by reference to this common name. The accrued income scheme deals with the transfer of interest bearing securities where the person taxable in respect of interest on the securities may not be the person who held the securities when that interest was accruing. The scheme attributes to certain persons "accrued income profits", taxed under Chapter 2 of this Part, and "accrued income losses", which may reduce liability under other provisions in respect of the interest arising. Certain transactions and/or certain persons may be excluded from the operation of the scheme (in particular, if an individual has, or personal representatives or certain trustees have, only small holdings of securities).

1793. Chapter 2 sets out the provisions which explain when the scheme applies and to whom, how to calculate accrued income profits and accrued income losses and when accrued income profits are taxed. It also contains definitions for the scheme.

1794. Chapter 3 sets out how relief is obtained for accrued income losses. Accrued income losses are not set against accrued income profits (as a figure of profits or losses is already a net figure for payments treated as made or received by the person in question). Rather, relief for accrued income losses is given by setting the losses against interest received on the securities in relation to which the losses arise (that is, the interest which has been taken into account in calculating the losses). In effect, the accrued income losses exempt from income tax so much of the interest as is equal to those losses.

1795. Prior to FA 1996, the accrued income scheme applied for both income tax and corporation tax. Chapter 2 of Part 4 of FA 1996 (loan relationships) now applies for corporation tax in relation to transfers of securities with accrued interest. The transitional application of the scheme for corporation tax as regards transfers of securities taking place before 1 April 1996, in section 710(1A) of ICTA, has been repealed as redundant in conjunction with the income tax rewrite (see Schedule 3 to this Act which repeals sections 710 to 727A of ICTA).

1796. Section 728 of ICTA (power to obtain information for the purposes of sections 710 to 727A) is not rewritten in this Part.

Chapter 1 Introduction

Section 615: Overview of Part

1797. This section describes the scope of the Part and provides or signposts the definition of a number of key terms used in the Part. It is based on sections 714, 716 and 723 of ICTA.

1798. *Subsections (2)* and *(3)* refer to “profits treated as made” under a number of sections in Chapter 2 where interest bearing securities are transferred. But for the charge made by this Part, the profit on the transfer in question would usually be a capital profit. See section 119 of TCGA (as amended by Schedule 1 to this Act) for rules which amend the calculation of a gain or loss under that Act if the accrued income scheme applies.

1799. Profits are treated as made under section 628 if the transfer occurs in an interest period of the security. Profits are treated as made under section 630 if the transfer is of variable rate securities or a transfer with unrealised interest and the settlement day for the transfer is outside an interest period. Section 670 treats as profits the recovery of relief given previously in respect of unremittable transfer proceeds from foreign securities. Some rules apply all such profits. But some apply only to one or to one or more but not all such types of profits or the transactions giving rise to them. References to sections 628, 630 and 670 are therefore used, both in this Part and in other provisions in the Tax Acts which refer to the accrued income scheme, to indicate which type of profit is in point for the operation of the other provision (for example, see section 667).

Chapter 2: Accrued income profits and losses

Section 616: Charge to tax on accrued income profits

1800. This section provides the charge to tax on accrued income profits. It is based on sections 714(2), 716(2) and (3) and 723(4) of ICTA.

Section 617: Income charged

1801. This section provides that the full amount of accrued income profits is charged to tax. It is based on sections 714(2), (2A), 716(2), (3) and (3A), 717(10) and (11) and 723(4) of ICTA.

1802. Accrued income profits are normally computed by reference to transfers of securities of the same kind where the transfer is settled in the same interest period. *Subsection (2)* provides that the profits are treated as made in the tax year in which that interest period ends.

1803. S*ubsection (3)* deals with unusual cases where the settlement day for the transfer falls outside an interest period. The last interest period of securities ends with the last interest payment day. So, if securities pay their last interest before their redemption date, their last interest period will end before the securities' redemption date. But, if a transfer occurs after the last interest payment, the settlement day for the transfer will not fall in an interest period.

1804. In such cases, subsection (3) treats the profits as made in the tax year in which the settlement day falls. It applies if:

- securities are transferred with unrealised interest (see section 625 for the meaning of "unrealised interest"); or
- variable rate securities are transferred (see section 627 for the meaning of "variable rate securities").

1805. See *Change 101* in Annex 1, by virtue of which all transfers of variable rate securities (and not just a transfer on redemption), where the settlement day for the transfer is outside an interest period, are treated alike for the purposes of subsection (3) and all other provisions applicable to such transfers.

1806. S*ubsection (4)* determines the tax year in which accrued income profits are treated as made if the proceeds of the transfer could not be remitted to the United Kingdom (and so relief from the accrued income scheme was claimed under section 668 or 669) but can be remitted subsequently (which triggers a charge by virtue of section 670).

Section 618: Person liable

1807. This section determines the person liable to income tax for the purposes of this Chapter. It is based on sections 714(2) and (2B), 716(3) and (3B) and 723(4) of ICTA. The accrued income profits that a person is treated as making may be from transfers where the person is the transferor, or from transfers where the person is the transferee, or from a mixture of such transfers.

1808. See also section 1015 (territorial scope of charges under certain provisions to which section 1016 applies). This Chapter is among the provisions listed in Part 2 of that section. But see also section 643 which in practice cuts down the extent to which a non-UK resident is chargeable to tax under this Chapter.

1809. (See Chapter 3 of Part 9 (special rates for trustees' income) for the rate that applies if trustees are the person liable. Section 482 (types of amount to be charged at special rates for trustees) is based in part on section 720(5) of ICTA.)

Section 619: Meaning of "securities" and when securities are of the same kind

1810. This section defines "securities" for the purposes of the Chapter. It is based on section 710 of ICTA.

1811. The rule in *subsection (6)*, what is meant by securities of the same kind, is important because accrued income profits and losses treated as made under section 628 are computed by reference to transfers of securities of the same kind which occur in the same interest period.

Section 620: Transactions which are transfers: general

1812. This section defines "transfer" for the purposes of the Chapter. It is based on section 710 of ICTA. "Transfers" are the transactions and events giving rise to the income tax charge (or relief) for accrued income profits (or losses).

1813. *Subsection (1)* is subject to the cases mentioned in *subsection (6)*, which exclude certain transfers from the application of the Chapter in the case of strips of gilt-edged securities, stock lending and sale and repurchase agreements.

1814. The vesting of securities in trustees is a transfer within subsection (1). But where securities vest on the appointment of a new or additional trustee, and the new or additional trustees are resident in the United Kingdom, there are no net accrued income scheme consequences because the payments treated as made effectively cancel each other out. This may not be the case if the new or additional trustees are not resident in the United Kingdom.

1815. *Subsection (3)* deals with the timing of the transfer where there is an agreement for the transfer of securities. The transfer is treated as taking place when the agreement is made, even if the agreement provides for the transfer of the securities at some future date.

1816. The time at which a transfer occurs is important for a number of provisions in the accrued income scheme (see, for example, section 660(1)). The time of the transfer must be distinguished from the settlement day for the transfer, although the two dates may be the same in certain circumstances.

Section 621: Transferors and transferees

1817. This section defines who is a "transferor" or "transferee" for the purposes of the Chapter. It is based on section 710(13) and section 717(8) of ICTA.

1818. *Subsections (2)* and *(3)* set out who is the transferor on conversion of securities or on the redemption of variable rate securities, as these are transactions under which the securities cease to exist rather than a transfer of a holding which continues to exist. The other party to the transaction, the issuer of the securities who has converted or redeemed them, is accordingly not treated as a transferee for the purposes of the Chapter.

Section 622: Application of Chapter to different kinds of transfer

1819. This section sets out the types of transfer for which rules are provided by the Chapter. It is new (but *subsection (3)* is based on section 716(2) of ICTA). The nature of the transfer determines:

- whether payments (or profits, in the case of a transfer to which section 630 applies) are treated as made;
- if so, who is treated as making the payment (or profits); and
- the amount of the payment (or profits).

1820. Sections 623 to 626 describe the various types of transfer. Sections 628 to 631 provide for the calculation of accrued income profits and losses and when such profits or losses arise. Sections 632 to 635 set out the payments on transfer that are needed for the application of sections 628 to 631.

1821. Securities transferred with unrealised interest may also be transferred with or without accrued interest or the securities transferred may be variable rate securities. Subsection (3) confirms that the transfer must be dealt with in accordance with the rules for both a transfer with unrealised interest and another type of transfer. So, in such a case, two payments may be treated as made – one which relates to the transfer being made with unrealised interest and one which relates to the transfer with or without accrued interest or the transfer of variable rate securities.

Section 623: Transfers with accrued interest

1822. This section explains when securities are transferred "with accrued interest". It is based on section 711 of ICTA.

1823. Generally, a transfer is with accrued interest when the right to interest payable at the next payment date is given to the transferee, regardless of when in the interest period the transfer took place. The transferor gets a higher price for the securities to reflect the interest accrued to the transfer which is not received by the transferor. Certain transfers are deemed to be with accrued interest.

1824. *Subsection (5)* makes the section subject to section 626, which provides that variable rate securities are not treated as transferred with accrued interest. Rather the special rules in sections 630, 631 and 635 apply (see the commentary on section 626 for further information on variable rate securities).

Section 624: Transfers without accrued interest

1825. This section explains when securities are transferred "without accrued interest". It is based on section 711(5) and (6) of ICTA.

1826. Generally, a transfer is without accrued interest when the right to interest payable at the next payment date is kept by the transferor, regardless of when in the interest period the transfer took place. The transferor gets a lower price for the securities to reflect the interest accruing after the transfer which is not received by the transferee. Certain transfers are deemed to be without accrued interest.

1827. Similarly to section 623, *subsection (5)* makes the section subject to section 626, which provides that variable rate securities are not treated as transferred without accrued interest.

Section 625: Transfers with unrealised interest

1828. This section explains what is meant by a transfer "with unrealised interest". It is based on section 716(1) of ICTA.

1829. It applies if securities are transferred together with interest which is ripe for payment because the due and payable date has passed, but the holder of the securities has not called for payment of the interest. This will most commonly arise in the case of bearer securities with separate coupons for each interest instalment. But it does not follow that there could not be other circumstances where securities are transferred with unrealised interest.

Section 626: Transfers of variable rate securities

1830. This section provides that a transfer of variable rate securities is not treated as a transfer with or without accrued interest, regardless of whether it would otherwise be such a transfer. It is new.

1831. By excluding transfers of variable rate securities from the normal rules for transfers with accrued interest, the special rules which apply to transfers of variable rate securities then apply directly without first treating them as transfers with accrued interest, and without having to modify the normal rules. See in particular sections 630, 631 and 635.

1832. See *Change 102* in Annex 1 which drops the fiction that transfers of variable rate securities are transfers with accrued interest.

Section 627: Meaning of "variable rate securities"

1833. This section defines "variable rate securities" for the purposes of the accrued income scheme. It is based on sections 717(1) to (3) and 726A(2), (7) and (8) of ICTA. They are all securities other than fixed rate securities and securities for which the interest rate is tied to a base rate or a recognised prices index. Variable rate securities may, for example, have periods for which no interest is payable or periods in which sharply different rates of interest are payable. The rules for transfers with and without interest work on the premise that interest accrues evenly, which is not the case with variable rate securities.

1834. *Subsection (4)* applies the test for qualifying as variable rate securities in a special way if securities are issued in tranches ("new securities") and section 649 applies.

Section 628: Making accrued income profits and losses: general rules

1835. This section determines if accrued income profits or accrued income losses are made when (as is normally the case) the settlement day for the transfer in question falls within an interest period. It is based on section 714 of ICTA.

1836. The accrued income scheme applies predominantly:

- where securities are transferred with accrued interest and
- where they are transferred without accrued interest.

1837. The aim in both cases is to ensure that the accruing interest is taxed as income of the person who is the owner of the securities over the period in which the interest accrued. The approach taken by this section is to treat the parties as though a payment is made from one to the other as a result of the transfer.

1838. Where securities are transferred with accrued interest, the transferee is treated as making a payment to the transferor. And, where securities are transferred without accrued interest, the transferor is treated as making a payment to the transferee (see sections 632 and 633). This approach reflects the reality of these transactions, as the purchase price on a sale of securities is increased or reduced according to whether interest which has accrued or will accrue goes to the transferor or transferee.

1839. The calculation in section 628 is made by comparing the total amount of the payments treated as made *by* a person to the total amount of the payments treated as made *to* that person for each kind of security transferred in each interest period.

1840. *Subsection (2)* provides that section 630 applies instead if the settlement day falls outside an interest period (this can only be the case in relation to some transfers of variable rate securities or a transfer with unrealised interest).

Section 629: Calculating accrued income profits and losses where section 628 applies

1841. This section determines the amount of the accrued income profit (*subsection (1)*) or the accrued income loss (*subsection (2)*) as the case may be. It is based on sections 714 and 716 of ICTA.

Section 630: Making accrued income profits: settlement day outside interest period

1842. This section provides that accrued income profits are made where the settlement day for the transfer involved occurs after the end of the securities' last interest period (and so does not fall in an interest period). It is based on sections 716(3), 717(10) and (11) of ICTA.

1843. A transfer of variable rate securities may also be a transfer with unrealised interest, so the section may apply doubly to a single transfer. An amount of accrued income profits will be found under both subsections (1) and (3) of section 631.

1844. In contrast with transfers which take place in an interest period (see section 634 and section 635), where there is a deemed payment made by the transferor (partly matching the approach in section 628 and section 629), no such deemed payment is introduced here. The section deems the transferor to have made accrued income profits by virtue of the circumstances set out in *subsection (1)*. And without any deemed payments, an accrued income loss cannot arise in the case of the transfers to which this section applies.

1845. See *Change 101* in Annex 1 which treats other transfers of variable rate securities where the settlement day is outside an interest period as redemption of such securities. And see

Change 102 in Annex 1 which drops the fiction that transfers of variable rate securities are transfers with accrued interest.

Section 631: Amount of accrued income profits where section 630 applies

1846. This section quantifies the amount of the accrued income profits for transfers within section 630. It is based on sections 716(3) and 717(9) of ICTA.

Section 632: Payment on transfer with accrued interest

1847. This section sets out the payments treated as made when securities are transferred with accrued interest. It is based on section 713 of ICTA.

1848. *Subsection (1)* sets out the payment treated as made by the transferee to the transferor. If there are no other transfers of the same kind of security in the interest period, the effect of treating this payment as made is:

- to charge the transferor to income tax on the interest accruing on a day-by-day basis to the settlement day, that is, the transferor makes an accrued income profit in accordance with section 628 which is taxed by section 616, and
- to give the transferee equivalent relief when the transferee is taxed (e.g. under Chapter 2 of Part 4 of ITTOIA) on the interest arising at the next interest payment date, that is, the transferee makes an accrued income loss in accordance with section 628 which is relieved under section 679.

1849. Subsection (1) also indicates that the payment is treated as made in the interest period in which the settlement day for the transfer falls. This also determines the interest period in which the profit arises and therefore the tax year in which the profit is taxed.

1850. *Subsections (2)* and *(3)* quantify the amount of the payment where the interest which has accrued to the settlement day is separately accounted for to the transferor by the transferee (as it is for many transactions within the financial markets, with a corresponding adjustment in the consideration for the transfer of the security). The amount of the payment is the amount of interest accounted for.

1851. If subsections (2) and (3) do not apply and the settlement day is coincidentally an interest payment day, *subsection (4)*quantifies the amount of the payment as the amount of the interest payable on that day.

1852. In other cases, *subsection (5)* provides for the interest due on the next interest payment day to be time apportioned to ascertain the interest accruing to the settlement of the transfer. The formula applies regardless of whether the interest period in question would be (but for section 673 (meaning of "interest period")) greater than 12 months.

1853. *Subsections (7)* and *(8)* modify the operation of subsection (1) if the transfer in point is one for which there is either no transferor or no transferee because of the rules applying in the sections mentioned.

Section 633: Payment on transfer without accrued interest

1854. This section sets out the payments treated as made when securities are transferred without accrued interest. It is based on section 713 of ICTA.

1855. In this case the transferor retains entitlement to all the interest due at the interest payment date falling after the transfer date although the transferor will not be the holder of the security at that time. This will commonly occur where the security in question has gone "ex-dividend" when the transfer is agreed (that is, interest will be paid on the next interest date to whoever is the registered holder when the books for the security are closed until after the interest payment date). *Subsection (1)* explains that, where securities are transferred without accrued interest, a payment is treated as made by the transferor to the transferee – the reverse of section 632(1).

1856. The right to the interest is retained by the transferor, who will be taxable on the interest arising at the next interest payment. If there are no other transfers of the same kind of security in the interest period, the effect of treating this payment as made is to charge the transferee to income tax on the interest accruing on a day-by-day basis *after* the settlement of the transfer, the accrued income profit, and to give the transferor equivalent relief when the transferor is taxed on the interest arising at the next interest payment date, the accrued income loss.

1857. Subsection (1) also provides that the payment is treated as made in the interest period in which the settlement day for the transfer falls.

1858. As in section 632, *subsections (2)* and *(3)* deal with transfers where the interest which will accrue from the settlement day to the next interest payment day is separately accounted for. The amount of the payment is the amount of the gross interest accounted for.

1859. If subsection (2) does not apply and the settlement day also happens to be an interest payment day, *subsection (4)* makes clear that the amount of the payment is nil. That reflects the fact that the interest retained by the transferor accrues wholly in the period to the settlement day (and is taxable on the transferor). The accrued income scheme is only interested in disturbing the normal tax rules, in the case of a transfer without accrued interest, where part of the interest period falls *after* the settlement day (and an amount representing interest should be attributed to the transferee).

1860. In other cases, *subsection (5)* provides for the interest due on the next interest payment day to be time apportioned to ascertain the interest which will accrue after the settlement of the transfer.

1861. *Subsections (7)* and *(8)* modify the operation of subsection (1) if the transfer in point is one for which there is either no transferor or no transferee.

Section 634: Payment on transfer with unrealised interest

1862. This section sets out the payment treated as made where securities are transferred with unrealised interest and where (as is normally the case) the settlement day for the transfer involved falls within an interest period. It is based on section 716 of ICTA. "Unrealised interest" is defined in section 625.

1863. A payment is treated as made to the transferor (see *subsection (1)*) but *subsection (4)* makes clear that no one is treated as making the payment. *Subsection (5)* therefore confirms that the deemed payment does not form part of any accrued income profit or loss calculation for the transferee.

1864. *Subsection (2)* provides that the amount of the payment is the amount of the unrealised interest. The effect of this section is that the transferor is charged to income tax on the amount of the unrealised interest.

1865. *Subsection (6)*signposts section 681 which, notwithstanding the rules in subsection (4) and (5), grants the transferee exemption from tax on the interest (when realised) if certain conditions are satisfied. That exemption is equivalent to the exemption given in section 679 by reference to accrued income losses.

1866. As explained in the commentary on section 622, where securities are transferred with unrealised interest they may also be transferred with or without accrued interest, and a payment may also arise under section 632 or 633.

Section 635: Payment on transfer of variable rate securities

1867. This section sets out the payment treated as made where variable rate securities are transferred and the settlement day for the transfer falls within an interest period. It is based on section 717 of ICTA. Section 627 gives the meaning of “variable rate securities”.

1868. *Subsection (1)* provides that a payment is treated as made to the transferor. But no one is treated as making the payment (see *subsection (3)*), nor does the payment enter the calculation of any accrued income profit or loss of the transferee (see *subsection (4)*).

1869. This is an anti-avoidance provision. The interest on a security could be structured so as to circumvent the intended effects of the accrued income scheme (for example, by using wide variations in the rate of interest payable at various times over the lifetime of the security). Where this happens, a time apportionment formula, which assumes that interest accrues at an even rate, would not produce an amount consistent with the value of the accruing interest. Instead, *subsection (2)* simply provides that the amount of the payment treated as made should be “just and reasonable” (and the transferor should make a self-assessment for the relevant tax year accordingly).

1870. No provision is made in this case for any exemption for interest received by the transferee.

Section 636: Exception where there is a transfer to a legatee

1871. This section disapplies rules which treat a payment (or profits) as made if personal representatives transfer securities to a legatee. It is based on section 721 of ICTA.

1872. Under *subsection (2)*, if the personal representatives of a deceased person transfer securities to a legatee in the interest period in which the individual died, neither the personal representatives nor the legatee are treated as making or receiving payments. So, in these circumstances no accrued income profit or accrued income loss can arise. But, because the transfer itself is not excluded, section 681 (exemption for unrealised interest received after a transfer within Chapter 2) may still be in point.

1873. *Subsection (3)* deals with certain transfers of variable rate securities. It treats accrued income profits as not arising, rather than a payment as not being made, in line with the approach taken in sections 630 and 631. It applies to all variable rate securities (see *Change 101* in Annex 1 which extends the treatment of transfers of variable rate securities on redemption which was provided under section 717(11) of ICTA to other transfers of variable rate securities where the settlement day is outside an interest period).

1874. If the transfer does not take place in the interest period in which the individual died, then the accrued income scheme applies to that transfer as normal.

1875. “Personal representatives” has the meaning given by section 989. (See *Change 150* in Annex 1.)

Section 637: Accrued income losses treated as payments in next interest period

1876. This section provides for a particular treatment of an accrued income loss. It is based on section 714 of ICTA.

1877. Where a person makes accrued income losses there are two ways of relieving those losses. The most common is by exempting the interest arising at the end of the interest period to which the accrued income loss relates to the extent of the amount of the loss. This relief is given by section 679, which is signposted in *subsection (3)* together with other exemptions which may apply when the interest period ends with an interest payment day.

1878. This section deals with the far less common circumstance where the interest period does not end with an interest payment day and so interest does not arise at the end of it. (This can occur where an interest payment day is more than twelve months after the previous one. The accrued income scheme restricts all interest periods to no more than twelve months. See section 673(1)(b)).

1879. *Subsection (2)* treats the person who made the accrued income loss as making a payment in the next interest period. So losses are in effect carried forward and taken into account in computing the accrued income profit (or accrued income loss as the case may be) on securities of the same kind in the next interest period. If that interest period does not end with an interest payment date and there are still losses to carry forward, the process repeats until the losses are those of an interest period which does end with an interest payment day.

Section 638: Excluded persons: disregard of certain payments and transfers

1880. This section disregards certain payments treated as made to or by a person, if that person is an "excluded transferor" or "excluded transferee", in calculating whether that person has made accrued income profits or losses. It is based on section 715 of ICTA.

1881. By virtue of this section, the accrued income scheme does not (or does not in full) apply to them. This is either because it is unnecessary to apply the scheme to them or because applying the scheme would be unduly burdensome for both taxpayers and HMRC. The section also explains the consequences of being excluded from the scheme.

1882. Although the section generally applies to both transferors and transferees, and operates by disregarding payments treated as made by or to a person, *subsection (3)* provides that in determining under section 630 whether a person has made accrued income profits, no account is taken of the transfer. There is an effect only for the transferor in that case.

1883. Under these provisions it is *persons* who are excluded in relation to a transfer rather than *transactions*. This means that, in respect of the same transfer, the transferor may be excluded but not the transferee (and vice versa).

Section 639: Small holdings: individuals

1884. This section excludes individuals whose holdings are below the specified limit. It is based on section 715(1)(b) of ICTA.

1885. *Subsections (1)* to *(3)* set out the limit for exclusion for individuals in relation to the various types of transfer of securities and by reference to the relevant basis on which income is charged under section 617. The limit is set at a total nominal value of £5,000 of all securities held by the individual on any day in the prescribed period. An individual's holding may, however, be combined with another's (see *subsection (5)*) and, where that is the case, the limit applies to the combined holding.

1886. *Subsection (3)* adapts the rule for transfers of variable rate securities as more than one basis on which income is charged under section 617 may apply to such securities. *Change 101* in Annex 1 (which applies to other transfers of variable rate securities the treatment of transfers of such securities on redemption that was provided by section 717(11) of ICTA) applies as regards such transfers for the purposes of this and the following two sections.

Section 640: Small holdings: personal representatives

1887. This section excludes personal representatives whose holdings are below the specified limit. It is based on section 715(1)(c) and (2)(b) of ICTA.

1888. When an individual dies, securities in the deceased's estate automatically vest in the deceased's personal representatives. This vesting is not a transfer for the purposes of the accrued income scheme. However, except where section 636 applies, the transfer of securities by an individual's personal representatives is a transfer for the purposes of the accrued income scheme.

1889. *Subsections (1)* to *(3)* accordingly provide exclusions for personal representatives identical to those for individuals. But there is no equivalent of section 639(5) so there is no question of the personal representatives' holding being combined with another's. (*Change 101* in Annex 1 applies here; see the commentary on section 639(3) (small holdings: individuals).)

1890. "Personal representatives" has the meaning given by section 989. (See *Change 150* in Annex 1.)

Section 641: Small holdings: trustees of a disabled person's trusts

1891. This section excludes trustees of a disabled person's trusts whose holdings are below the specified limit. This section is based on section 715(1)(e) and (2)(b) of ICTA.

1892. *Subsections (1)* to *(3)* provide exclusions for trustees of a disabled person's trusts identical to those for individuals and personal representatives. (*Change 101* in Annex 1 applies here; see the commentary on section 639(3) (small holdings: individuals).)

1893. *Subsection (4)* signposts the definition of "disabled person's trusts" which applies for the purpose of this provision. Broadly, that definition includes trusts where the beneficiary may be incapacitated to a degree that interferes with their management of their affairs.

Section 642: Traders

1894. This section excludes financial traders from the accrued income scheme. It is based on sections 715(1)(a) and 715(2)(a) of ICTA.

1895. It is unnecessary for such traders to be included in the scheme as profits and losses on any securities they transfer are already included in their trading profits and losses.

Section 643: Non-residents

1896. This section excludes persons who are non-UK residents or are not ordinarily UK resident from the accrued income scheme. It is based on section 715(1)(f) and (2)(b) of ICTA.

1897. In practice it would be very difficult to apply the scheme to such non-residents consistently. While non-residents could take the benefit of relief for accrued income losses to get repayments of tax suffered if tax is deducted at source, it would be difficult to enforce the charge to tax on accrued income profits.

1898. *Subsections (2)* to *(4)* ensure that non-residents who trade in the United Kingdom through a branch or agency are not excluded from the scheme by subsection (1) if the securities are situated in the United Kingdom and are used or held for the purposes of the branch or agency (such non-residents may still be excluded by section 642).

Section 644: Individuals to whom the remittance basis applies

1899. This section excludes from the accrued income scheme individuals entitled to the benefit of the remittance basis in respect of interest on the securities transferred. It is based on section 715(1)(k) and (2)(b) of ICTA.

1900. Such individuals are taxed on the amounts of income received in the tax year and not on the amount of income arising in that year. The accrued income scheme applies the equivalent of the arising basis to the amounts it charges as accrued income profits.

Section 645: Charitable trusts etc

1901. This section excludes persons from the accrued income scheme in relation to a transfer of securities if they would be entitled to exemption from tax on the interest on the securities under section 532 or 533. It is based on section 715(1)(d) and (2)(b) of ICTA.

Section 646: Pension scheme trustees

1902. This section excludes pension scheme trustees from the accrued income scheme in relation to a transfer of securities if the trustees would be entitled to exemption from income tax on the interest on the securities under section 186 of FA 2004. It is based on section 715(1)(k) and (2)(b) of ICTA.

Section 647: Makers of manufactured payments

1903. This section excludes makers of "manufactured payments" from the accrued income scheme. It is based on section 715(6) of ICTA.

1904. Broadly, a person may "manufacture" interest by buying a security without accrued interest and then selling it with accrued interest just before the next interest payment date. The maker of the manufactured payment can deliver only an "ex-dividend" security and so "manufactures" (makes) a payment to the buyer as compensation for the buyer not receiving the interest to which the buyer is entitled. The manufactured payment is taxed as though it is actual income. Chapter 2 of Part 11 applies to manufactured payments.

1905. This section ensures that the tax charge under that Part takes priority over any possible tax charge under the accrued income scheme. It does so by treating the person who manufactures interest:

- as an excluded transferee in relation to the transfer under which the securities were acquired; and
- as an excluded transferor in relation to the onward sale.

1906. This treatment applies only if the value of the securities sold on at least equals the value of the securities acquired (but see section 663 for the reduction made where that value is insufficient).

Section 648: Strips of gilt-edged securities

1907. This section provides special rules for exchanges of gilt-edged securities for strips of such securities (and vice versa). It is based on section 722A of ICTA.

1908. Where a gilt-edged security is "stripped", *subsection (1)* treats the exchange as a transfer by the person who held the gilt-edged security but no one is treated as the transferee (see *subsection (2)*). The strips themselves are not within the accrued income scheme regime and any disposals of strips are dealt with under the rules relating to deeply discounted securities (see Chapter 8 of Part 4 of ITTOIA).

1909. Where strips are consolidated into a gilt-edged security (by exchanging the strips for a newly issued gilt-edged security), *subsection (3)* treats the acquisition of the gilt-edged security as a transfer to the person acquiring the single gilt-edged security but no one is treated as the transferor (see *subsection (4)*). The disposal of the strips is dealt with under the deeply discounted securities regime.

1910. For both kinds of transfer the settlement day for the transfer is the day on which the securities are transferred (see section 674(4)).

1911. The reference in *subsection (5)* to the time "after the balance has been struck for a dividend on the security" is to the time when the security goes ex-dividend in respect of the next interest payment day. Interest at the next interest payment date will go to the person registered as entitled to the security at that date, so an exchange after that date is treated as a transfer without accrued interest.

1912. Where a gilt-edged security is "stripped", although the security itself may be cancelled part of the way through an interest period, the formulas in sections 632(5)(b) and 633(5)(b) still work because they operate by reference to interest periods of securities of that kind. The assumption is that there will always be unstripped gilt-edged securities of the same kind as the stripped security. If not, however, section 673(4) deals with the possibility of all gilt-edged securities of a particular kind being stripped.

1913. Where strips are consolidated into a gilt-edged security, the consolidated security may be issued part way through an interest period for securities of that kind. As the consolidated security is fully fungible with other securities of the same kind, that interest period is taken (by virtue of the general rule in section 673(1)) to have begun immediately after the last interest payment day before the settlement day. (See *Change 106* in Annex 1 which amends the meaning of "interest period" for the purposes of that section.) The formulas in sections 632(5) and 633(5) can work on that basis because they operate by reference to interest periods of securities of that kind.

1914. *Subsection (7)* disregards as transfers transactions between the person making the exchange and the market maker (that is, the only type of person authorised by the rules of the market to facilitate the exchanges in question). So the market maker is not a transferee for the purposes of the accrued income scheme in respect of such exchanges.

1915. The definition of "gilt-edged security" is that in section 1024.

Section 649: New securities issued with extra return

1916. This section provides a special rule where securities are issued in tranches. It treats the issue of the new securities as a transfer with accrued interest. It is based on section 726A of ICTA.

1917. See also the commentary on section 662 which explains the special rule about payments treated as made.

1918. To raise finance, debt issuers may make further issues of the same securities ("new securities") rather than issue fresh securities. The new securities issued in each new tranche are intended to be fungible with the very first securities of that kind issued, so they have identical terms.

1919. However, where new securities are issued part way through an interest period, the interest payable on the next interest payment date would be less than the interest payable on that date for existing securities (assuming the same rate of accrual). To compensate for this and to ensure complete fungibility, the issuer will pay an extra amount of interest on these securities. The issue price of the securities in the new tranche may therefore be set to take account of this extra return.

1920. Under the accrued income scheme the extra return is treated in the same way as accruing interest.

1921. As the new securities have identical terms to the original securities they should pay the same interest on the next interest payment day. However, if they are issued part of the way through an interest period, the effective rate of interest will be different. So the securities may well fall within the definition of "variable rate securities", in which case this provision will not apply. Section 627(4) applies the test for variable rate securities to the new securities as though the interest payable on the first interest payment day after their issue relates to the period from the last interest payment day (or, if there was no such day, the date of issue) of the original securities to that day.

1922. This section makes the equivalent provision for the accrued income scheme that section 845 makes in relation to the charge to tax on interest.

Section 650: Trading stock appropriations etc

1923. This section treats as a transfer of securities certain changes in the capacity in which securities are held by a trader. It is based on section 722 of ICTA.

1924. Section 642 excludes financial traders from the accrued income scheme as profits and losses on any securities they transfer are already included in trading profits and losses. But a financial trader may hold securities as personal investments as well as in the capacity of financial trader.

1925. *Subsections (1)* and *(2)* deal with the case where securities are acquired in a non-trading capacity and are then appropriated as trading stock.

1926. *Subsections (3)* and *(4)* deal with the reverse case where securities held as trading stock are appropriated for some non-trading purpose.

1927. *Subsections (5)* and *(6)* deal with the case where securities are held as trading stock but the trade ceases without the securities changing ownership.

1928. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 651: Owner becoming entitled to securities as trustee

1929. This section treats the owner of securities who settles the securities on trust and becomes trustee of them (or one of the trustees of them) as transferring them. It is based on section 720 of ICTA.

1930. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 652: Securities ceasing to be held on charitable trusts

1931. This section treats trustees as transferring the securities in their capacity as charitable trustees to themselves in another capacity, if securities cease to be held on charitable trusts. It is based on section 715(3) of ICTA.

1932. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 653: Stock lending

1933. This section excludes stock lending transactions from the accrued income scheme. It is based on section 727 of ICTA.

1934. Broadly, stock lending is a mechanism by which a securities dealer makes an arrangement for an institutional investor to place some of its securities at the dealer's disposal. The dealer is therefore able to deliver securities the dealer has contracted to sell even if the dealer has been unable or unwilling to buy them in the market. (The dealer undertakes to return the securities, or equivalents, to the institution later. Although the mechanism is referred to as "lending", the securities do change ownership.)

1935. As the lending institution is entitled to the return of securities of the kind transferred under the lending arrangement, and effectively retains rights to the interest on them, the accrued income scheme disregards stock lending transfers.

Section 654: Sale and repurchase arrangements

1936. This section sets out the conditions under which section 655 applies. It also applies for the purposes of sections 656 to 658 which provide powers to modify the application of section 655. It is based on sections 727A, 730B and 737E(8) and (9) of ICTA.

1937. The section makes provision for repos for the purposes of the accrued income scheme equivalent to that made for repos in Part 11 (manufactured payments and repos) (see sections 569, 570 and 571).

1938. See paragraphs 125 and 126 of Schedule 2 which modify the operation of this and the following section for securities in relation to which amendments to the source legislation, by FA 1995 and FA 2003 respectively, do not apply.

1939. See also SI 1995/3220 (Sale and repurchase of securities (modification of enactments) Regulations 1995) which provides that in certain circumstances securities include substituted securities and the meaning of "buying back" securities is extended.

Section 655: Transfers under sale and repurchase arrangements

1940. This section excludes transfers under sale and repurchase agreements ("repos") from the accrued income scheme, if the transferor or a person connected with the transferor is required or entitled to repurchase the securities. It is based on section 727A of ICTA.

1941. Under a repo, as with stock lending, the economic benefit of the interest on the securities sold and repurchased remains with the original holder of the securities, to whom they return. The original owner is taxed on the interest under other rules so there is no need for the accrued income scheme to apply to either the sale or the repurchase.

1942. This section exempts the transfer under the sale and the transfer under the repurchase.

Section 656: Power to modify: non-standard sale and repurchase arrangements

1943. This section provides powers for regulations to modify the application of section 655 in relation to cases involving "non-standard sale and repurchase arrangements" (as defined in *subsection (2)*). It is based on section 737E of ICTA.

1944. The section makes provision for repos for the purposes of the accrued income scheme equivalent to that made for repos in Part 11 (manufactured payments and repos). See section 612.

Section 657: Power to modify: redemption arrangements

1945. This section provides powers for regulations to modify the application of section 655 in relation to cases involving "redemption arrangements" (as defined in *subsection (2)*). It is based on section 737E of ICTA.

1946. The section makes provision for repos for the purposes of the accrued income scheme equivalent to that made for repos in Part 11 (manufactured payments and repos). See section 613.

Section 658: Powers to modify: supplementary

1947. This section further describes the scope of the powers in sections 656 and 657 and defines terms used in those sections. It is based on section 737E of ICTA.

1948. It is broadly equivalent to section 614 in Part 11 (manufactured payments and repos).

Section 659: Transfers with or without accrued interest: interest in default

1949. This section modifies the calculation of the payments treated as made under a number of provisions if the interest is in default. It is based on section 718 of ICTA.

1950. The value of the right to receive interest may be affected if the issuer defaults or has previously defaulted on the obligation to pay interest. If this is the case, *subsection (2)*substitutes the value of the right to receive interest for the interest payable in the various calculations.

Section 660: Transfers with unrealised interest: interest in default

1951. This section deals with a transfer of securities with unrealised interest where interest is in default. It is based on section 719 of ICTA.

1952. Where securities are transferred with unrealised interest, the transferor is effectively charged to income tax on the unrealised interest (see section 630 and section 634). (The transferor may also be charged on other accrued income profits in respect of the same transfer if it is also a transfer of another of the types mentioned in section 622(2).)

1953. Where the issuer of the securities has defaulted on the obligation to pay interest, that default may affect the value of the interest coupons which are transferred (as, for example, when bearer securities are transferred with uncashed coupons attached). Where this is the case, under *subsections (2)* and *(3)*, when calculating the amount of the payment under section 634 or the amount of the accrued income profits under section 631, the value of the right to receive interest ("A") is substituted for the amount of the unrealised interest.

1954. However, A may be reduced where there have been successive transfers. Where this is the case, the calculation rules in section 661 apply.

1955. This section only deals with the position of the transferor. Accordingly *subsection (6)* signposts the exemption under section 681 for interest payable to the transferee. See in particular subsections (3) to (6) of that section which deal with the situation where unrealised interest is in default.

Section 661: Successive transfers with unrealised interest in default

1956. This section modifies the application of section 660 where the securities have previously been transferred with unrealised interest in default. It is based on section 719(4) of ICTA.

1957. *Subsection (1)* applies where the transferor originally acquired the securities with unrealised interest. In that case, A (see commentary on section 660) is reduced by the value of the right to receive the interest ("B") on the day the transferor acquired the securities (see *subsection (5)*). That is, the transferor is now given credit for the amount of consideration given for that value when the securities were acquired.

1958. But, if the transferor has received any of the interest in the meantime (or an amount on account of that interest), *subsection (4)* applies so that B is reduced by the amount of the interest received, thus increasing A. That is, to the extent the transferor has received the benefit of B, and has therefore recouped some of the consideration given for the securities, the credit given against the amount now chargeable, on the present transfer of the securities, is reduced.

1959. *Subsection (6)* makes clear that the amount of the reduction of A is itself reduced to nil where the amount of the credit found under subsection (4) or (5) exceeds the value found under subsection (1) by reference to section 660. That is, if the transferor has recouped amounts equal to or exceeding the value of the right to receive unrealised interest, at the time the securities were acquired, there is no credit to set against the value, A, which is now used in section 634(2) rather than the amount of the unrealised interest itself.

1960. Paragraph 127 of Schedule 2 saves the transitional rule that was in section 716(6) of ICTA (as substituted by section 719(4) of ICTA). That paragraph disapplies this section if the acquisition of the securities by the transferor occurred before 28 February 1986.

Section 662: New securities issued with extra return: special rules about payments

1961. This section provides for calculating the amount of the payment treated as made where securities have been issued in tranches and the conditions in section 649 apply. It is based on section 726A of ICTA.

1962. *Subsection (1)* provides that the amount of the payment is not calculated under section 632. Instead the amount is calculated by reference to *subsection (3)* or *(4)* (which are equivalent to the calculation rules in sections 632 and 633).

1963. The amount of the payment (that is, the extra return) is therefore taken into account under section 628 in calculating whether an accrued income profit or an accrued income loss is made. The effect of this (assuming no other transfer of the same kind of security has taken place in the interest period) is that the recipient of the new securities will only be taxed on the interest which accrued during the time he or she owned the securities.

Section 663: Transfers without accrued interest to makers of manufactured payments

1964. This section reduces the amount of the payment treated as made to the maker of a manufactured payment (the transferee) under section 633 if that person is not an excluded transferee under section 647(3) because the transferee has contracted to sell fewer securities than have been transferred to the transferee. It is based on section 715(6) and (7) of ICTA.

1965. The amount of the payment is treated as reduced to the extent that the maker of the manufactured payment has already contracted to sell securities of that kind. That is, while the maker of the manufactured payment is only an "excluded transferee" in relation to the acquisition of the securities if the securities sold on equal or exceed in amount those acquired, this section abates the amount of the payment under section 633 to the extent the acquisition and onward sale are in fact matched. This again ensures there is not a double charge to tax under Part 11 (manufactured payments and repos) and under the accrued income scheme.

Section 664: Foreign currency securities: sterling equivalent of payments on transfers

1966. This section provides for the application of the accrued income scheme if the interest on the securities is payable in a currency other than sterling. It is based on sections 713(7), (8), 716(6) and 726A(5) of ICTA.

1967. This section sets out the rules for converting amounts into sterling.

Section 665: Foreign currency securities: unrealised interest payable in foreign currency

1968. This section provides for the application of the accrued income scheme if unrealised interest on the securities is payable in a currency other than sterling. It is based on sections 713(7), (8), 716(6) and 726A(5) of ICTA.

1969. This section sets out the rules for converting amounts or values into sterling.

Section 666: Certain transfers by or to nominees or trustees treated as made by or to others

1970. This section provides for another person (or persons) to be regarded as the transferor or transferee if there is a transfer by or to trustees or nominees. It is based on section 720 of ICTA.

1971. *Subsection (1)* ensures that, where someone holds securities through a nominee, transfers of securities by or to the nominee are treated as being made by or to the person for whom the nominee acts. Consequently the charges under the accrued income scheme fall not on the nominee but on the principal.

1972. Likewise, *subsection (2)* ensures that, where securities are held on trust but the beneficiary is absolutely entitled to direct how the securities are to be dealt with, transfers of securities by or to the trustees are treated as being made by or to the beneficiary.

1973. *Subsections (3)*, *(4)* and *(5)* explain what is meant by a beneficiary being "absolutely entitled" against a trustee. *Subsection (8)* provides that a lack of legal capacity is ignored in deciding whether someone is absolutely entitled against a trustee.

1974. *Subsections (6)* and *(7)* apply the same rules as in subsections (1) and (2) but where two or more persons effectively own the securities. As subsection (7) makes provision for the case where two or more persons are absolutely entitled against a trustee, for consistency subsection (6) spells out for the case of nominees what may otherwise be derived from the application of the Interpretation Act 1978.

Section 667: Trustees' accrued income profits treated as settlement income

1975. This section provides for certain accrued income profits to be taken into account for the purposes of Chapter 5 of Part 5 of ITTOIA (where settlement income is taxed on the settlor). It is based on section 720(6) of ICTA.

1976. *Subsection (4)* defines the accrued income profits in question. They do not include profits in respect of a transfer with unrealised interest or profits chargeable under section 670 on the withdrawal of unremittable income relief. But they include profits in respect of transfers of variable rate securities. (See *Change 101* in Annex 1 which treats other transfers of variable rate securities where the settlement day is outside an interest period as redemption of such securities is treated.)

1977. *Subsection (1)* ensures that qualifying accrued income profits treated as received by trustees of a settlement are treated as arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA. The income is then chargeable on the settlor. The settlor may be eligible under section 680 for exemption in respect of interest on the securities, if the interest is also chargeable under that Chapter, by reference to accrued income losses arising to the trustees under section 628.

1978. *Subsections (2)* and *(3)* ensure that trustees who are non-UK resident or domiciled outside the United Kingdom are treated as receiving, for the purposes of the same Chapter, the amount of accrued income profits they would have been treated as receiving if they had been UK resident or domiciled in the United Kingdom. That is, by virtue of their actual residence status, the trustees are likely to be excluded transferors or transferees under section 643 in which case accrued income profits to which subsection (1) applies will not arise to them. By virtue of subsection (3), the same results follow as under subsection (1).

Section 668: Relief for unremittable transfer proceeds: general

1979. This section provides relief from the accrued income scheme charge if transfer proceeds cannot be remitted to the United Kingdom. It is based on section 723 of ICTA.

1980. It is equivalent to the relief provided by Chapter 4 of Part 8 of ITTOIA (unremittable income) for other foreign income.

1981. The section applies if a person is chargeable to income tax on accrued income profits arising from the transfer or transfers of "foreign securities" (defined in *subsection (4)*) and those proceeds are unremittable.

1982. *Subsection (1)* applies to all transfers and includes transfers of securities with unrealised interest. See *Change 103* in Annex 1 which extends the relief to such transfers.

1983. *Subsection (2)* indicates that a claim must be made for the relief to apply. Subsection (2) also explains that the accrued income profits are either reduced to nil or reduced by the amount of the relevant payments.

1984. *Subsection (5)* defines when proceeds are unremittable. Any one of the three reasons given is sufficient for proceeds to be unremittable. See *Change 104* in Annex 1 which broadens one condition in the source legislation for the relief and removes another.

1985. *Subsection (7)* explains that the claim must be made on or before the fifth anniversary of 31 January following the end of the tax year for which the profits would be chargeable were it not for the relief. See *Change 105* in Annex 1 which substitutes this time limit for claiming relief in respect of accrued income profits if the proceeds of the transfer of foreign securities are unremittable for the time limit in the source legislation.

Section 669: Relief for unremittable transfer proceeds: section 630 profits

1986. This section provides the same relief as section 668 but in respect of section 630 profits (cases where the settlement day is outside the interest period). It is based on section 723 of ICTA.

1987. See also *Change 101*, *Change 103* and *Change 105* in Annex 1.

Section 670: Withdrawal of relief

1988. This section treats the claimant of relief under section 668 or section 669 as making accrued income profits if relief has been granted and the proceeds of the transfer cease to be unremittable. It is based on section 723(4) of ICTA.

Section 671: Meaning of "interest"

1989. This section defines "interest" for the purposes of this Chapter. It is based on section 711(9) of ICTA.

1990. This section expands the meaning of "interest" beyond its normal meaning to take account of the meaning of "security" for the purposes of the accrued income scheme. The return on a gilt-edged security may be referred to as "dividend" (hence references to sales of securities "cum-dividend" or "ex-dividend") even though the return is in fact in the form of interest.

Section 672: Meaning of "interest payment day"

1991. This section defines "interest payment day" for the purposes of this Chapter. It is based on section 711(2) of ICTA.

Section 673: Meaning of "interest period"

1992. This section defines "interest period" for the purposes of this Chapter. It is based on section 711(3) of ICTA.

1993. If the period between interest payment days exceeds twelve months, it is not an interest period. Instead, the first twelve months of the period, each succeeding period of twelve months within that period, and any rump period, is an interest period. This ensures that charges under the accrued income scheme cannot be deferred by having long intervals between interest payment days.

1994. *Subsection (1)* defines when an interest period begins and when an interest period ends (which includes when twelve months has expired). This is subject to special rules in some cases – see *subsections (3)* to *(6)*.

1995. See *Change 106* in Annex 1 which amends the meaning of "interest period" in relation to this section.

Section 674: Meaning of "the settlement day"

1996. This section defines the "settlement day" in relation to any particular transaction for the purposes of this Chapter. It is based on section 712 of ICTA.

1997. The main rule is set out in *subsection (1)* and applies where securities are transferred under the rules of a recognised market (such as a stock exchange). Three other rules are set out in *subsections (3)*, *(4)* and *(6)*, which apply where a transfer is not made under the rules of a recognised stock exchange.

Section 675: The holding of securities

1998. This section sets out when someone is regarded as holding securities for the purposes of the Chapter. It is based on section 710(7), (8) and (10) of ICTA.

1999. This definition is needed for the "small holdings" tests in sections 639 to 641.

2000. *Subsection (3)* ensures that in Scotland, as elsewhere in the United Kingdom, transfers of securities involving partnerships are treated as though they were carried out by the individual partners and securities held by partnerships are treated as held by the individual partners. (In contrast to the rest of the United Kingdom, where a partnership has no separate legal personality, a partnership under Scots law is a legal person distinct from the partners it comprises.)

Section 676: Nominal value of securities: general

2001. This section determines the nominal value for the purposes of the Chapter. It is based on section 710(11) of ICTA.

2002. *Subsection (2)* deals with relatively rare cases where interest on the securities is not expressed to be payable by reference to a given value.

Section 677: Nominal value: foreign currency securities

2003. This section determines the nominal value of securities where that nominal value is expressed in a foreign currency. It is based on section 710(12) of ICTA.

Chapter 3: Exemptions relating to interest on securities

Section 678: Exemptions relating to interest on securities: preliminary

2004. This section introduces three exemptions from income tax on interest received following the transfer of securities and signposts relevant definitions and provisions in Chapter 2 of this Part. It is new.

Section 679: Interest on securities involving accrued income losses: general

2005. This section provides an exemption for interest on securities by reference to accrued income losses arising in respect of those securities. It is based on section 714(3) to (5) of ICTA.

2006. This is the commonest way in which exemption for interest on securities by reference to accrued income losses is given.

2007. *Subsection (1)* explains the conditions to be satisfied before relief is given and *subsection (2)* explains how much of the interest is exempt from tax. If the amount of interest exceeds the accrued income loss, the excess remains subject to income tax (i.e. under Chapter 2 of Part 4 of ITTOIA or, where a settlor is chargeable on the settlement income under Chapter 5 of Part 5 of ITTOIA, under that Chapter).

2008. For individuals, interest is taxed in the tax year in which it arises. So the tax year in which the accrued income losses arise will be the same as the tax year in which the interest is taxed.

2009. For partnerships, interest may be taxed more than once in different tax years (and may therefore be taxed in a different tax year from that in which it arises). *Subsection (3)* prevents any person from being entitled to a reduction from interest in more than one tax year, and restricts the year when the reduction may be made to the tax year in which the interest period ends.

2010. See *Change 107* in Annex 1 which substitutes an exemption for a reduction and determines the tax year for which the exemption is available to partners.

Section 680: Interest on securities involving accrued income losses: foreign trustees

2011. This section provides an exemption for a settlor chargeable under Chapter 5 of Part 5 of ITTOIA if the settlor would have benefited from exemption under section 679 had the foreign trustees of the settlement in question been resident or domiciled in the United Kingdom. It is based on section 720(7) of ICTA.

2012. This section complements section 667 in Chapter 2.

2013. *Subsection (2)* confirms that the amount of relief given against a charge under Chapter 5 of Part 5 of ITTOIA is equal to the amount of the settlor's income under that Chapter that would have benefited from exemption under section 679 if the trustees had been resident in the United Kingdom or domiciled in the United Kingdom. (That is, by virtue of their actual residence status, the trustees are likely to be excluded transferors or transferees under section 643 and accrued income profits will therefore not arise to them, so that the condition in section 679(1)(b) is not met.)

2014. See again *Change 107* in Annex 1.

Section 681: Unrealised interest received by transferee after transfer

2015. This section provides an exemption for unrealised interest on securities if the securities have been transferred with unrealised interest. It is based on sections 716(4) and (5) and 719(3) of ICTA.

2016. As explained in the commentary on section 634, if securities are transferred with unrealised interest (and the settlement day falls before the end of the last interest period) a payment is treated as made to the transferor but no one is treated as making the payment. The unrealised interest is acquired by the transferee from the transferor and the effect of treating this payment as made to the transferor is to charge the transferor to income tax on the interest (which accrued while in the transferor's ownership).

2017. It follows that when the unrealised interest is subsequently received by the transferee it should not be taxed in the transferee's hands or the interest would be taxed twice. This section prevents double taxation by exempting the interest from income tax.

2018. *Subsection (2)* indicates that the transferee is exempt from income tax on the receipt of the unrealised interest unless *subsections (3)* and *(4)* apply.

2019. Subsection (3) applies if the issuer of the securities has defaulted on the obligation to pay interest. In such a case, the payment treated as made to the transferor under section 634 is changed to reflect the value of the right to receive interest (instead of the amount of the interest). The amount of the interest which is exempt from tax in the hands of the transferee is correspondingly restricted. See the commentary on sections 660 and 661.

2020. The result is that the interest is taxed, but only (see *subsection (6)*) to the extent that it exceeds the value on the day of the transfer of the right to receive the interest (see subsection (4)).

2021. See paragraph 128 of Schedule 2 which restricts the application of the section if the transfer mentioned in subsection (1) occurred before 19 March 1986.

Part 13: Tax avoidance

Overview

2022. This Part contains provisions relating to various types of tax avoidance. The Chapters are arranged as follows:

- Transactions in securities (Chapter 1);
- Transfer of assets abroad (Chapter 2);
- Transactions in land (Chapter 3);
- Sales of occupation income (Chapter 4);
- Avoidance involving trading losses (Chapter 5).

Chapter 1: Transactions in securities

Overview

2023. This Chapter rewrites, for the purposes of income tax, sections 703 to 709 of ICTA.

2024. Sections 703 to 709 of ICTA were enacted as a wide-ranging anti-avoidance rule which would enable the Crown to counter all manner of devices to avoid income tax involving transactions in shares or other securities or the manipulation of a company's assets or both, and to forestall the creation of such devices in future.

2025. The sections of this Chapter are arranged in the following order:

- Sections 682 and 683 – introduction (section 683 defines the central concept of "income tax advantage");
- Sections 684 and 685 – definition of the person liable to counteraction of income tax advantages;
- Sections 686 to 694 – circumstances in which, if income tax advantages are obtained or obtainable, the Chapter may apply;
- Sections 695 to 700 – procedure for counteraction of income tax advantages;
- Sections 701 to 703 – clearance procedure and information powers;
- Section 704 – how the special tribunal for the purposes of this Chapter is to be constituted;
- Sections 705 to 711 – appeals;
- Sections 712 and 713 – supplementary.

Section 682: Overview of Chapter

2026. This section provides an overview of the Chapter. It is based on section 703(1) of ICTA.

2027. *Subsection (2)* provides a signpost to section 698, which is concerned with the issue of notices counteracting income tax advantages.

Section 683: Meaning of "income tax advantage"

2028. This section defines "income tax advantage" for the purposes of this Chapter. It is based on section 709(1) and (2A) of ICTA.

2029. This Act consequentially amends sections 703 to 709 of ICTA to apply solely for corporation tax purposes. In particular, sections 703 to 709 of ICTA will use the term "corporation tax advantage".

2030. But the definition of "tax advantage" in section 709(1) of ICTA is used in a large number of other anti-avoidance provisions (such as paragraph 13 of Schedule 9 to FA 1996 (loan relationships: unallowable purposes test)). To ensure that these provisions are not disturbed, this Act inserts a new section 840ZA of ICTA (meaning of "tax advantage"), and consequentially amends those provisions outside Chapter 1 of Part 17 of ICTA which use the section 709(1) definition of "tax advantage".

Section 684: Person liable to counteraction of income tax advantage

2031. This section defines the person liable to counteraction. It is based on section 703(1) and (2) of ICTA.

2032. *Subsection (1)* sets three positive conditions for this section to apply to a person in respect of a transaction in securities or two or more such transactions.

2033. The first condition, in the opening words of subsection (1), is that the person is in a position to obtain or has obtained an income tax advantage.

2034. The second condition, in subsection (1)(a), is that the person is in a position to obtain or has obtained the income tax advantage in circumstances where any of the specified provisions applies in relation to the person.

2035. The third condition, in subsection (1)(b), is that the person is in a position to obtain or has obtained the income tax advantage in consequence of either the transaction or the combined effect of the transactions.

2036. *Subsection (3)* covers the situation when an income tax advantage is obtained or obtainable by a person in consequence of the combined effect of the transaction or transactions and the liquidation of a company.

Section 685: Exception where no tax avoidance object shown

2037. This section provides an exception to section 684 in certain circumstances. It is based on the escape clause in section 703(1) of ICTA.

2038. *Subsection (1)* provides that a person is taken out of section 684 if that person shows that both conditions A and B are met. These conditions are defined in *subsections (2)* and *(3)*.

2039. Section 703(1) contains a reference to "the transaction or transactions being carried out". In Greenberg v CIR (1971), 47 TC 240 HL (at pages 279 and 283) Lord Guest and Lord Simon of Glaisdale said that "carried out" in section 703(1) of ICTA meant "effected" as in section 707 of ICTA rather than "implemented". Sections 685(2) and 701 (which is based on section 707 of ICTA) therefore both refer to transactions being "effected". This is a verbal change to provide consistency. It does not change the law.

Section 686: Abnormal dividends used for exemptions or reliefs (circumstance A)

2040. This section is the first in a sequence of sections in which the sets of circumstances in section 704 of ICTA are laid out and expanded in five separate sections. It is based on sections 704 A and 709(3) of ICTA.

2041. The sequence also includes four interpretative sections based on sections 704 D and 709 of ICTA. The approach here takes account of the comments of Slade J in CIR v Garvin (1981), 55 TC 24[1] at page 50:

> "The five circumstances set out in [what is now section 704 of ICTA] are set out in minute detail, not for the assistance of the Crown but for the protection of the subject, in the context of a preceding section of a penal nature.

2042. *Subsection (1)* requires that three conditions set out in subsections (2) to (4) must be satisfied if section 686 is to apply to a person.

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1 [1981] STC 344.

2043. *Subsection (3)* lays down what the receipt must be in connection with. The approach taken here differs from that in the source legislation. First, the subsection brings together provisions that were previously drafted in separate subsections. Second, in line with judicial comment on these provisions, it does not treat section 709(3)(a) and (b) as non-exhaustive definitions. The approach taken here is consistent with the case law on these provisions: CIR v Parker (1966) 43 TC 396 HL, CIR v Cleary (1967) 44 TC 399 HL, Hague v CIR (1968) 44 TC 619 CA, CIR v Horrocks (1968) 44 TC 645 Ch D and CIR v Wiggins (1978) 53 TC 639 Ch D[2].

2044. *Subsection (4)* prescribes the tax purposes for which the amount received must be taken into account.

2045. Section 704 A(f) of ICTA is redundant and, accordingly, is repealed without replacement.

Section 687: Deductions from profits obtained following distribution or dealings (circumstance B)

2046. This section is based on sections 704 B(1) and 709(3)of ICTA.

2047. *Subsection (1)* requires that three conditions set out in subsections (2) to (4) must be satisfied if section 687 is to apply to a person.

2048. *Subsection (2)* provides that the person must become entitled to a deduction in calculating profits or gains in respect of securities.

2049. *Subsection (3)* prescribes what the person's entitlement must arise in connection with. See also the commentary on section 686(3).

2050. This section does not rewrite section 704 B(2), which is corporation tax specific.

Section 688: Receipt of consideration representing company's assets, future receipts or trading stock (circumstance C)

2051. This section is based on sections 704 B, 704 C and 709 of ICTA.

2052. *Subsection (1)* requires that three conditions set out in subsections (2), (3) and (6) must be satisfied if section 688 is to apply to a person (A).

2053. *Subsection (2)* is about the receipt of consideration. It prescribes what the consideration must be if section 688 is to apply to A.

2054. *Subsection (3)* requires that, if section 688 is to apply to a receipt, it must be in consequence of a transaction whereby another person (B) – to summarise – either receives an abnormal amount by way of dividend or becomes entitled to a deduction in calculating profits or gains in respect of B's securities. Subsection (3) retains the source legislation's connective "whereby", which has been the subject of judicial comment.

2055. *Subsection (4)* prescribes what B's entitlement (in subsection (3)) must arise in connection with. On the rewrite of section 709(3)(a) and (b) in this context, see the comment on section 686(3).

2056. Section 709(3)(c) of ICTA (meaning of "consideration") is rewritten for the purposes of section 688 in *subsection (8)*. Subsection (8) extends "consideration" to include non-contractual receipts of money or money's worth.

Section 689: Receipt of consideration in connection with relevant company distribution (circumstance D)

2057. This section is based on sections 704 C, 704 D and 709 of ICTA.

2 [1979] STC 244.

2058. *Subsection (1)* requires that three conditions set out in subsections (2) to (4) must be satisfied if section 689 is to apply to a person.

2059. *Subsection (2)* is concerned with the receipt of consideration. It prescribes what the receipt must be in connection with if section 689 is to apply to the person in question. It is based on sections 704 D(1) and 709(3)(a) and (b) of ICTA.

2060. On the rewrite of section 709(3)(a) and (b) in this context, see the comment on section 686(3).

2061. *Subsection (6)* is concerned with "consideration". It is based on section 709(3)(c) of ICTA. It extends "consideration" to include non-contractual receipts of money or money's worth.

Section 690: Receipt of assets of relevant company (circumstance E)

2062. This section is based on section 704 E and 709(3) of ICTA.

2063. *Subsection (1)* requires that four conditions set out in subsections (2) to (4) and (7) must be satisfied if section 690 is to apply to a person.

2064. *Subsection (8)* defines "security" and (non-exhaustively) "consideration" and "share" in section 690. It extends "consideration" to include non-contractual receipts of money or money's worth.

Section 691: Meaning of "relevant company" in sections 689 and 690

2065. This section defines the term "relevant company", which is used in sections 689 and 690. It is based on section 704 D of ICTA.

Section 692: Abnormal dividends: general

2066. This section is the first of three interpretative sections about abnormal dividends. It is based on section 709(4) of ICTA.

2067. *Subsection (1)* provides that a dividend is abnormal if "the appropriate authority" is satisfied either that "the excessive return condition" is met or that "the excessive accrual condition" is met. Signposts are provided to sections 693 and 694, where these conditions are defined.

2068. *Subsection (2)* defines "the appropriate authority". It replaces the reference to "the Board" with a reference to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2069. HMRC's internal procedures restrict the exercise of the Commissioners for Revenue and Customs' functions under Chapter 1 of Part 17 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

Section 693: Abnormal dividends: the excessive return condition

2070. This section defines the excessive return condition. It is based on section 709(4) and (6) of ICTA.

Section 694: Abnormal dividends: the excessive accrual condition

2071. This section defines the excessive accrual condition. It is based on section 709(4) and (5) of ICTA.

Section 695: Preliminary notification that section 684 may apply

2072. This section is concerned with preliminary notification that section 684 (person liable to counteraction of income tax advantages) may apply. It is based on section 703(3) and (9) of ICTA.

2073. The section is the first of a group of sections (sections 695 to 700) which lay down the procedure for counteraction of income tax advantages.

2074. As explained in the note on section 692, section 695 similarly replaces a reference to “the Board” with a reference to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

Section 696: Opposed notifications: statutory declarations

2075. This section applies if the person on whom the preliminary notification is served considers that section 684 does not apply. It is based on section 703(9) and (10) of ICTA.

2076. As explained in the note on section 692, this section similarly replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2077. *Subsections (1)* and *(2)* are about the person’s right to make a statutory declaration that section 684 does not apply and the time limit for doing so.

2078. *Subsection (3)* lays down the legal consequences if the person makes a statutory declaration, sends it to the officer and the officer sees no reason to take further action.

Section 697: Opposed notifications: determinations by tribunal

2079. This section applies if the officer receiving a statutory declaration sees reason to take further action. It is based on section 703(10) of ICTA.

2080. As explained in the note on section 692, section 697 similarly replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2081. *Subsections (2)* and *(3)* are about what the officer must and may do.

2082. If the taxpayer gives a statutory declaration that section 684 does not apply and the officer sees reason to take further action, subsection (2) requires the officer to send the tribunal a certificate to that effect, together with the statutory declaration.

2083. *Subsection (4)* is about what the tribunal must do.

2084. *Subsection (5)* lays down the legal consequences if the tribunal determines that there is no case for the officer to take further action.

2085. *Subsection (6)* limits those consequences to cases where the transaction or transactions under review are the only ones involved.

Section 698: Counteraction notices

2086. This section is concerned with notices for the counteraction of income tax advantages. It is based on section 703(3), (9), (10) and (12) of ICTA.

2087. As explained in the note on section 692, section 698 similarly replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2088. *Subsection (1)* lays down that the officer can serve a counteraction notice in two circumstances, namely if:

- the person on whom a preliminary notification has been served has not exercised the right to make a statutory declaration in the time allowed; or
- the person has exercised this right, but the tribunal has determined that there is a prima facie case for counteraction.

2089. Subsection (1), unlike the source legislation, makes it explicit that counteraction can proceed once the tribunal has determined that there appears to be a case for counteraction. This follows a dictum to that effect from Oliver J in Balen v CIR (1978) 52 TC 406[3] at page 408.

2090. *Subsection (4)* specifies the kinds of adjustment which a notice may require to be made, including an assessment.

Section 699: Limit on amount assessed in section 689 and 690 cases

2091. This section sets a limit on the amount assessed in cases within sections 689 and 690. It is based on section 703(3A) of ICTA.

Section 700: Timing of assessments in section 690 cases

2092. This section is a special rule for the timing of assessments in section 690 cases. It is based on section 704 E(2) and (3) of ICTA.

Section 701: Application for clearance of transactions

2093. This section is concerned with applications for clearance of transactions. It is based on section 707(1) of ICTA.

2094. This section will apply solely for income tax purposes, and section 707 of ICTA will apply solely for corporation tax purposes. HMRC's operational guidance will tell officers what action they should take if a clearance application is made which appears to refer to the wrong provision.

Section 702: Effect of clearance notification under section 701

2095. This section lays down the legal consequences of HMRC giving a clearance notification under section 701. It is based on section 707 of ICTA.

2096. This section will apply solely for income tax purposes, and section 707 of ICTA will apply solely for corporation tax purposes. If HMRC issue a section 702 or section 707 clearance which refers by mistake to the wrong provision, HMRC will treat it as if it referred to the correct provision.

Section 703: Power to obtain information

2097. This section gives HMRC power to obtain information relevant to this Chapter. It is based on section 708 of ICTA.

2098. Section 703 changes the 28-day information gathering time limit to 30 days. See *Change 108* in Annex 1.

2099. As explained in the note on section 692, section 703 replaces references to "the Board" with references to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2100. This section will apply solely for income tax purposes, and section 708 of ICTA will apply solely for corporation tax purposes.

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3 [1978] STC 420.

Section 704: The tribunal

2101. This section prescribes how the special tribunal for the purposes of this Chapter is to be constituted. It is based on section 706 of ICTA.

Section 705: Appeals against counteraction notices

2102. This section is concerned with appeals against counteraction notices. It is based on section 705(1) and(5) of ICTA.

2103. Section 705(5) of ICTA gives the Special Commissioners the power not only to vary or quash an assessment but also, implicitly, to affirm it: see Browne-Wilkinson J in Anysz v CIR (1977), 53 TC 601 ChD at page 630[4]. *Subsection (3)* makes this implication explicit, and similarly makes it explicit that the Special Commissioners have the power to affirm a counteraction notice.

Section 706: Rehearing by tribunal of appeal against counteraction notice

2104. This section is concerned with the tribunal rehearing appeals against counteraction notices. It is based on section 705(2), (3) and (5) of ICTA.

2105. As explained in the note on section 692, this section similarly replaces references to "the Board" with a reference to "an officer of Revenue and Customs" (namely, the officer dealing with the case) See *Change 5* in Annex 1.

2106. Section 705(3) of ICTA provides that the tribunal shall "have and exercise" the same "powers and authorities" as the Special Commissioners. In the present context, exercising a power is implicit in having it and it is unnecessary to refer to both "powers" and "authorities". *Subsection (4)*, which is based on this part of section 705(3), therefore merely says that the tribunal have the same powers in relation to the appeal as the Special Commissioners.

Section 707: Statement of case by tribunal for opinion of High Court or Court of Session

2107. This section is concerned with appeals from the tribunal to the High Court (in England and Wales) or the Court of Session (in Scotland). It is based on sections 705(5) and 705A of ICTA.

2108. As explained in the note on section 692, this section similarly replaces a reference to "the Board" with a reference to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2109. This section removes the requirement in section 705A of ICTA for the dissatisfied party to declare "his or their dissatisfaction" before requiring the tribunal to state a case for the opinion of the court. This is a minor administrative change in the law. See *Change 109* in Annex 1.

Section 708: Cases before High Court or Court of Session

2110. This section is concerned with cases before the High Court or the Court of Session. It is based on section 705A of ICTA.

Section 709: Effect of appeals against tribunal's determination under section 706

2111. This section sets out the legal consequences if the tribunal have made a determination under section 706 about an assessment and a case has been required to be stated about it under section 707 or is pending before the High Court or the Court of Session. It is based on section 705A(10) to (12) of ICTA.

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4 [1978] STC 296 at page 321.

Section 710: Appeals from High Court or Court of Session

2112. This section is concerned with appeals from the High Court and the Court of Session. It is based on section 705A(8), (9) and (12) of ICTA.

2113. This section refers to "the Supreme Court" rather than "the House of Lords". This anticipates the substitutions to be made by paragraph 47 of Schedule 9 to the Constitutional Reform Act 2005. This Act includes a transitional amendment substituting "the House of Lords" for "the Supreme Court" for the period before the paragraph 47 amendments come into force.

Section 711: Proceedings in Northern Ireland

2114. This section deals with proceedings in Northern Ireland. It is based on section 705B of ICTA.

2115. Section 705B of ICTA (transactions in securities: proceedings in Northern Ireland) applies the procedures of section 705A of ICTA to Northern Irish appeals. In particular, it provides that "the Taxes Acts (as defined in section 118(1) of [TMA])" shall have effect as if section 705A of ICTA applied with modifications to reflect the court system in Northern Ireland.

2116. Section 118(1) of TMA defines "the Taxes Acts" as "this Act [ie TMA] and (a) the Tax Acts and (b) the Taxation of Chargeable Gains Act 1992 and all other enactments relating to capital gains tax."

2117. The implicit reference to the enactments relating to capital gains tax is redundant. This section therefore omits it.

2118. This section refers to "the Supreme Court" rather than "the House of Lords". In this connection see the commentary on section 710.

Section 712: Application of Chapter where individual within section 684 dies

2119. This section is concerned with the application of this Chapter where an individual within section 684 has died. It is based on section 703(11) of ICTA.

2120. *Subsection (3)* expressly refers not only to the making of a statutory declaration, rights of appeal and the giving of information (like the source legislation) but also to notices and notifications such as are mentioned in *subsection (2)*. This reference is implicit in section 703(11) of ICTA.

Section 713: Interpretation of Chapter

2121. This section is interpretative. It is based on section 709(2) of ICTA.

2122. In CIR v Joiner (1975), 50 TC 449 HL[5] Lord Diplock said (at page 487):

> "In the instant case the explanation in [what is now section 709(2) of ICTA] of the expression "transaction in securities", though introduced by the word "includes", speaks of "transactions, of whatever description, relating to securities" as well as referring to particular examples of such transactions. This is so extensive as to leave no possibility of there being any transaction which could sensibly be described as a "transaction in securities" without also falling within the longer description in the interpretation clause. So it is no more than a direction to the reader: "Whenever you see the words "transaction in securities" in this Chapter of the Statute you must treat them as being shorthand for the whole of the words in [what is now section 709(2)] that are preceded by the verb "includes" [in the fourth place in which it occurs]."

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5 [1975] STC 657.

2123. Buckley J and Lord Simon of Glaisdale had made the same point in Greenberg v CIR (1971), 47 TC 240 at pages 260 and 282.

2124. This section therefore expressly rewrites the definition of "transaction in securities" as exhaustive.

Chapter 2: Transfer of assets abroad

Overview

2125. This Chapter contains provisions directed against tax avoidance by means of transfers of assets.

2126. The sections of this Chapter are arranged in the following order:

- Sections 714 to 719 – introduction;
- Sections 720 to 726 – charge where power to enjoy income;
- Sections 727 to 730 – charge where capital sums received;
- Sections 731 to 735 – charge where benefit received;
- Sections 736 to 742 – exemptions: no tax avoidance purpose or genuine commercial transaction;
- Sections 743 to 747 – general;
- Sections 748 to 751 – supplementary.

Section 714: Overview of Chapter

2127. This section provides an overview of the Chapter.

2128. *Subsection (1)* introduces the three charges that are imposed by the Chapter. It is new.

2129. *Subsection (4)* extends references to individuals to include their spouses and their civil partners. It is based on section 742(9) of ICTA.

Section 715: Meaning of "relevant transaction"

2130. This section defines the expression "relevant transaction". It is based on section 741B(2) of ICTA.

2131. Either a "relevant transfer" or an "associated operation" may be a "relevant transaction", and the convenient new label "relevant transaction" is used extensively in this Chapter.

2132. The expressions "relevant transfer" and "associated operation" are defined in sections 716 and 719, to which *subsection (2)* provides signposts.

Section 716: Meaning of "relevant transfer" and "transfer"

2133. This section defines "relevant transfer" and "transfer" for the purposes of this Chapter. It is based on sections 739(1), 740(1) and 742(1A) and (9) of ICTA.

Section 717: Meaning of "assets" etc

2134. This section non-exhaustively defines the term "assets" and makes provision about the interpretation of references to assets representing assets, income or accumulations of income. It is based on section 742(9) of ICTA.

Section 718: Meaning of "person abroad" etc

2135. This section introduces the term "person abroad", meaning a person who is resident or domiciled outside the United Kingdom. It is based on sections 739(1) to (3), 740(1) and (3), 742(2), (4), (8) and (9A) and 745(3) of ICTA and section 111(1) of FA 1989.

2136. *Subsection (2)* provides that a UK resident body corporate that is incorporated outside the United Kingdom is treated as if it were resident outside the United Kingdom. It forestalls arguments that a non-UK incorporated but UK resident body corporate is somehow domiciled in a part of the United Kingdom and therefore not a person abroad.

2137. Subsection (2) also provides that a person treated as neither UK resident nor ordinarily UK resident under section 475(3) (trustees of settlements) and persons treated as non-UK resident under section 834(4) (personal representatives) are treated as resident outside the United Kingdom (and thus persons abroad).

Section 719: Meaning of "associated operation"

2138. This section defines the term "associated operation". It is based on section 742(1) of ICTA.

2139. This section includes a minor change in the law relating to the references to "assets" in section 742(1) of ICTA. See *Change 110* in Annex 1.

Section 720: Charge to tax on income treated as arising under section 721

2140. This section imposes the charge to income tax on individuals with power to enjoy income as a result of relevant transactions and indicates the measure of income and the person liable. It is based on sections 739(1), (2) and 743(1) of ICTA. It is the first of a sequence of sections (sections 720 to 726) which deal with this charge.

2141. *Subsection (5)* provides that the individual to whom income is treated as arising is the person liable. This person is defined in section 721.

2142. This section also provides signposts to other sections detailing how the income charged is calculated and when exemption is due.

Section 721: Individuals with power to enjoy income as a result of relevant transactions

2143. This section describes the individual to whom income is treated as arising and the circumstances in which it is treated as arising. It is based on sections 739(1) to (2) and 742(1B) of ICTA.

2144. Sections 739(2) and (3) of ICTA indicate the person liable by using the expression "such an individual" – but do not make it clear how much of section 739(1) is implied by that expression. This section and section 728, which are based on section 739(2) and (3), reproduce the expression "such an individual", which has been the subject of case law: see, in particular, Vestey v CIR (1979), 54 TC 503 HL[6].

Section 722: When an individual has power to enjoy income of person abroad

2145. This section defines in general terms when an individual has power to enjoy income of a person abroad. It is based on section 742(2) and (3) of ICTA. One of the conditions for liability under section 720 is that the individual has "power to enjoy" income of a person abroad: section 721(2).

2146. *Subsection (1)* introduces the concept of the enjoyment conditions. *Subsection (2)* provides a link to section 723, which sets out those conditions.

6 [1980] STC 10.

Section 723: The enjoyment conditions

2147. This section continues the definition of when an individual has power to enjoy income of a person abroad, by detailing "the enjoyment conditions". It is based on section 742(2) of ICTA.

Section 724: Special rules where benefit provided out of income of person abroad

2148. This section deals with the quantum of charge where:

- the enjoyment condition is the receipt of a benefit provided out of the income of the person abroad or related money; and
- the individual has not been charged previously to income tax on that income.

It is based on section 743(5) of ICTA.

Section 725: Reduction in amount charged where controlled foreign company involved

2149. This section gives apportionment under the controlled foreign company (CFC) rules in Chapter 4 of Part 17 of ICTA priority over the income treated as arising under section 721. It is based on section 747(4) of ICTA.

2150. The CFC rules address a similar mischief to the transfer of assets abroad legislation (avoidance by companies rather than individuals), but in a different way. This section prevents double taxation and determines which branch of anti-avoidance legislation takes priority.

Section 726: Non-domiciled individuals

2151. This section provides that an individual is not chargeable to tax under section 720 in respect of income treated as arising to the individual under section 721 if two conditions are met. It is based on section 743(3) of ICTA.

2152. This section is similar to sections 831 and 832 of ITTOIA 2005 (claims by non-domiciled individuals for relevant foreign income to be charged on the remittance basis).

Section 727: Charge to tax on income treated as arising under section 728

2153. This section imposes the charge to income tax, on individuals receiving capital sums as a result of relevant transactions, which was previously imposed by section 739(3) of ICTA. It indicates the measure of income and the person liable. It is based on sections 739 and 743 of ICTA. It is one of a sequence of sections (sections 727 to 730) which are based on the former charge under section 739(3).

2154. Sections 727 to 730 defeat schemes designed to avoid liability under sections 720 to 726.

Section 728: Individuals receiving capital sums as a result of relevant transactions

2155. This section largely replicates section 721. It is based on sections 739(1), (1A) and (3), 742(1A) and 747(4) of ICTA.

Section 729: The capital receipt conditions

2156. This section is concerned with the expression "receives or is entitled to receive any capital sum". It is based on section 739(3) to (6) of ICTA.

2157. This section also makes it clear that where liability arises because an individual has only an entitlement to receive a capital sum, rather than actual receipt, then liability under section 727 continues only for as long as the entitlement to receive a capital sum exists. See *Change 111* in Annex 1.

2158. If the entitlement to the capital sum ceases because the capital sum is actually paid to the transferor (either in whole or in part), then the receipt of the capital sum does result in continuing liability under this section; *subsection (1)* reflects this.

2159. *Subsection (2)* makes an exception to this rule. If a sum is received by way of loan, this does not give rise to liability if the loan is wholly repaid before the tax year begins. Subsection (2) is based on section 739(6) of ICTA.

2160. *Subsection (4)* comments on the expression "receives or is entitled to receive" in subsection (1).

Section 730: Non-domiciled individuals

2161. This section is the equivalent, for this sequence of sections, of section 726. It is based on section 743(3) of ICTA.

Section 731: Charge to tax on income treated as arising under section 732

2162. This section imposes the charge, on non-transferors receiving a benefit as a result of relevant transactions, previously imposed by section 740 of ICTA. It indicates the measure of income and the person liable. It is based on section 740(2). It is one of a sequence of sections (sections 731 to 735) which are based on the former charge under section 740 of ICTA.

2163. Sections 731 to 735 deem individuals to receive taxable income if (broadly speaking) they receive benefits as a result of transfers of the kind envisaged in sections 720 to 730 but are not liable under those sections.

Section 732: Non-transferors receiving a benefit as a result of relevant transactions

2164. This section sets out the circumstances under which income is treated as arising. It is based on sections 740(1) and (2) and 742(1A) of ICTA.

2165. *Subsection (1)(d)* also makes it clear that persons who are liable to income tax under section 720 or section 727 are not subject to the charge under section 731. See *Change 112* in Annex 1.

Section 733: Income charged under section 731

2166. This section sets out in a method statement the rules for determining the amount (if any) of income treated as arising under section 731. It is based on sections 740(2) and (3) and 741C(7) of ICTA.

2167. It also spells out some implications which involve minor changes to the law. See *Change 113* in Annex 1.

2168. In broad terms, the effect of this section and section 734 is:

- to tax non-transferors on benefits which they receive (but only on the amount or value of those benefits);
- to ensure that tax will only be charged on a benefit to an individual if income has arisen by the use of which such benefits could be provided; and
- to ensure nevertheless that tax will not be avoided merely by conferring the benefit before the "relevant income" is actually available.

2169. The method statement in this section will make no practical difference to taxpayers' record-keeping obligations.

2170. The method statement makes it clear that "relevant income" in relation to an individual is not actually taxable income of the individual, but is an element in the calculation of taxable income. "Relevant income" is actual income arising to a person abroad; the income charged under section 731 is income treated as arising to the individual in question. This deemed income may be more or less than "the relevant income of the tax year" in relation to the individual and the tax year identified at Step 3.

2171. The Act will have effect for income tax purposes for 2007-08 and later tax years. But the calculation of income charged under section 731 in (for example) 2007-08 will take account of "relevant income" in relation to the individual, not only of 2007-08 but (if the statutory conditions were satisfied) of earlier tax years – whether or not the individual had any liability under section 740 of ICTA for those tax years.

Section 734: Reduction in amount charged: previous capital gains tax charge

2172. This section supplements section 733; it is directed against the same amount being charged to both income tax and capital gains tax. It is based on section 740(6) of ICTA.

Section 735: Non-domiciled individuals

2173. This section gives a measure of relief to non-domiciled individuals. It is based on section 740(5) of ICTA.

2174. *Subsection (1)* lays down the conditions for this section to apply. If an individual receives a benefit which would otherwise be chargeable to income tax under section 731, this section applies if conditions A to C are met. These conditions are set out in subsections (2), (3) and (4).

2175. If this section applies, *subsection (5)* provides that the benefit does not give rise to an income tax charge on the individual, to the extent that the chargeable amount of this benefit is determined by reference to the relevant income to which condition C applies.

2176. This section is similar to sections 831 and 832 of ITTOIA 2005 (claims by non-domiciled individuals for relevant foreign income to be charged on the remittance basis).

Section 736: Exemptions: introduction

2177. This section introduces sections 737 to 742, a sequence of sections giving exemption from liability under this Chapter. It is based on section 741B(2) to (5) of ICTA.

2178. *Subsection (3)* defines the expressions "post-4 December 2005 transaction" and "pre-5 December 2005 transaction", which are used extensively in this sequence of sections.

Section 737: Exemption: all relevant transactions post-4 December 2005 transactions

2179. This section sets the purpose test which applies if all the relevant transactions are post-4 December 2005 transactions. It is based on section 741A(1) to (4), (7) and (8) and section 741B(4) of ICTA.

Section 738: Meaning of "commercial transaction"

2180. This section defines the expression "commercial transaction", which is used in Condition B in section 737(4). It is based on section 741A(5) to (7) of ICTA.

Section 739: Exemption: all relevant transactions pre-5 December 2005 transactions

2181. This section sets the purpose test which applies if all the relevant transactions are pre-5 December 2005 transactions. It is based on sections 741(1) and 741B(3) of ICTA.

2182. This section replaces references to "the Board" with references to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2183. HMRC's internal procedures restrict the exercise of the Commissioners for Her Majesty's Revenue and Customs' functions under section 741 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

2184. This section continues to use the source legislation's word "taxation", which has been the subject of case law. For example, Sassoon v CIR (1943), 25 TC 154 CA indicates that "taxation" in this context is not restricted to income tax.

Section 740: Exemption: relevant transactions include both pre-5 December 2005 and post-4 December 2005 transactions

2185. This section lays down how the purpose tests are to be applied if the relevant transactions include both pre-5 December transactions and post-4 December transactions. It is based on sections 741B(5) and 741C(1) to (6) and (8) of ICTA..

Section 741: Application of section 742 (partial exemption)

2186. This section lays down the conditions for section 742 (partial exemption where later associated operations fail conditions) to apply. It is based on section 741D(1) to (5) and (9) of ICTA.

2187. In summary, this section applies if an arrangement originally satisfies the purpose tests but is tainted by later associated operations.

Section 742: Partial exemption where later associated operations fail conditions

2188. This section restricts the income in respect of which the individual is liable to tax under this Chapter. It is based on section 741D(6) and (7) of ICTA.

Section 743: No duplication of charges

2189. This section is directed against multiple taxation. It is based on sections 743(4) and 744(1) of ICTA.

2190. This section replaces references to "the Board" with references to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2191. HMRC's internal procedures restrict the exercise of the Commissioners for Her Majesty's Revenue and Customs' functions under section 744 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

Section 744: Meaning of taking income into account in charging income tax for section 743

2192. This section relates to the interpretation of section 743. It is based on section 744(2) of ICTA.

Section 745: Rates of tax applicable to income charged under sections 720 and 727 etc

2193. This section deals with rates of tax applicable to income charged under sections 720 and 727. It is based on section 743(1) to (1B) and (5) of ICTA.

2194. *Subsection (1)* retains the expression "by deduction or otherwise", as it has been the subject of judicial comment: see paragraph 53 of the judgment of Lord Scott in R v Dimsey & Allen (2001), 74 TC 263 HL[7] at page 312.

Section 746: Deductions and reliefs where individual charged under section 720 or 727

2195. This section applies for the purposes of calculating an individual's liability to income tax, and is concerned with the availability of deductions and reliefs. It is based on section 743(2) of ICTA.

Section 747: Amounts corresponding to accrued income scheme profits and related interest

2196. This section ensures that any charge made on an individual under this Chapter takes proper account of accrued income when the assets of the person abroad include securities for the purposes of Chapter 2 of Part 12 (accrued income profits). It is based on section 742(4) to (7) of ICTA.

2197. Although section 742(5) of ICTA says "Sections 739 to 741 shall have effect …", this section works on the basis that the operation of the other sections in Chapter 3 of Part 17 of ICTA is not excluded.

2198. *Subsections (1), (6)* and *(7)* include by implication a minor change in the law on accrued income profits; see *Change 101* in Annex 1.

Section 748: Power to obtain information

2199. This section enables HMRC to obtain information which is relevant to the operation of this Chapter. It is based on section 745(1) to (3) of ICTA.

2200. *Subsection (1)* includes two minor changes.

2201. First, it refers to "an officer of Revenue and Customs" (namely, the officer dealing with the case) instead of "the Board". See *Change 5* in Annex 1. HMRC's internal procedures restrict the exercise of the Commissioners for Her Majesty's Revenue and Customs' functions under section 745 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

2202. Second, it expressly restricts the particulars to be provided to those which an officer of Revenue and Customs may reasonably require. See *Change 114* in Annex 1.

2203. *Subsection (2)* also includes a minor change in the law. It sets the minimum time which HMRC may allow for the particulars to be provided at 30 days rather than 28 days. See *Change 108* in Annex 1.

Section 749: Restrictions on particulars to be provided by solicitors

2204. This section restricts HMRC's power to require solicitors to provide information under section 748. It is based on section 745(3), (4) and (6) of ICTA.

Section 750: Restrictions on particulars to be provided by banks

2205. This section restricts HMRC's power to require banks to provide information under section 748. It is based on section 745(5) to (6) of ICTA.

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7 [2001] STC 1520.

Section 751: Special Commissioners' jurisdiction on appeals

2206. This section gives the Special Commissioners, on appeal, jurisdiction to affirm or replace officers' decisions in exercise of certain functions under this Chapter. It is based on sections 741(1), 741A(9), 741D(8) and 744(1) of ICTA.

2207. This section replaces references to "the Board" with references to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

Chapter 3: Transactions in land

Overview

2208. This Chapter contains a wide-ranging anti-avoidance rule specifically aimed at transactions in land. It is based on sections 776 to 778 of ICTA.

2209. The sections of this Chapter are arranged in the following order:

- Sections 752 to 754 – introduction;
- Sections 755 to 760 – charge on gains from transactions in land;
- Sections 761 to 764 – further provisions relevant to the charge;
- Sections 765 to 767 – exemptions;
- Sections 768 and 769 – recovery of tax;
- Sections 770 and 771 – clearances and power to obtain information;
- Section 772 – interpretation.

Section 752: Overview of Chapter

2210. This section provides an overview of the Chapter. It is based on section 776(1) and (2) of ICTA.

Section 753: Meaning of disposing of land

2211. This section explains the expression "disposing of land". It is based on section 776(4) of ICTA.

Section 754: Priority of other income tax provisions

2212. This section provides for other tax provisions to apply in priority to Chapter 3. It is based on section 777(10) of ICTA.

Section 755: Charge to tax on gains from transactions in land

2213. This section imposes the charge to income tax on gains from transactions in land. It is based on section 776(3A) of ICTA. It is the first of a group of sections (sections 755 to 760) which form the core of the Chapter.

2214. *Subsection (2)* signposts exemptions from the charge.

Section 756: Income treated as arising where gains obtained from some land disposals

2215. This section sets out the circumstances in which income is treated as arising. It is based on section 776(2), (3), (5), (13) and (14) of ICTA.

2216. *Subsection (1)* specifies the requirements which must all be met if this section is to apply. One of the requirements is that all or any part of the land is situated in the United Kingdom.

2217. HMRC's interpretation of the territorial scope of section 776 of ICTA is summarised in the table below.

Residence of taxpayer	***Where land is located***	***Application of section 776***
United Kingdom	Wholly in the United Kingdom	Section 776 applies (assuming all the other conditions are met).
United Kingdom	Wholly outside the United Kingdom	Section 776 does not apply.
United Kingdom	Partly in the United Kingdom, partly outside the United Kingdom	Section 776 applies to the whole of the gain (assuming all the other conditions are met).
Non-UK	Wholly in the United Kingdom	Section 776 applies (assuming all the other conditions are met).
Non-UK	Wholly outside the United Kingdom	Section 776 does not apply.
Non-UK	Partly in the United Kingdom, partly outside the United Kingdom	Section 776 applies (assuming all the other conditions are met), but only to the gain attributable to the UK land.

2218. This section and section 759 reflect this interpretation, and make a minor change in the law (although not in practice). See *Change 115* in Annex 1.

2219. The expression "all *or part* of the land" in subsection (1)(c) is based on section 776(14) of ICTA; it will (for example) cover a case in which several areas of land, some within the UK and some outside the United Kingdom, pass under a single bargain. In such a case, if the person liable is non-UK resident, the total consideration will be apportioned, and the provisions will be applied to the separate gain for each area of land in the United Kingdom to arrive at the non-UK resident's deemed income.

2220. If this section applies, s*ubsection (2)* treats the gain as income and deems it to arise when the gain is realised.

2221. For the sake of consistency with the rest of the section, *subsection (5)* refers to the opportunity of "realising" a gain, rather than (as in the source legislation) the opportunity of "making" it. This difference is verbal not substantive.

Section 757: Person obtaining gain

2222. This section specifies the person obtaining the gain. It is based on section 776(2)(c)(i) and (ii) and 776(5)(b) of ICTA.

2223. *Subsection (3)* indicates when a number of transactions may be regarded as constituting a single arrangement or scheme. Subsection (3) differs from the source legislation in that it is not drafted to apply for the purposes of section 753(1). There is no need for subsection (3) to bring a plurality of transactions within section 753(1)(b), since a plurality of transactions will already be within section 753(1)(a).

Section 758: Income charged

2224. This section defines the measure of income and gives a signpost to section 760 (method of calculating gain). It is based on section 776(3B) of ICTA.

Section 759: Person liable

2225. This section defines the person liable, bringing together a number of previously separate provisions. It is based on section 776(3)(b), (3B) and (8) of ICTA.

2226. *Subsection (1)* states that the person liable for any tax charged under this Chapter on income is the person whose income it is.

2227. *Subsection (2)* then lays down the general rule: that person is the person who realises the gain.

2228. *Subsection (3)* states that the general rule is subject to two exceptions, set out in subsections (4) and (6).

2229. *Subsection (4)* deals with the case where there is a person providing value. If all or any part of the gain accruing to a person ("A") is derived from value provided directly or indirectly by another person ("B"), the income is B's.

2230. *Subsection (5)* makes it clear that it does not matter for the purpose of subsection (4) whether or not the value is put at the disposal of A.

2231. *Subsection (6)* deals with the case where there is a person providing an opportunity to realise a gain. If all or any part of the gain accruing to a person is derived from an opportunity of realising a gain provided directly or indirectly by another person, the income is the other person's.

2232. There is no equivalent of subsection (5) to back up subsection (6), because none is needed. This is a change in the law but not in practice. See *Change 116* in Annex 1.

2233. *Subsection (8)* makes a minor change in the law, although not in practice. See the commentary on section 756 and *Change 115* in Annex 1.

Section 760: Method of calculating gain

2234. This section lays down how a gain is to be calculated for the purposes of this Chapter. It is based on section 776(6) of ICTA.

Section 761: Transactions, arrangements, sales and realisations relevant for Chapter

2235. Section 761 concerns transactions, arrangements, sales and realisations relevant for this Chapter. It is based on section 777(2) and (3) of ICTA.

2236. This section is the first of a group of supplementary sections (sections 761 to 764). These sections apply for the purposes of the Chapter as a whole; because of their importance, they have been placed immediately after sections 755 to 760, the core sections.

Section 762: Tracing value

2237. This section is about tracing value. It is based on section 777(5) of ICTA.

Section 763: Meaning of "another person"

2238. This section explains the meaning of "another person" in this Chapter. It is based on section 777(7) of ICTA.

Section 764: Valuations and apportionments

2239. This section is about valuations and apportionments. It is based on section 777(6) of ICTA.

Section 765: Exemption: gain attributable to period before intention to develop formed

2240. This section exempts that part of a gain which is fairly attributable to a period before the intention to develop the land was formed. It is based on section 776(7) of ICTA.

2241. It is the first of a group of three exemptions, which are set out in sections 765 to 767.

Section 766: Exemption: disposals of shares in companies holding land as trading stock

2242. This section limits the scope of the charge by providing an exemption for disposals of shares in companies holding land as trading stock. It is based on section 776(10) of ICTA.

Section 767: Exemption: private residences

2243. This section gives exemption in respect of private residences, if certain conditions are met. It is based on section 776(9) of ICTA.

Section 768: Recovery of tax where consideration receivable by person not assessed

2244. This section deals with recovery of tax where consideration is receivable by a person (B) other than the person assessed (A). It is based on section 777(8) and (13) of ICTA.

2245. Under *subsection (3)* A is entitled to recover from B any part of the tax which A has paid. To assist with this, A may obtain a certificate of tax paid: see the commentary on section 769.

2246. This section also includes a tie-breaker provision. This is a minor change in the law. See *Change 117* in Annex 1.

Section 769: Recovery of tax: certificates of tax paid etc

2247. This section deals with certificates of tax paid for the purposes of section 768(3). It is based on section 777(8) of ICTA.

2248. Section 777(8) of ICTA provides that the certificate is to be furnished by “the Board or an inspector”. In 1969, when this legislation was introduced, section 5 of the Income Tax Management Act 1964 provided that all assessments to income tax at the standard rate were to be made by an inspector and all assessments to surtax were to be made by the Board. The reference to “the Board” in section 777(8) appears to be a missed consequential on the abolition of surtax. This section therefore omits “the Board” as redundant and, following section 7 of CRCA, refers to “an officer of Revenue and Customs” rather than “an inspector”.

2249. *Subsection (3)* gives a signpost to section 944 in Part 15 (Deduction of tax at source) which rewrites section 777(9) of ICTA.

Section 770: Clearance procedure

2250. This section deals with clearances. It is based on section 776(11) and (12) of ICTA.

2251. Section 770 includes a minor change in the law. Section 776(11) of ICTA gives the clearance function to “the inspector to whom [the taxpayer] makes his return of income”. In practice, HMRC do not interpret this restrictively. Section 770 gives the clearance function to the Commissioners for Her Majesty’s Revenue and Customs. This will be consistent with section 707 of ICTA (transactions in securities: clearance procedure), which is rewritten in sections 701 and 702. See *Change 118* in Annex 1.

2252. Section 770 will apply solely for income tax purposes and section 776(11) and (12) of ICTA will apply solely for corporation tax purposes. HMRC’s operational guidance will tell officers what action they should take if a clearance application is made which appears to refer to the wrong provision. If HMRC issue a clearance under section 770 of this Act or under section 776 of ICTA which refers by mistake to the wrong provision, HMRC will treat it as if it referred to the correct provision.

Section 771: Power to obtain information

2253. This section enables HMRC to obtain information which is relevant to this Chapter. It is based on section 778 of ICTA.

2254. Section 778 of ICTA refers to "the Board or an inspector" and "the Board or the inspector". For the reason given in the commentary on section 769, the references to "the Board" in section 778 appear be a missed consequential on the abolition of surtax. Section 771 therefore now omits "the Board" as redundant and, following section 7 of CRCA, refers to "an officer of Revenue and Customs" rather than "an inspector".

2255. *Subsection (1)* includes a minor change in the law: it expressly restricts the particulars to be provided to those which an officer of Revenue and Customs may reasonably require. See *Change 114* in Annex 1.

Section 772: Interpretation of Chapter

2256. This section is interpretative. It is based on sections 776(13) and 777(13) of ICTA.

2257. Section 777(13) defines "capital amount" to mean any amount, in money or money's worth, which, apart from the sections 775 and 776, does not fall to be included in any computation of income for purposes of the Tax Acts. It provides that other expressions including the word "capital" are to be construed accordingly. The drafting of subsection (1) reflects the fact that a gain is the result of an arithmetical calculation, arrived at very broadly by deducting receipts from expenses, and cannot itself be said to be in money or money's worth.

2258. *Subsection (2)* (meaning of "property deriving its value from land") is based on section 776(13)(b) of ICTA.

Section 776(13)(a) of ICTA: "land"

2259. This section does not rewrite the second limb of the definition of "land" in section 776(13)(a) of ICTA.

2260. In Schedule 1 to the Interpretation Act 1978 land is defined as including "buildings and other structures, land covered with water, and any estate, interest, easement, servitude or right in or over land." Although the Interpretation Act 1978 was largely a consolidation, the definition of land was new and only applies from the commencement of that Act.

2261. The origin of section 776(13)(a) of ICTA is section 32(12)(a) of FA 1969. This definition therefore predates the definition of land in Schedule 1 to the Interpretation Act 1978.

2262. The definition of "land" in force in 1969 was that contained in the Interpretation Act 1889. In section 3 of that Act land was defined as including "messuages, tenements, and hereditaments, houses and buildings of any tenure". This section was derived from section 4 of Lord Brougham's Act of 1850. The definition was never appropriate for Scotland where messuages and hereditaments were unknown to the law.

2263. There is nothing in the definition of "land" in the Interpretation Act 1978 which is not also within the definition of "land" in section 776(13)(a) of ICTA.

2264. The Interpretation Act 1978 refers to "buildings and other structures". Section 776(13)(a) of ICTA merely refers to "buildings". But this cannot be read as excluding "structures", because what is a building is a question of degree and circumstance and case law makes it clear that virtually any kind of structure is capable of being a building.

2265. Adopting the Interpretation Act definition of "land" for the purposes of this Chapter would only be a change in the law if a "structure" (a) was not, as a matter of normal English usage, "land", (b) was not a "building" (and was therefore not brought within "land" by the second limb of section 776(13)(a) of ICTA), and (c) was nevertheless brought within "land" by the provision in the Interpretation Act that "land" includes buildings and other structures. There is no reason to believe that there are such "structures".

2266. The Interpretation Act 1978 refers to "land covered with water"; section 776(13)(a) of ICTA does not. But there is no doubt that for legal purposes land includes every species of ground as well as waters and marshes. The term "land covered with water" has been used in legislation to distinguish, for rating purposes, land covered by artificial bodies of water such as reservoirs, filter beds belonging to water companies, canals, dry docks etc; no such distinction would be appropriate in the context of section 776 of ICTA, and therefore none was made.

2267. Finally, section 776(13)(a) of ICTA refers to "any estate or interest in land or buildings", whereas the Interpretation Act 1978 is more specific, referring to "any estate, interest, *easement*, *servitude* or *right in or over land*" (emphasis added). Nonetheless, the section 776(13)(a) definition of land includes the rights italicised above. It is couched in generic terms and does not need to mention specific interests in land, including those particular to Scots law.

2268. It is therefore a matter of historical accident that section 776 of ICTA includes its own non-exhaustive definition of "land", rather than using the standard non-exhaustive definition in the Interpretation Act 1978. The Act therefore omits the second limb of section 776(13)(a) of ICTA as redundant.

2269. The Act does not rewrite the first limb of section 776(13)(a) of ICTA as a Chapter-wide definition. Instead, references to "the land" are expanded to "all or part of the land" where appropriate.

Section 777(13) of ICTA: "receivable"

2270. Section 777(13) of ICTA provides:

> "For the purposes of the relevant provisions … any amount in money or money's worth shall not be regarded as having become receivable by some person until that person can effectively enjoy or dispose of it.

2271. Section 777(1) of ICTA defines "the relevant provisions" as sections 775 to 777 of ICTA. On the face of it, therefore, the qualification of "receivable" in section 777(13) of ICTA applies to section 776 of ICTA. But the word "receivable" is not actually used in section 776.

2272. In Yuill v Wilson (1980), 52 TC 674 HL[8] and Yuill v Fletcher (1984), 58 TC 145 CA[9] the courts interpreted "realised" in section 776(3) of ICTA consistently with the explanation of "receivable" in section 777(13) of ICTA. In the House of Lords in Yuill v Wilson, Viscount Dilhorne said (52 TC 674 at page 714):

> ""I have based my conclusions on the meaning which I think should be given to the expression "the gain is realised". Section [777] of the Act is as I have said intended to supplement sections [775] and [776]. Subsection (13) of section [777] is a definition subsection and, *inter alia*, states that for the purposes of sections [775] and [776] "any amount in money or money's worth shall not be regarded as having become receivable by some person until that person can effectively enjoy or dispose of it." The operation of [section 776] does not depend on whether money or money's worth is receivable. One does not find in it any reference to money or money's worth being receivable. It

8 [1980] STC 460.
9 [1984] STC 401.

depends on whether a gain is obtained or realised. So the operation of this definition is, to say the least, obscure in relation to section [776]. It, however, accords with the meaning which I think should be given to the word "realised", that is to say, that a gain is not realised until it can be effectively enjoyed or disposed of."

2273. Lord Salmon agreed with Viscount Dilhorne. Other judges interpreted "realised" in the same way as Viscount Dilhorne, but relied on what is now section 777(13) of ICTA to do so[10].

2274. Following Viscount Dilhorne and Lord Salmon, this Act does not rewrite the explanation of "receivable" for the purposes of this Chapter. This omission does not change the law.

Chapter 4: Sales of occupation income

Overview

2275. This Chapter contains an anti-avoidance provision directed against schemes which turn income from an occupation into capital. It is based on sections 775, 777 and 778 of ICTA.

2276. The sections of this Chapter are arranged in the following order:

- Sections 773 to 775 – introduction;
- Sections 776 to 779 – charge on sale of occupation income;
- Sections 780 to 783 – further provisions relevant to the charge;
- Sections 784 and 785 – exemption for sales of going concerns;
- Sections 786 and 787 – recovery of tax;
- Section 788 – power to obtain information;
- Section 789 – interpretation.

Section 773: Overview of Chapter

2277. This section provides an overview of the Chapter, outlining its purpose and the charge it imposes. It is based on section 775(1) of ICTA.

2278. Although section 775(1)(a) and (b) of ICTA refer to "transactions or arrangements", section 775(1)(c) only refers to "transactions". The original source legislation, section 31(1)(c) of FA 1969, refers to "transactions or arrangements" and *subsection (2)* restores this phrase.

Section 774: Meaning of "occupation"

2279. This section explains the expression "occupation". It is based on section 775(3) of ICTA.

Section 775: Priority of other tax provisions

2280. This section provides for other tax provisions to apply in priority to Chapter 4. It is based on section 777(10) of ICTA.

10 In the Court of Appeal, Buckley LJ and Goff LJ had used the explanation of "receivable" to interpret "realised" and in the House of Lords so too did Lord Russell of Killowen and Lord Keith of Kinkel. Lord Edmund-Davies did not express an opinion on this point. In Yuill v Fletcher, the Special Commissioners noted this difference of approach, and inferred that the application of what is now section 777(13) of ICTA to what is now section 776 of ICTA could "be legitimately regarded as an open question, or at least as containing open questions": (paragraph 9.9 of the Decision: 58 TC 145 at page 163). Neither the High Court nor the Court of Appeal expressed any view on this point; the Court of Appeal held that the House of Lords' decision in Yuill v Wilson should be followed as either a binding precedent or of the highest persuasive authority.

Section 776: Charge to tax on sale of occupation income

2281. This section sets out the scope of the charge. It is based on section 775(2A) of ICTA.

2282. Sections 776 to 779 form the core of the Chapter.

Section 777: Conditions for sections 778 and 779 to apply

2283. This section sets out the circumstances in which income is treated as arising. It is based on sections 775(1), (3), and (7) to (9) and 777(13) of ICTA.

2284. *Subsection (1)* specifies three conditions (labelled A to C) which must all be met if section 778 or, as the case may be, section 779 is to apply.

2285. *Subsection (2)* sets out condition A, which is about location of the occupation carried on by the individual.

2286. *Subsection (3)* sets out condition B, which is about the ways in which transactions are effected or arrangements made to exploit the individual's earning capacity in the occupation.

2287. *Subsection (4)* is based on the explanation of the meaning of "income or receipts derived from the individual's activities" in section 775(3) of ICTA.

2288. *Subsection (5)*sets out condition C, which is about the receipt of a capital amount by the individual, either for the individual or for another person.

2289. *Subsection (6)* provides further details about what the previous subsection includes.

2290. *Subsection (7)* defines "capital amount". It is based on section 777(13) of ICTA. Section 777(13) of ICTA refers to "any amount … which, apart from the sections 775 and 776, does not fall to be included in any computation of income for purposes of the Tax Acts". It is not possible for an amount to be treated as income both by section 775 and by section 776 of ICTA, and so subsection (7) does not rewrite the reference to section 776.

Section 778: Income arising where capital amount other than derivative property or right obtained

2291. This section applies if the capital amount mentioned in section 777(5) does *not* consist of either property which derives substantially the whole of its value from the individual's activities or a right which does so. It is based on sections 775(1), (2) and (7) and 777(13) of ICTA.

2292. If section 778 applies, s*ubsection (2)* treats the capital amount as income.

2293. Subsection (2) omits the reference in section 775(2) to the capital amount being treated as "earned income". The only place in the Income Tax Acts where the expression "earned income" is used, following the reform of the pensions legislation in FA 2004, is section 282A of ICTA (jointly held property). As explained in the commentary on Chapter 3 of Part 14, section 282A has been rewritten in direct terms without reference to earned income. Accordingly, this section does not refer to earned income either.

2294. HMRC's interpretation of the territorial scope of section 775 of ICTA is summarised in the table below.

Taxpayer's residence	*Where occupation is carried on*	*Application of section 775*
UK	Wholly in the United Kingdom	Section 775 applies (assuming all the other conditions are met).
UK	Wholly outside the United Kingdom	Section 775 does not apply.

Taxpayer's residence	***Where occupation is carried on***	***Application of section 775***
UK	Partly in the United Kingdom, partly outside the United Kingdom	Section 775 applies to the whole of the gain (assuming all the other conditions are met).
Non-UK	Wholly in the United Kingdom	Section 775 applies (assuming all the other conditions are met).
Non-UK	Wholly outside the United Kingdom	Section 775 does not apply.
Non-UK	Partly in the United Kingdom, partly outside the United Kingdom	Section 775 applies (assuming all the other conditions are met), but only to the capital amount attributable to that part of the occupation carried on in the United Kingdom.

2295. The sections reflect this interpretation, and make a minor change in the law (although not in practice) to clarify the territorial scope of section 775. See *Change 115* in Annex 1.

2296. At first sight, section 775(9) of ICTA ("This section shall apply to all persons …") seems to apply to the "other person" mentioned in section 775(1)(a) of ICTA. But, to the extent that section 775(9) of ICTA applies to the "other person", it is redundant. To that extent, therefore, it is repealed without replacement.

Section 779: Income arising where derivative property or right obtained

2297. This section applies if the capital amount mentioned in section 777(5) *does* consist of either property which derives substantially the whole of its value from the individual's activities or a right which does so. It is based on section 775(2) and (7) of ICTA.

2298. The effect of this section replicates that of section 775(7) of ICTA, which imposes a separate charge from section 775(1) to (2A) of ICTA. It may apply in (for example) cases where individuals acquire stock options and subsequently exercise them.

Section 780: Transactions, arrangements, sales and realisations relevant for Chapter

2299. This section concerns transactions, arrangements, sales and realisations relevant for this Chapter; it greatly extends the circumstances in which a charge to tax may arise. It is based on section 777(2) and (3) of ICTA.

Section 781: Tracing value

2300. This section is about tracing the value of any property or right. It is based on section 777(5) of ICTA.

Section 782: Meaning of "other person"

2301. This section explains the meaning of "other person" in this Chapter. It is based on section 777(7) of ICTA.

Section 783: Valuations and apportionments

2302. This section is about valuations and apportionments. It is based on section 777(6) of ICTA.

Section 784: Exemption for sales of going concerns

2303. This section limits the scope of the charge by providing an exemption (itself limited by section 785) for transfers of businesses and companies as going concerns. It is based on section 775(4) and (6) of ICTA.

Section 785: Restriction on exemption: sales of future earnings

2304. This section is directed against abuse of the exemption given by section 784. It is based on section 775(5) of ICTA.

2305. The taxpayer might attempt to avoid the charge under this Chapter by exploiting section 784, namely by transferring a future income stream into a business or company carrying on a going concern and obtaining a capital amount for the disposal of the entire package. In such a case, this section would require an apportionment and restrict the exemption.

2306. Section 785 also includes a minor change in the law, although not in practice. See *Change 119* in Annex 1.

Section 786: Recovery of tax where consideration receivable by person not assessed

2307. This section deals with recovery of tax where consideration is receivable by a person (B) other than the person assessed (A). It is based on section 777(8) and (13) of ICTA.

2308. Under *subsection (3)* A is entitled to recover from B any part of the tax which A has paid. To assist with this, A may obtain a certificate of tax paid. See the commentary on section 787.

2309. Section 786 also includes a tie-breaker provision. This is a minor change in the law. See *Change 117* in Annex 1.

Section 787: Recovery of tax: certificates of tax paid etc

2310. This section deals with certificates of tax paid for the purposes of section 786(3). It is based on section 777(8) of ICTA.

2311. Section 777(8) of ICTA provides that the certificate is to be furnished by “the Board or an inspector”. In 1969, when this legislation was introduced, section 5 of the Income Tax Management Act 1964 provided that all assessments to income tax at the standard rate were to be made by an inspector and all assessments to surtax were to be made by the Board. A consequential amendment to the reference to “the Board” in section 777(8) appears to have been missed on the abolition of surtax. This section therefore now omits the reference to “the Board” as redundant and, following section 7 of CRCA, refers to “an officer of Revenue and Customs” rather than “an inspector”.

2312. *Subsection (3)* gives a signpost to section 944 in Part 15 (Deduction of tax at source) which rewrites section 777(9) of ICTA.

Section 788: Power to obtain information

2313. This section enables HMRC to obtain information which is relevant to this Chapter. It is based on section 778 of ICTA.

2314. Section 778 of ICTA refers to “the Board or an inspector” and “the Board or the inspector”. For the reason given in the note on section 787, consequential amendments to the references to “the Board” in section 778 appear to have been missed on the abolition of surtax. This section therefore now omits the references to “the Board” as redundant and, following section 7 of CRCA, refers to “an officer of Revenue and Customs” rather than “an inspector”.

2315. *Subsection (1)* includes a minor change in the law: it expressly restricts the particulars to be provided to those which an officer of Revenue and Customs may reasonably require. See *Change 114* in Annex 1.

Section 789: Minor definitions

2316. This section non-exhaustively defines "company" and "share". It is based on section 777(13) of ICTA.

Chapter 5: Avoidance involving trading losses

Overview

2317. The Chapter provides for the recovery of certain loss reliefs if regulations apply to reduce an individual's contribution to the firm so that the contribution becomes lower, or even lower, than relief already given to the individual.

2318. This Chapter also sets out provisions about avoidance involving trade losses made by individuals in a trade exploiting a film or licence. The provisions tackle schemes used by individuals to try to convert a tax deferral into a permanent tax gain.

2319. The Chapter is based on Chapter 9 of Part 3 of FA 2004 and Chapter 7 of Part 2 of FA 2005.

Section 790: Overview of Chapter

2320. This section provides an overview of the Chapter. It is new.

2321. *Subsection (1)* signposts the sections dealing with the three sets of circumstances addressed by the Chapter.

2322. The definition of "capital gains relief" refers to section 261B of TCGA, which is inserted by Schedule 1 to this Act.

Section 791: Charge to tax on income treated as received under section 792

2323. This section imposes a charge to tax on income treated as received under section 792. It is based on section 74(4) of FA 2005.

2324. The section follows the approach to charging provisions adopted in ITTOIA.

Section 792: Partners claiming excess sideways or capital gains relief

2325. This section treats an individual as receiving income in certain cases where regulations made under section 114 of this Act result in the individual having claimed excessive sideways relief or capital gains relief for post-1 December 2004 trade losses made by the individual as a limited partner, a member of a limited liability partnership or a non-active partner. It is based on section 74 of FA 2005.

2326. The section specifies that income is treated as arising when a "chargeable event" occurs, and that such an event occurs at any time when the regulations result in the individual having claimed excessive relief. Such excesses (of losses so claimed over the individual's contribution to the firm) arise because the individual's contribution to the firm is treated by the regulations as reduced on the occurrence of certain events. Such an event might be, for example, the release of a loan taken out to finance the individual's contribution to the firm (see Condition 3 of Regulation 4(1) of SI 2005/2017, as consequentially amended by Schedule 2 Part 5 (application of existing regulations under sections 114 and 802)).

2327. *Subsection (2)(b)* refers to "capital gains relief" as part of making explicit the interaction between section 72 of FA 1991 and the provisions in ICTA, FA 2004 and FA 2005 which restrict the giving of sideways relief. See *Change 13* in Annex 1.

2328. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 793: Calculating the amount of income treated as received

2329. This section specifies how the amount of income treated as received by the previous section is to be calculated. It is based on section 75 of FA 2005.

2330. The basic proposition is that the amount is the reduction in the individual's contribution to the firm resulting from the application of the regulations. Nevertheless, the amount of income treated as received cannot exceed the amount of post-1 December 2004 trade losses claimed (and not reclaimed). Neither can it exceed the excess of the trade losses claimed (and not reclaimed) over the contribution to the firm.

2331. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 794: Meaning of "the total amount of trade losses claimed" etc

2332. This section defines "the total amount of the trade losses claimed", "the individual's contribution to the firm" and other terms. It is based on section 74 of FA 2005.

2333. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 795: Meaning of "post-1 December 2004 loss"

2334. This section defines "post-1 December 2004 loss". It is based on section 76 of FA 2005.

Section 796: Charge to tax on income treated as received under section 797

2335. This section imposes a charge to tax on income treated as received under section 797. It is based on section 119(4) of FA 2004.

2336. The section follows the approach to charging provisions adopted in ITTOIA.

Section 797: Individuals claiming sideways or capital gains relief for film-related losses

2337. This section sets out circumstances in which an individual, who has claimed sideways or capital gains relief for film-related losses, is treated as receiving income. It is based on section 119 of FA 2004.

2338. The section specifies that income is treated as arising when a "chargeable event" occurs, and that such an event occurs at the time that the last of three conditions (relevant claim, relevant disposal and exit event) become satisfied.

2339. *Subsection (2)* specifies that an exit event will occur every time an individual receives non-taxable consideration for a relevant disposal, as well as certain times when the individual makes a further claim for sideways relief or capital gains relief or the individual's contribution to the firm is reduced. So a number of exit events may occur for any particular relevant disposal. And a number of chargeable events may occur for a particular tax year.

2340. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 798: Meaning of "non-taxable consideration" etc

2341. This section defines "non-taxable consideration". It is based on sections 122(3) and 123(2) of FA 2004.

2342. In particular, the section makes it clear that, if the consideration is received after deduction of costs or any other payment relating to the relevant disposal or exit event, it is the gross amount that is treated as the non-taxable consideration.

Section 799: Meaning of "disposal of a right of the individual to profits" etc

2343. This section specifies a number of things that are to count as a disposal of a right of an individual to profits arising from a trade. It is based on section 120 of FA 2004.

Section 800: Meaning of "film-related losses" etc

2344. This section defines various terms. It is based on sections 121(1) and (1A) and section 123(1) of FA 2004.

2345. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 801: Meaning of "capital contribution"

2346. This section defines "capital contribution". It is based on sections 121 and 122(1) of FA 2004.

2347. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 802: Exclusion of amounts in calculating capital contribution by a partner

2348. This section enables regulations to be made, which can apply on a retrospective basis, to exclude certain amounts from the calculation of an individual's capital contribution. It is based on section 122A of FA 2004.

2349. Regulations under this provision are subject to the affirmative resolution procedure.

2350. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

2351. Some regulations have been made under section 122A of FA 2004. See the Partnerships (Restrictions on Contributions to a Trade) Regulations 2005 (SI 2005/2017) and the Partnerships (Restrictions on Contributions to a Trade) Regulations 2006 (SI 2006/1639). See also the commentary on Parts 5 and 13 of Schedule 2 about consequential amendments made to these regulations by this Act.

2352. In s*ubsection (5)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

Section 803: Prohibition against double counting

2353. This section ensures that consideration is only brought into account once. It is based on section 122(2) of FA 2004.

2354. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 804: Charge to tax on income treated as received under section 805

2355. This section imposes a charge to tax on income treated as received under section 805. It is based on section 127(2) of FA 2004.

2356. The section follows the approach to charging provisions adopted in ITTOIA.

Section 805: Partners claiming relief for licence-related trading losses

2357. This section sets out circumstances in which an individual, who was a non-active partner in an early year, and who has claimed sideways relief or capital gains relief for a loss deriving from expenditure related to a licence, is treated as receiving income. It is based on sections 126 and 127 of FA 2004.

2358. The meaning of non-active partner is explained in section 809, by reference to provisions in Chapter 3 of Part 4.

2359. There must be a relevant disposal of the licence which requires that the individual receives non-taxable consideration (defined in *subsection (5)*).

2360. Income is treated as arising when a "chargeable event" occurs which could be at any time when an individual receives non-taxable consideration for a disposal or the individual makes a further claim for sideways relief or capital gains relief. So a number of chargeable events may occur for a particular tax year.

Section 806: Calculation of amount of income treated as received by the individual

2361. This section sets out a step calculation for finding the income which the individual is treated as receiving. It is based on section 127(4) to (6) of FA 2004.

Section 807: Supplementary provision relating to calculation in section 806

2362. This section supplements section 806. It is based on section 128 of FA 2004.

Section 808: Meaning of "disposal of the licence" etc

2363. This section specifies a number of things that are to count as a disposal of a licence. It is based on section 129 of FA 2004.

Section 809: Other definitions

2364. This section includes various definitions used in relation to the restrictions for losses related to a licence. It is based on sections 126, 127(7) and 130 of FA 2004.

Part 14: Income tax liability: miscellaneous rules

Overview

2365. This Part contains four Chapters setting out various miscellaneous rules.

2366. Chapters 1 to 3 contain rules relating to:

- limits on the liability to income tax of non-UK residents,
- residence for income tax purposes of individuals and personal representatives (together with signposts to the income tax residence rules for trustees and companies) and
- liability to income tax in respect of income from property held in the joint names of spouses or civil partners.

2367. Chapter 4 contains a miscellany of other rules.

Chapter 1: Limits on liability to income tax of non-UK residents

Overview

2368. This Chapter brings together the provisions of FA 2003 limiting the liability to income tax of non-UK resident companies (liable otherwise than as trustees) and those of FA 1995 limiting such liability of all other non-UK residents (including companies liable as trustees).

2369. This Chapter is based on:

- section 128 of FA 1995 which limits the liability to income tax of non-UK residents, except the liability of non-UK resident companies liable otherwise than as trustees;
- section 127 of FA 1995 so far as it supplements section 128 of that Act;
- section 151 of FA 2003 which limits the liability to income tax of non-UK resident companies liable otherwise than as trustees; and
- Schedule 26 to FA 2003 so far as it supplements section 151(2)(c) of that Act.

2370. So far as they respectively supplement section 128 of FA 1995 and section 151(2)(c) of FA 2003, section 127 of FA 1995 and Schedule 26 to FA 2003 are in many respects substantially the same. Those provisions have, as far as possible, been combined in this Chapter.

2371. Section 127 of FA 1995 continues in force for the purpose of supplementing section 126 of that Act (UK representatives of non-residents) and Schedule 26 to FA 2003 continues in force for the purpose of supplementing section 148(3) of that Act (meaning of "permanent establishment").

Section 810: Overview of Chapter

2372. This section identifies the categories of non-UK residents to which this Chapter applies and provides signposts to the sections applicable to each category. It is new.

Section 811: Limit on liability to income tax of non-UK residents

2373. This section relates to the liability to income tax for a tax year of non-UK residents other than companies and of non-UK resident companies liable as trustees. It is based on section 128(1), (2), (4) and (12) of FA 1995.

2374. This section does not create any liability to income tax but rather sets a limit on the amount of income tax to which the non-UK resident would otherwise be liable.

2375. The combined effect of *subsections (4)* and *(5)* is that the non-UK resident is not liable to income tax in respect of disregarded income (see section 813), except so far as income tax is deducted or treated as deducted from it or is paid in respect of it, or it carries a tax credit.

2376. Subsection (5)(a) is drafted in terms of the non-UK resident's disregarded income being left out of account, rather than in terms of its being deducted from total income as provided in section 128(1)(a)(i) of FA 1995.

2377. Subsection (5)(b) provides that personal reliefs are to be left out of account. A non-UK resident may be entitled to such reliefs under section 278(2)(a) of ICTA, under section 56 or 460 of this Act or by virtue of a double taxation agreement. See the overview commentary on Part 3 for the interrelation of section 278(2)(a) of ICTA and sections 56 and 460 of this Act.

2378. All the reliefs to which section 278 of ICTA and sections 56 and 460 of this Act apply are listed in *subsection (6)*.

Section 812: Case where limit not to apply

2379. This section provides that the liability of non-UK resident trustees to income tax is not limited, if a beneficiary of the trust has a residence connection with the United Kingdom. It is based on section 128(5) and (6) of FA 1995.

Section 813: Meaning of "disregarded income"

2380. This section sets out the various descriptions of income which are defined as "disregarded income". It is based on section 128(2) and (3) of FA 1995.

2381. *Subsection (2)* provides that income is not disregarded income if the non-UK resident has a UK representative in relation to the income. This is the case if, for example, the non-UK resident has income within the description of disregarded savings and investment income in section 825 which is brought into account in computing the profits of a manufacturing business carried on by the non-UK resident through a branch in the United Kingdom.

2382. The definition of "disregarded pension income" in *subsection (3)* is based on section 128(3)(cc), (cca) and (cd) of FA 1995. Section 128(3)(cd) of FA 1995 relates to income which arises from a source in the United Kingdom and is chargeable to tax under Part 9 of ITEPA because section 609, 610 or 611 of that Act applies to it.

2383. Each of sections 609, 610 and 611 of ITEPA states that the section applies to an annuity which arises from a source outside the United Kingdom only if it is paid to a person resident in the United Kingdom. The definition of disregarded pension income omits the reference to the income arising from a source in the United Kingdom, on the basis that the wording of those sections of ITEPA makes it unnecessary.

Section 814: Meaning of "disregarded transaction income"

2384. This section defines "disregarded transaction income". It is based on sections 127(1) and (15) and 128(3)(d) of FA 1995.

2385. *Subsections (1)* and *(2)* relate to income arising from a business carried on through a broker in the United Kingdom and introduce the conditions, referred to as "the independent broker conditions", which must be met if the income is to be disregarded transaction income.

2386. *Subsections (3)* and *(4)* relate to income arising from a business carried on through an investment manager in the United Kingdom and introduce the conditions, referred to as "the independent investment manager conditions", which must be met if the income is to be disregarded transaction income.

2387. The independent broker conditions in section 817 and the independent investment manager conditions in sections 818 to 824 replace for the purposes of subsections (2) and (4) the indirect references in section 128(3)(d) of FA 1995, through section 127(1)(b) and (c) of that Act, to section 127(2) and (3) of that Act.

2388. The words "without being chargeable as mentioned in paragraphs (a) to (ce) above" in section 128(3)(d) of FA 1995 have been omitted in subsections (2) and (4) on the basis that they are unnecessary.

2389. *Subsection (5)* defines the term "transaction income". This definition includes the provisions of section 127(15)(b) of FA 1995 which explain what is meant by income arising from so much of a business as relates to transactions carried out through a branch or agency on behalf of a non-UK resident.

Section 815: Limit on liability to income tax of non-UK resident companies

2390. This section relates to the liability to income tax for a tax year of a non-UK resident company which is liable otherwise than as a trustee. It is based on section 151(1), (3) and (4) of FA 2003.

2391. This section does not create any liability to income tax but rather sets a limit on the amount of income tax to which the non-UK resident company would otherwise be liable.

2392. The combined effect of *subsections (3)* and *(4)* is that the non-UK resident company is not liable to income tax in respect of disregarded company income except so far as income tax is deducted or treated as deducted from it or is paid in respect of it, or it carries a tax credit.

2393. Subsection (4) is drafted in terms of the non-UK resident company's disregarded company income being left out of account, rather than in terms of its being deducted from total income as provided in section 151(1)(a)(i) of FA 2003.

2394. Section 151(1)(a)(ii) of FA 2003, which disregards reliefs to which a company is entitled under section 788 of ICTA, has been omitted. It is not appropriate to companies. See *Change 120* in Annex 1.

Section 816: Meaning of "disregarded company income"

2395. This section sets out the various descriptions of income which are defined as "disregarded company income". It is based on section 151(2) of FA 2003 and paragraphs 1(1) and (2), 2(1) and 3(1) of Schedule 26 to that Act.

2396. The term "disregarded company income" mirrors the term "disregarded income" defined in section 813 for the purposes of section 811. Section 151(2) of FA 2003 sets out the "income to which this section applies", but does not make use of a defined term.

2397. *Subsection (1)(c)* relates to income arising from transactions carried out through a broker in the United Kingdom and introduces the conditions, referred to as "the independent broker conditions", which must be met if the income is to be disregarded company income.

2398. *Subsection (1)(d)* relates to income arising from investment transactions carried out through an investment manager in the United Kingdom and introduces the conditions, referred to as "the independent investment manager conditions", which must be met if the income is to be disregarded company income.

2399. Subsection (1)(c) and (d) are based on section 151(2)(c) of FA 2003, which refers to a transaction carried out through a broker or investment manager in the United Kingdom "acting as an agent of independent status in the ordinary course of his business". Schedule 26 to that Act then sets out the conditions which must be met if the broker or investment manager is to be treated as so acting.

2400. This structure has been simplified so that subsection (1)(c) and (d) refer directly to the independent broker conditions in section 817 and the independent investment manager conditions in sections 818 to 824.

2401. The effect of the words "in the course of that company's trade" in paragraph 1(1) of Schedule 26 to FA 2003 has been preserved by including the equivalent words in subsection (1)(c) and (d).

Section 817: The independent broker conditions

2402. This section sets out the independent broker conditions to be met in relation to a transaction carried out on behalf of a non-UK resident by a broker in the United Kingdom for the purposes of sections 813 and 816. It is based on the provisions of sections 127(1) and (2) and 128(3) of FA 1995 and section 151(2) of and paragraph 2(1) and (2) of Schedule 26 to FA 2003.

2403. Three of the conditions, in section 127(2)(a) to (c) of FA 1995 and paragraph 2(2)(a) to (c) of Schedule 26 to FA 2003, are substantively the same. Accordingly, there is a set of common conditions, A to C, in s*ubsections (2)* to *(4)*, which apply to all non-UK residents, including non-UK resident companies.

2404. The final condition in section 127(2)(d) of FA 1995 is not substantively the same as the final condition in paragraph 2(2)(d) of Schedule 26 to FA 2003. These conditions are, therefore, set out separately.

2405. Condition D in *subsection (5)*, based on the condition in section 127(2)(d) of FA 1995, applies for the purposes of section 813.

2406. Condition E in *subsection (6)*, based on the condition in paragraph 2(2)(d) of Schedule 26 to FA 2003, applies for the purposes of section 816.

2407. In subsection (5), the words "amounts which are chargeable to capital gains tax" reflect the words "other amounts" in section 127(2)(d) of FA 1995. Those other amounts are the "amounts which, by reference to that branch or agency, are chargeable to capital gains tax under section 10 of the Taxation of Chargeable Gains Act 1992 (non-residents)" mentioned in section 126(2)(c) of FA 1995.

2408. In subsection (5), a reference to "transaction income" has been substituted for the reference in section 127(2)(d) of FA 1995 to "taxable sums". The latter expression includes not only income but also chargeable gains arising from transactions in respect of which the independent broker conditions are met. It is not necessary to include specific reference here to such chargeable gains, as, by virtue of the reference to taxable sums in section 127(2)(d) of FA 1995, the non-UK resident will not, under section 126(2) of that Act, have the broker as the non-UK resident's UK representative in relation to such chargeable gains.

2409. In subsection (6), it has been made clear that the other transaction carried out in the same accounting period may be of any kind and is not limited to broking transactions.

Section 818: The independent investment manager conditions

2410. This section sets out the independent investment manager conditions to be met in relation to a transaction carried out on behalf of a non-UK resident by an investment manager in the United Kingdom for the purposes of sections 813 and 816. It is based on the provisions of sections 127(1) and (3) and 128(3) of FA 1995 and section 151(2) of and paragraphs 3(1) and (2) and 7(2) of Schedule 26 to FA 2003.

2411. Five of the conditions, in section 127(3)(a) to (e) of FA 1995 and paragraph 3(2)(a) to (e) of Schedule 26 to FA 2003, are substantively the same. Accordingly, there is a set of common conditions, A to E, in *subsections (2)* to *(6)*, which apply to all non-UK residents, including non-UK resident companies.

2412. The final condition in section 127(3)(f) of FA 1995 is not substantively the same as the final condition in paragraph 3(2)(f) of Schedule 26 to FA 2003. These conditions are, therefore, set out separately.

2413. Condition F in *subsection (7)*, based on the condition in section 127(3)(f) of FA 1995, applies for the purposes of section 813.

2414. Condition G in *subsection (8)*, based on the condition in paragraph 3(2)(f) of Schedule 26 to FA 2003, applies for the purposes of section 816.

2415. In subsection (7), the words "amounts which are chargeable to capital gains tax" reflect the words "other amounts" in section 127(3)(f) of FA 1995. Those other amounts are the "amounts which, by reference to that branch or agency, are chargeable to capital gains tax under section 10 of the Taxation of Chargeable Gains Act 1992 (non-residents)" mentioned in section 126(2)(c) of FA 1995.

2416. In subsection (7), a reference to "transaction income" has been substituted for the reference in section 127(3)(f) of FA 1995 to "taxable sums". The latter expression includes not only income but also chargeable gains arising from transactions in respect of which the independent investment manager conditions are met. It is not necessary to include specific reference here to such chargeable gains, as, by virtue of the reference to taxable sums in section 127(3)(f) in FA 1995, the non-UK resident will not under section 126(2) of that Act have the investment manager as the non-UK resident's UK representative in relation to such chargeable gains.

2417. In subsection (8), it has been made clear that the other transaction carried out in the same accounting period may be of any kind and is not limited to investment transactions.

Section 819: Investment managers: the 20% rule

2418. This section sets out the "20% rule" for investment managers. It is based on section 127(4) of FA 1995 and paragraph 4(1) of Schedule 26 to FA 2003 which are substantively the same.

2419. The 20% rule has two requirements. The first requirement is that the investment manager and connected persons must intend that any interest that they may have in the non-UK resident's "relevant disregarded income" will not exceed 20% of that income. The second requirement applies if that intention is not fulfilled. The 20% rule will continue to be met if the only reason why it is not fulfilled is because of matters outside the control of the investment manager or connected persons despite their having taken reasonable steps to mitigate the effect of those matters.

Section 820: Meaning of "qualifying period"

2420. This section defines the term "qualifying period". It is based on section 127(7) of FA 1995 and paragraph 4(2) of Schedule 26 to FA 2003.

2421. *Subsection (2)*, based on section 127(7) of FA 1995, makes use of the term "transaction income", defined in section 814(5), in substitution for the term "taxable sums" in the source legislation. "Taxable sums" includes not only income but also chargeable gains, but in this context a reference to chargeable gains is otiose and has been omitted.

2422. *Subsection (3)*, based on paragraph 4(2) of Schedule 26 to FA 2003, makes explicit that the accounting period referred to is that of the non-UK resident company.

2423. The separate definitions in subsections (2) and (3) preserve the difference between their respective source provisions and ensure that those subsections remain in line with those provisions as they continue to apply for the purposes of section 126 of FA 1995 and section 148 of FA 2003 respectively.

Section 821: Meaning of "relevant disregarded income"

2424. This section defines the term "relevant disregarded income". It is based on section 127(5) of FA 1995 and paragraph 4(3) of Schedule 26 to FA 2003.

2425. In *subsection (2)*, a reference to "the total of the non-UK resident's income" has been substituted for the reference in section 127(5) of FA 1995 to "the aggregate of such of the profits and gains of the non-resident". As section 127(5)(b) of FA 1995 requires that this aggregate falls to be treated (apart from the 20% rule) as excluded income, the reference to "such of the profits and gains" is limited by the source legislation to so much of the profits and gains as is income. The substitution makes this clear.

2426. In *subsection (3)*, a reference to "the total of the non-UK resident company's income" has been substituted for the reference in paragraph 4(3) of Schedule 26 to FA 2003 to "the aggregate of such of the chargeable profits of the company". See *Change 121* in Annex 1.

2427. The separate definitions in subsections (2) and (3) preserve the difference between the respective source provisions and ensure that those subsections remain in line with those provisions as they continue to apply for the purposes of section 126 of FA 1995 and section 148 of FA 2003 respectively.

2428. In *subsection (4)* it is made clear that the transactions referred to are investment transactions. That only investment transactions are referred to in section 127(5) of FA 1995 is clear as the profits or gains there mentioned must be excluded income. But paragraph 4(3) of Schedule 26 to FA 2003 refers only to transactions. That paragraph does not, however, cover any wider class of transactions than section 127(5) of FA 1995.

2429. In subsection (4)(b), the words:

"in relation to which the independent investment manager conditions are met, ignoring the requirements of the 20% rule

are substituted both for the words in section 127(5)(b) of FA 1995:

"for the purposes of section 128 below would fall (apart from the requirements of subsection (4) above) to be treated as excluded income for any of those chargeable periods

and for the words in paragraph 4(3) of Schedule 26 to FA 2003:

"in relation to which the manager does not (apart from the requirements of the 20% rule) fall to be treated as a permanent establishment of the company.

2430. The substituted words do not change the law relating to the limit on the liability of a non-UK resident other than a company in section 811. Only income deriving from investment transactions is measured for the purposes of the 20% rule in section 127(4) of FA 1995. Income arising from any other type of transaction is irrelevant.

2431. Income is only "relevant excluded income" under section 127(5) of FA 1995 if it derives from investment transactions carried out by the manager while acting on the non-resident's behalf (see section 127(5)(a) where the word "transactions" refers back to "investment transactions" in section 127(1)(c)). Under section 127(5)(b) of FA 1995, it also has to be treated as "excluded income" under section 128(3) of that Act. The only way that income arising from so much of a business as relates to investment transactions can be "excluded income" is if the conditions in section 127(3) of FA 1995 (the investment manager conditions) are met.

2432. In relation to the limit on the liability of a non-UK resident company in section 815, this substitution avoids the need for the reader to refer to section 148 of and Schedule 26 to FA 2003 in order to determine whether the investment manager is a permanent establishment. The substituted words do not change the law. If the independent investment manager conditions are met, or would be if the 20% rule were met, the investment manager cannot be a permanent establishment of the company in relation to the transaction.

Section 822: Meaning of "beneficial entitlement"

2433. This section defines the term "beneficial entitlement". It is based on section 127(6) of FA 1995 and paragraph 4(4) of Schedule 26 to FA 2003, which are substantively the same.

Section 823: Treatment of transactions where requirements of 20% rule not met

2434. This section provides that, if the 20% rule is not met but all the other independent investment manager conditions are met, only the income in relation to which the 20%

rule is not met is not relevant disregarded income. It is based on section 127(8) of FA 1995 and paragraph 4(5) of Schedule 26 to FA 2003.

2435. So far as that section and that paragraph differ in approach, the difference is preserved by *subsection (2)* so that those provisions remain in line with their source provisions as they continue to apply for the purposes of section 126 of FA 1995 and section 148 of FA 2003 respectively.

2436. A reference to "transaction income", which is defined in section 814(5), has been substituted in subsection (2)(a) for the reference to "taxable sums" in section 127(8) of FA 1995. The term "taxable sums", as defined in section 127(3) of that Act read with sections 127(1) and 126(2)(c) of that Act, includes amounts chargeable to capital gains tax under section 10 of TCGA. But, in relation to section 127(8) of FA 1995 as it has effect for the purposes of determining whether income is excluded income within section 128(3)(d) of that Act, reference to chargeable gains is unnecessary.

2437. In subsection (2)(b), a reference to "the income of the non-UK resident company" has been substituted for the reference in paragraph 4(5) of Schedule 26 to FA 2003 to "the chargeable profits of the non-resident company". See *Change 121* in Annex 1.

Section 824: Application of 20% rule to collective investment schemes

2438. This section modifies the 20% rule where the non-UK resident is a participant in a collective investment scheme. It is based on section 127(9), (10) and (11) of FA 1995 and paragraph 5 of Schedule 26 to FA 2003, which are substantively the same.

2439. This section applies at the level of the scheme itself, treating it as if it were a non-UK resident company, see *subsection (3)*.

2440. *Subsection (4)* applies to a scheme which, if it was assumed to be a non-UK resident company, would *not* be regarded as carrying on a trade in the United Kingdom. The 20% rule is treated as satisfied in relation to such a scheme.

2441. *Subsection (5)* applies to a scheme which, if it was assumed to be a non-UK resident company, would be regarded as carrying on a trade in the United Kingdom. The 20% rule applies to such a scheme with the modifications in *subsection (6)*.

2442. The definition of "the appropriate relevant period" in *subsection (7)* links into the meaning of "qualifying period" given by section 820. The reference to the term "transaction income" in paragraph (a) of that definition follows from the reference to that term in section 820(2)(a). See the commentary on section 820(2).

Section 825: Meaning of "disregarded savings and investment income"

2443. This section defines the term "disregarded savings and investment income" which is principally used in sections 813 and 816. It is based on the corresponding parts of paragraph (a) of section 128(3) of FA 1995 and of paragraph (a) of section 151(2) of FA 2003 and on paragraph (aa) of each of those subsections, all of which are substantively the same.

2444. Income chargeable under Chapter 5 of Part 4 of ITTOIA (stock dividends from UK resident companies) has been included in *subsection (1)(a)* as an additional description of disregarded income. See *Change 122* in Annex 1.

Section 826: Meaning of "disregarded annual payments"

2445. This section defines the term "disregarded annual payments" which is principally used in sections 813 and 816. It is based on the corresponding parts of section 128(3)(a) of FA 1995 and section 151(2)(a) of FA 2003 other than those on which section 825 is based.

Section 827: Meaning of "investment manager" and "investment transaction"

2446. This section defines the terms "investment manager" and "investment transactions" which underlie the independent investment manager conditions. It is based on section 127(12) and (13) of FA 1995 and paragraph 3(1), (3) and (4) of Schedule 26 to FA 2003.

2447. *Subsection (1)* is based on the definition of an "investment manager" in paragraph 3(1) of Schedule 26 to FA 2003 rather than the slightly different, but substantively the same, definition of "the manager" in section 127(3)(a) of FA 1995.

2448. The definition of "transaction" in *subsections (2)* and *(3)* is based on section 127(12) and (13) of FA 1995 and paragraph 3(3) and (4) of Schedule 26 to FA 2003, which are identical.

2449. Section 1014 containing general provision for the making of regulations applies for the purposes of subsection (2)(c).

2450. Regulations (SI 2003/2172 and SI 2003/2173) have been made in identical terms under the source legislation, section 127(12)(c) of FA 1995 and paragraph 3(3)(c) of Schedule 26 to FA 2003, designating as investment transactions swap contracts settled in cash or foreign currency (other than contracts relating to land, insurance or capital redemption business).

Section 828: Transactions through brokers and investment managers

2451. This section explains when a person is to be regarded as carrying out a transaction on behalf of another and makes provision for a person part only of whose business is as a broker or investment manager. It is based on section 127(14) and (15) of FA 1995 and paragraph 7(1) and (4) of Schedule 26 to FA 2003.

2452. There is a slight difference between the wording of section 127(14) of FA 1995 which refers to:

"a person who…provides investment management services

and that of paragraph 7(4) of Schedule 26 to FA 2003 which refers to:

"a person who…provides investment services.

2453. The words in paragraph 7(4) of Schedule 26 to FA 2003 are not capable, in practice, of having any different meaning from those in section 127(14) of FA 1995 and s*ubsection (2)* accordingly applies for all purposes of this Chapter.

Chapter 2: Residence

Overview

2454. This Chapter contains provisions relating to the determination of residence for the purposes of liability to income tax.

2455. The question whether or not a person is UK resident is primarily to be determined in accordance with case law. A limited number of statutory rules either supplement or disapply the case law rules in specific circumstances.

2456. Sections 829 to 833 contain provisions relating to the residence of individuals, section 834 contains provisions relating to the residence of personal representatives and section 835 provides signposts to provisions relating to the residence of trustees and companies.

Section 829: Residence of individuals temporarily abroad

2457. This section provides that an individual who is ordinarily UK resident is not treated as becoming non-UK resident for income tax purposes if the individual has left the United Kingdom for the purpose only of occasional residence abroad. It is based on section 334 of ICTA.

2458. Section 334 of ICTA applies only to a person who is a Commonwealth citizen or a citizen of the Republic of Ireland. This section is not limited in this way. In addition, it is made explicit that the rule in this section applies only if the individual is UK resident, as well as ordinarily UK resident, at the time the individual leaves the United Kingdom. See *Change 123* in Annex 1.

2459. The provisions in section 334 of ICTA can be traced back to the Napoleonic period and have been in continuous existence since the reintroduction of income tax by the Income Tax Act 1842, where the provisions were to be found in section 39. A lengthy discussion of the history of the provisions (then to be found in section 49 of ICTA 1970) can be found in the judgment of Nicholls J in Reed (HM Inspector of Taxes) v Clark (1985), 58 TC 528 Ch D[11].

2460. This section moves away from the historic language which has caused the effect of section 334 of ICTA and its predecessors to be somewhat obscured. During the course of his judgment in Reed v Clark, Nicholls J stated (at page 552E-G) that:

“Section 49 is a puzzling section, in that precisely what was its intended purpose is not at all easy to perceive. This makes interpretation of its terms the more difficult. …

Despite this I am in no doubt that section 49 is a substantive charging provision.

2461. *Subsection (1)* makes clear that this section applies only to determine the residence status of individuals and the term “individual” is, accordingly, used throughout this section in place of “person” in section 334 of ICTA.

2462. The term “occasional residence abroad” has been retained, as it has been the subject of judicial interpretation in the decided cases on section 334 of ICTA and its predecessors.

2463. *Subsection (2)* replaces the words in section 334 of ICTA providing that the individual to whom the section applies shall:

“(a) …be assessed and charged to income tax notwithstanding that at the time the assessment or charge is made he may have left the United Kingdom…

(b) …be charged as a person actually residing in the United Kingdom upon the whole amount of his profits or gains, whether they arise from property in the United Kingdom or elsewhere, or from any allowance, annuity or stipend, or from any trade, profession, employment or vocation in the United Kingdom or elsewhere.

2464. Unlike the provisions of section 334 of ICTA as interpreted in Reed v Clark, subsection (2) does not impose a separate charge to income tax but treats the individual as UK resident for the purpose of determining the individual’s liability to income tax for a tax year, leaving the charging provisions of the Income Tax Acts to determine whether and to what extent the individual is so liable in respect of any particular source of income. The effect on the liability of the individual is the same.

2465. Subsection (2) also clarifies that the provision continues to apply for any tax year in which the individual remains outside the United Kingdom for the purpose only of occasional residence abroad. See the judgment of the Lord President in Lloyd v Sulley (1884), 2 TC 37 (Court of Exchequer (Scotland) - First Division) at page 42, referring to section 39 of the Income Tax Act 1842:

11 [1985] STC 323

"Now that is a very important provision as extending the meaning of the words in the taxing clause, 'residing in the United Kingdom'. It extends it to a person who is not for a time actually residing in the United Kingdom, but who has constructively his residence there because his ordinary place of abode and his home is there, although he is absent for a time from it, however long continued that absence may be.

2466. Subsection (2) does not itself determine whether or not the individual's residence abroad is occasional. That is to be determined in accordance with the principles set out in the cases in which section 334 of ICTA and its predecessors have been considered.

2467. Like section 334 of ICTA, this section does not include anything concerning the ordinary residence of the individual after the individual has left the United Kingdom. The question whether the individual continues to be ordinarily UK resident falls to be determined in accordance with case law.

Section 830: Residence of individuals working abroad

2468. This section provides that, in the cases to which it applies, the fact that living accommodation in the United Kingdom is available for the individual's use is to be ignored in determining whether or not the individual is UK resident. It is based on section 335 of ICTA.

2469. *Subsection (1)* makes clear that this section relates only to the residence status of individuals and the term "individual" is, accordingly, used throughout this section in place of "person" in section 335 of ICTA.

2470. In *subsection (2)* the phrase "any living accommodation available in the United Kingdom for the individual's use" has been substituted for the phrase "any place of abode maintained in the United Kingdom for his use" in section 335(1) of ICTA. The reference to the availability of living accommodation brings the wording into line with the wording in HMRC booklet IR20 (Residents and non-residents: Liability to tax in the UK) and with the phrase "living accommodation available in the United Kingdom for his use" in section 336(3) of ICTA, on which sections 831(1) and 832(1) are based.

2471. This does not amount to a change in the law. To the extent that there is any difference between "living accommodation" and "place of abode maintained", "living accommodation" is the broader concept. In any event, available living accommodation which does not amount to a place of abode maintained for the use of an individual to whom section 335 of ICTA applies does not fall to be taken into account for the purposes of determining the individual's residence status.

Section 831: Foreign income of individuals in the United Kingdom for temporary purpose

2472. This section provides that an individual who is in the United Kingdom for a temporary purpose and stays there for only a limited period is not to be treated as UK resident for the purposes of certain charges to income tax on income from a source outside the United Kingdom. It is based on section 336(1), (1A) and (3) of ICTA.

2473. The provisions of section 336(2) of ICTA which deals with employment income of individuals in the United Kingdom for a temporary purpose are contained in section 832.

2474. The language of section 336(1) of ICTA dates back to Napoleonic times, while that of section 336(2) dates back only just over 50 years. These differences in language have been preserved where necessary.

2475. *Subsection (1)*, which describes to whom this section applies, makes clear that this section relates only to the residence status of individuals and the term "individual" is used throughout this section in place of "person" in section 336 of ICTA.

2476. Subsection (1)(a) retains the distinction between section 336(1)(a) of ICTA which refers to the person not being in the United Kingdom (emphasis added):

"with any *view or intent* of establishing his residence there

and section 336(2) of that Act which refers to the person not being in the United Kingdom (emphasis added):

"with the *intention* of establishing his residence there.

2477. Subsection (1)(a) refers only to "view" and omits reference to "intent" on the basis that "view" is wider than "intent" or "intention".

2478. Section 336(1)(b) of ICTA refers to the person having:

"not actually resided in the United Kingdom at one time or several times for a period equal in the whole to six months in any year of assessment

"while section 336(2) of that Act refers to the person having:

not in the aggregate spent at least six months in the United Kingdom in the year of assessment.

2479. Subsection (1)(b) retains the expression "actually resided" rather than adopting the expression "spent", as "actually resided" may not in every circumstance be synonymous with "spent". But the language of section 336(1)(b) of ICTA relating to the determination of the period has been modernised, including by substituting reference to 183 days for the reference to six months in section 336(1)(b) of ICTA. See *Change 124* in Annex 1.

2480. *Subsection (2)* restates the provisions listed in section 336(1A) of ICTA. Rule 1 is based on section 336(1A)(b) and (c) and Rule 2 on section 336(1A)(a) of that Act.

2481. The reference in each Rule to treating the individual as non-UK resident follows the approach of section 336(2) of ICTA and replaces the reference in section 336(1) of that Act to the person not being charged "as a person residing in the United Kingdom".

2482. The words "income arising from a source outside the United Kingdom" in both Rules give effect to the words "profits or gains received in respect of possessions or securities out of the United Kingdom" in section 336(1) of ICTA.

2483. *Subsection (3)*supplements paragraph (e) of Rule 1 with a reminder that a claim has to have been made under section 647 of ITEPA and to have been accepted by the Commissioners for Her Majesty's Revenue and Customs for the individual to have the benefit of the exemption in section 651 of that Act.

2484. *Subsections (4)* and *(5)* are based on the final words of section 336(1)(b) of ICTA:

"but if any such person resides in the United Kingdom for such a period he shall be so chargeable for that year.

Section 832: Employment income of individuals in the United Kingdom for temporary purpose

2485. This section provides that an individual who is in the United Kingdom for a temporary purpose and stays there for only a limited period is not to be treated as UK resident for the purposes of the rules in Chapters 4 and 5 of Part 2 of ITEPA which determine taxable earnings from employment. It is based on section 336(2) and (3) of ICTA.

2486. *Subsection (1)*, which describes to whom this section applies, makes clear that this section relates only to the residence status of individuals and the term "individual" is used throughout this section in place of "person" in section 336 of ICTA.

2487. In subsection (1)(b), reference to 183 days has been substituted for the reference to six months in section 336(2) of ICTA. See *Change 124* in Annex 1 and the commentary on section 831.

2488. *Subsections (3)* and *(4)* are based on the final words of section 336(2) of ICTA:

"but shall be treated as resident there if he has.

Section 833: Visiting forces and staff of designated allied headquarters

2489. This section provides that the presence in the United Kingdom of certain individuals who are in the United Kingdom for specific purposes only does not cause the individual to be treated, for income tax purposes, as being UK resident or as changing the individual's residence or domicile (see *subsection (4)*). It is based on section 323 of ICTA.

2490. This section applies to an individual who is in the United Kingdom by reason only of being a member of a visiting force of a designated country or of a civilian component of such a force (see *subsection (1)*) or by reason of falling into one of the categories of individuals mentioned in*subsections (2)* and *(3)*. But it does not apply to British and certain other citizens (see subsection (1)(c)).

2491. As it is clear that this section can only relate to individuals, the term "individual" is used throughout this section in place of "person" in section 323 of ICTA.

2492. Subsection (1) sets out in full the description of a member of a visiting force to whom this section applies. This avoids the cross-reference to section 303(1) of ITEPA in section 323(2) of ICTA.

2493. The definitions of "member" (in relation to a visiting force), "visiting force" and "member of a civilian component of a visiting force" are contained in Part 1 of the Visiting Forces Act 1952 (the 1952 Act). Those definitions have not been set out in full in this section - partly for reasons of length and partly to retain the explicit link between this section and the 1952 Act. *Subsection (6)* incorporates them by reference.

2494. This section corrects a minor drafting error in section 323(4) of ICTA. Section 323(4) of ICTA provides that references to a visiting force in section 323(2) apply also to a civilian component of such a force and that "that subsection shall be construed as one with Part 1 of the Visiting Forces Act 1952". As there is no reference to "civilian component" in section 323(2) of ICTA, construing that subsection as one with Part 1 of the 1952 Act does not have the effect of applying the definition of "member of a civilian component of a visiting force" in section 10 of that Act for the purposes of section 323(4) or (5) of ICTA. There is no doubt that the definition is intended to apply.

2495. This section makes the correction by:

- incorporating in subsection (1) the provisions of section 323(4) of ICTA applying section 323(2) of that Act to a member of a civilian component of a visiting force; and
- providing in subsection (6) not only for subsection (1) to be interpreted as if in Part 1 of the 1952 Act, but also for subsection (2), which is based on section 323(5) of ICTA, to be so interpreted.

2496. Section 303 of ITEPA, which is based on part of section 323 of ICTA and applies to the individuals to whom this section applies, provides that earnings paid to such individuals by the government of a designated country or by a designated allied headquarters are exempt from income tax.

2497. The effect of section 833 of this Act is that an individual to whom it applies is not liable to United Kingdom income tax on income arising from a source outside the United Kingdom.

2498. *Subsection (5)* ensures that an individual to whom this section applies has the benefit of the personal reliefs to which the individual would be entitled if resident in the United Kingdom. Such reliefs will, accordingly, be available in calculating the individual's liability to United Kingdom income tax on such income as, for example, United Kingdom bank interest, dividends from UK resident companies and UK-based earnings which are not exempt under section 303 of ITEPA.

Section 834: Residence of personal representatives

2499. This section sets out rules for determining the residence status of personal representatives, in their capacity as such, where one or more (but not all) of them are UK resident in their own capacity. It is based on section 111(1) and (2) of FA 1989.

2500. Section 111 of FA 1989 was enacted, together with section 110 of that Act (residence of trustees), following the decision in Dawson v CIR (1989), 62 TC 301 HL[12]. Section 110 of FA 1989 was repealed by FA 2006 and replaced by similar but extended provisions in section 685E(2) to (7) of ICTA (see the commentary on sections 475 and 476).

2501. In Dawson it was held that under the law then in force trust income from a foreign source could not be assessed on a UK resident trustee whose fellow trustees were non-UK resident. In his speech, with which the other members of the Judicial Committee concurred, Lord Keith of Kinkel stated (at page 329):

> "The argument for the Revenue accepts that the income of the settlements arose or accrued to the three trustees jointly, and not jointly and severally, so that none of them was entitled in law separately to any particular share or fraction of the income. It is contended, however, that the whole income from the foreign investments did, on a proper construction of para 1(a)(i) of s 108 [of ICTA 1970], arise or accrue to the Respondent as a person residing in the United Kingdom, and that the circumstance that it did so to him jointly with two co-trustees resident abroad is irrelevant. However, the word "person" in that sub-sub-paragraph must include the plural "persons" by virtue of s 6(c) of the Interpretation Act 1978. If all three trustees had been resident in the United Kingdom application of the enactment would have been such the income would have been treated as arising or accruing to all three, and all three would have been jointly assessable to tax. In the situation which prevails here, namely that one of the trustees is resident in the United Kingdom but the other two are resident abroad, the income likewise arises or accrues to all three, but all three cannot be jointly assessed to tax. There can be no justification for assessing to tax the Respondent alone, on the ground that he is resident in the United Kingdom, because the income does not arise or accrue to him personally. He has no right of control over the income. His only interest in it is a right and duty to secure, in conjunction with his co-trustees, that it is applied in accordance with the directions of the trust deeds. Similarly, when one turns to s 114(1) of the Act of 1970 it is found that the persons receiving or entitled to the income are the three trustees jointly. Should the plural "persons" be turned into the singular "person" it is found that the Respondent as an individual cannot properly be described as the person receiving or entitled to the income.

2502. The effect of section 111 of FA 1989 is to determine, in a case where some of the persons who are the personal representatives are in their own capacity UK resident and some are not, that the personal representatives, in their capacity as such, are either all UK resident or all non-UK resident.

2503. If all the personal representatives are UK resident, then, as the persons jointly receiving or entitled to the income, the personal representatives are chargeable in that capacity to income tax in respect of all the income so arising, whether from a United Kingdom or a foreign source. If none of them is UK resident, they are only chargeable in that capacity to income tax in respect of any of that income from a United Kingdom source.

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12 [1989] STC 473

2504. This section determines the residence status of all of the personal representatives in that capacity by reference to the residence or domicile of the deceased at the time of death.

2505. If the deceased was UK resident, ordinarily UK resident or domiciled in the United Kingdom at the time of death, any of the deceased's personal representatives who are non-UK resident in their own capacity are to be treated as UK resident in their capacity as personal representatives of the deceased. See *subsections (2)* and *(3)*.

2506. If the condition in subsection (3) is not met in relation to the deceased, any of the deceased's personal representatives who are UK resident in their own capacity are to be treated as non-UK resident in their capacity as personal representatives of the deceased. See *subsection (4)*.

2507. The provision in section 111(1)(b) of FA 1989 that a personal representative who is treated as non-UK resident under that paragraph is also to be treated as resident outside the United Kingdom is included in Chapter 2 of Part 13 (see the commentary on section 718). The provisions of section 111(7) and (8) of FA 1989, relating to the effect of that rule on liability under sections 739 and 740 of ICTA, are included in Part 14 of Schedule 2.

2508. The definition of "personal representatives" in section 111(3) of FA 1989 has been omitted. Instead, the general Income Tax Acts definition of "personal representatives" in section 989 applies to this section. See *Change 150* in Annex 1 and the commentary on section 989.

Section 835: Residence rules for trustees and companies

2509. This section provides signposts to other provisions relating to residence, not included in this Chapter. It is new.

2510. Those provisions are:

- sections 475 and 476 of this Act which contain rules for determining the residence of trustees and
- sections 66 and 66A of FA 1988 and section 249 of FA 1994 which contain rules for determining the residence of a company.

2511. The provisions in FA 1988 and FA 1994 do not form part of this Act, as they apply not only for the purposes of the Tax Acts but also for the purposes of TMA and of TCGA and all other enactments relating to capital gains tax.

2512. In relation to a company, this section is to be read with section 5 which provides that income tax is not charged on the income of a company if the company is within the charge to corporation tax in respect of the income. That section contains a signpost to sections 6(2) and 11(1) of ICTA for the circumstances in which a company is within the charge to corporation tax in respect of its income. Those circumstances in turn depend upon the residence of the company.

Chapter 3: Jointly held property

Overview

2513. These sections rewrite the rules in sections 282A and 282B of ICTA that apply to income arising from property held in the joint names of a husband and wife or civil partners who are living together. In general, the effect of the rules is that such income is allocated equally between the parties.

2514. There are no specific rules dealing with the allocation of income arising from property owned jointly by other persons. If assets are held in common so that each party has a specific share, then the allocation of income would normally reflect those shares. And if assets are held by joint tenants, then in law each person owns the whole of the property and is entitled to the whole of the income. But in practice such income is not subject to double assessment and is normally allocated equally.

Relevance of "earned income"

2515. The term "earned income" has a long history. It is defined in section 833(4) to (6) of ICTA, and subsection (6) indicates that there are a number of further provisions under which certain sorts of income are treated as earned.

2516. Following the changes made to pensions tax legislation in FA 2004 which came into force on 6 April 2006, section 282A of ICTA is now the only place in the Income Tax Acts which makes specific use of the term earned income. (And it is not used in relation to national insurance purposes.) There is a single reference to patent income within section 833(5B) of ICTA, in the definition of "relevant UK earnings" in section 189(2)(c) of FA 2004.

2517. Rather than retain this concept, the joint property rule is rewritten in direct terms without reference to earned income, mainly by excluding all income within Part 9 of ITTOIA from the joint property rule. Accordingly, it is no longer necessary to define earned income, and specific provisions treating income as earned are repealed by this Act. In addition, the reference to section 833(5B) of ICTA in section 189 of FA 2004 is amended by Schedule 1 to this Act. See *Change 125* in Annex 1.

Section 277 of ICTA

2518. This section, dating in part from 1842, also relates to income arising from jointly owned property. It is not related to sections 282A and 282B. It is instead about how personal reliefs may be claimed against income arising from jointly owned property. As there is no longer any form of joint assessment of income belonging to more than one person, this provision is otiose and has not been rewritten.

Section 836: Jointly held property

2519. This section provides the general rule (the 50:50 rule) that income from jointly held property is allocated equally between the spouses or civil partners. It is based on section 282A of ICTA.

2520. *Subsection (1)* explains that the section applies to married couples and civil partners provided that they live together. The meaning of "living together" is explained in section 1011.

2521. *Subsection (2)*gives the general rule and *subsection (3)* provides exceptions.

2522. Exception A relates to income to which neither of the individuals is beneficially entitled. It follows that the 50:50 rule does not apply when the couple hold the property as nominees or trustees.

2523. Exception B applies where the couple own property in common in unequal shares and make a declaration under section 837.

2524. Exception C applies to all income that arises to the individuals as partners. This exception covers not only income arising from a trade or profession carried on in partnership, but any other business income arising to a firm. See *Change 125* in Annex 1 and the overview commentary on this Chapter.

2525. Exception D applies to the commercial letting of furnished holiday accommodation, which is treated as a trade. See *Change 125* in Annex 1 and the overview commentary on this Chapter.

2526. Exception E is based on section 282A(4A) of ICTA. It ensures that if close company shares or securities are held in common, income arising from that property is allocated according to true beneficial ownership rather than equally.

2527. Exception F ensures that the rule in subsection (2) does not apply to income that is treated as the income of the other individual or a third party under any other provision of the Income Tax Acts.

Section 837: Jointly held property: declarations of unequal beneficial interests

2528. This section enables couples to specify that the 50:50 rule does not apply to income arising from particular property held in common, so that the income is then allocated according to each individual's beneficial interest. It is based on sections 282A and 282B of ICTA.

2529. A declaration can only be made where the entitlement of each individual to a share in the income matches the entitlement to his or her share in the underlying property (*subsection (1)*).

Chapter 4: Other miscellaneous rules

Overview

2530. This Chapter contains miscellaneous income tax provisions.

Section 838: Local authorities and local authority associations

2531. This section exempts United Kingdom local authorities and local authority associations from income tax. It is based on section 519 of ICTA.

Section 839: Issue departments of the Reserve Bank of India and the State Bank of Pakistan

2532. This section exempts from income tax the income of the issue departments of the central banks of India and Pakistan. It is based on section 517 of ICTA.

Section 840: Government securities held by non-UK resident central banks

2533. This section exempts from income tax certain income arising in the United Kingdom to overseas central banks. It is based on section 516 of ICTA.

2534. The scope of the exemption is specified in an order made by Her Majesty in Council. It does not extend to income arising in the normal course of a bank's trading operations in the United Kingdom.

Section 841: Official agents of Commonwealth countries etc

2535. This section provides an exemption from income tax for certain income arising to official agents of Commonwealth countries and of the Republic of Ireland and of states or provinces of those countries. It is based on section 320(2) to (4) of ICTA.

2536. The exemption is the same as that given to members of the staff of a diplomatic mission under the Diplomatic Privileges Act 1964 which gives force to the United Kingdom's international obligations under the Vienna Convention on Diplomatic Relations. In most cases, provided the agent is not a United Kingdom national and is present in the United Kingdom solely for the purpose of the agent's duties, that is an exemption for the agent's official earnings and other income arising outside the United Kingdom. Private income arising in the United Kingdom remains liable to income tax.

2537. Section 320(1) of ICTA provides an exemption to an Agent-General and section 320(3)(a) an exemption to his or her personal staff. These exemptions have not been rewritten as they merely duplicate exemptions now given under the Commonwealth Countries and Republic of Ireland (Immunities and Privileges) Order SI 1985/1983.

2538. Section 320(3)(c), which provides an exemption to an official agent of a self-governing colony, has not been rewritten because there are no overseas territories now certified as self-governing colonies.

Section 842: European Economic Interest Groupings

2539. This section sets out the basic rules that determine how the members of a European Economic Interest Grouping are to be taxed. It is based on section 510A of ICTA to the extent that it relates to income tax.

2540. Members of a Grouping may be companies, individuals or partnerships.

Section 843: Restriction of deductions for annual payments

2541. This section prevents annual payments for which the consideration is either a dividend or not taxable from being deducted in calculating a person's income from any source. It is based on section 125(1) of ICTA.

2542. Section 899(5)(f) prevents the annual payments concerned from being qualifying annual payments. So they are not subject to deduction of tax at source, nor eligible for relief under Chapter 4 of Part 8 (annual payments and patent royalties). This section extends the ban on relief so that no annual payment that meets the definition in section 904 is an allowable deduction in calculating income in any circumstances.

Section 844: Letters patent etc: exempting provisions

2543. This section voids the impact of exempting provisions in letters patent. It is based on section 829(4) of ICTA.

2544. The words "to be granted" in the source legislation have been omitted as it is not possible for an exemption to be in point until the letters patent are actually granted.

2545. *Subsection (3)* is drafted on the basis that purported exemptions in all letters patent etc are void.

2546. Section 829(4) of ICTA also contains the rule that any statute which purports to confer income tax exemptions on a particular person or class of persons is void. It is not considered that "statute" can have its modern meaning of "Act of Parliament", since it is always open to Parliament to enact specific tax exemptions if it chooses to do so. It is instead aimed at provisions of a quasi-legislative nature such as bye-laws. But the idea of a local rule overriding an Act of Parliament by providing an income tax exemption is no longer tenable. So this part of section 829(4) is repealed as obsolete.

Section 845: Extra return to be treated as interest etc

2547. This section treats as interest certain "extra returns" that arise in some circumstances if new securities are issued of the same kind as existing securities. It is based on section 587A(1) to (3) of ICTA.

2548. The section applies where new securities are issued which are of the same kind as existing securities, except that at the issue date the existing securities will have accrued a certain amount of interest. In order to pay the same amount of "interest" on all the securities at the next interest payment date, the issue price of the new securities is increased to reflect the accrued interest on the existing securities. This section contains special rules for the treatment of the amount by which the issue price is increased.

2549. *Subsection (1)* sets out the conditions that must be met for the provision to operate. The total amount by which the issue price of the new securities is increased and which is then returned to the holder along with the true interest on the securities at the next interest payment date is called the "extra return".

2550. *Subsection (2)*specifies that the extra return must be equal to the interest that accrued for the relevant period on an equivalent number of existing securities. The relevant period is defined in section 846.

2551. *Subsection (3)* ensures that the extra return is treated as a payment of interest. It then follows that where deduction of tax applies, it will apply to the whole amount of "interest" including the extra return.

2552. *Subsection (4)* ensures that no relief is given to the issuer for the extra return.

2553. For corporation tax purposes, section 587A of ICTA applies only if the new securities were issued before 1 April 1996. Accordingly, this provision has not been retained for corporation tax purposes.

Section 846: Interpretation of section 845

2554. This section provides definitions for terms used in section 845. It is based on section 587A(3) to (6) of ICTA.

Part 15: Deduction of income tax at source

Overview

2555. This Part concerns the main rules about deduction of income tax at source.

2556. The Part sets out the various duties to deduct, apart from those arising in connection with PAYE (see Part 11 of ITEPA) and the Construction Industry Scheme (see Chapter 3 of Part 3 of FA 2004, which is taking over from Chapter 4 of Part 13 of ICTA).

2557. The Part retains the distinction in the source legislation between the deduction of "sums representing income tax" and the collection of the income tax which those sums represent. This reflects the conceptual distinction between income tax which is charged on a person's income and income tax which is deducted at source (and not subject to a charge to tax). The Part also contains provisions which make clear the link between the sums deducted and the amount to be collected (eg section 951(2)).

Chapter 1: Introduction

Section 847: Overview of Part

2558. This section provides an overview to the Part. It is new.

Section 848: Income tax deducted at source treated as income tax paid by recipient

2559. This section treats sums representing income tax deducted (or treated as deducted) from a payment under this Part (other than under sections 966 (visiting performers) or 971 (non-resident landlords)) as tax paid by the recipient, and links such amounts with the provisions of TMA concerning payment of income tax. It is based on sections 348(1) and 349(1) of ICTA and sections 426, 550, 602, 618 and 686(1) of ITTOIA.

Section 849: Interaction with other Income Tax Acts provisions

2560. This section provides information about how this Part interacts with other provisions. It is new.

2561. *Subsection (1)* gives a signpost to regulations made under the provisions of ICTA about double taxation relief, such as the Double Taxation Relief (Taxes on Income) (General) Regulations 1970 (SI 1970/488). Under these regulations a duty to deduct may be disapplied or modified.

2562. *Subsection (3)* provides that anything covered by the general disregard in section 783 of ITTOIA is ignored for the purposes of the duties under this Part, subject to any contrary provision.

2563. *Subsection (4)* gives a signpost to paragraphs 11 to 13 of Schedule 2 to FA 2005 (alternative finance arrangements) inserted by this Act. Alternative finance return and profit share return are treated as interest (and therefore, if the arrangements meet the relevant conditions, yearly interest) for the purposes of this Part.

Chapter 2: Deduction by deposit-takers and building societies

Overview

2564. This Chapter requires the deduction of sums representing income tax from certain payments of interest made by deposit-takers and from certain payments of interest and dividends made by building societies. It is based on sections 477A and 480A to 482 of ICTA.

2565. Banks are the most obvious example of deposit-takers, but the definition of deposit-taker also includes other persons, for example individuals who have permission to accept deposits under Part 4 of FISMA.

2566. Many of the detailed provisions are in regulations, and this will remain the case.

2567. The main source rules for deposit-takers are in primary legislation, but all of the source rules for building societies are in regulations. For historical reasons, the two sets of rules adopt different approaches to identifying the payments subject to deduction of tax.

2568. A common basis for the split between primary and secondary legislation has resulted from the enactment in this Act of certain provisions of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations). See *Change 126* in Annex 1, which affects sections 852, 853, 871 and 872 in this Chapter and some sections in Chapter 15 of this Part.

2569. And, building on this, a common basis for identifying payments subject to deduction of tax has resulted from aligning the gross payment category rules for building societies with deposit-takers. See *Change 127* in Annex 1, which affects sections 851, 856, 858, 859 and 872.

2570. Those regulations not being rewritten will continue in force, as explained in *Change 126* in Annex 1. HMRC specialists are working on rationalising the remaining regulations.

Section 850: Overview of Chapter

2571. This section provides an overview of the Chapter. It is new.

2572. The section provides signposts to the sections dealing with the main features of the Chapter, including key definitions and rules about when investments are (or are not) relevant investments.

2573. It also makes it clear that:

- references to “interest” include a reference to “dividends” paid by building societies; and
- crediting interest counts as paying it for all purposes of the Chapter.

2574. Sections 858 to 870 (investments which are not relevant investments) are placed in order of their relative significance.

Section 851: Duty to deduct sums representing income tax

2575. This section sets out the general duty to deduct a sum representing the savings rate of income tax from interest payments made by deposit-takers and building societies on relevant investments. It is based on sections 4 and 480A of ICTA and regulation 3 of the building society regulations.

2576. In accordance with section 850(6), "interest" includes dividend payments made by building societies.

2577. The definition of "relevant investment" for building societies has been aligned to the deposit-taker regime. See *Change 127* in Annex 1 and the overview commentary for this Chapter.

Section 852: Power to make regulations disapplying section 851

2578. This section allows the Commissioners for Her Majesty's Revenue and Customs to make regulations so that section 851 will not apply in relation to an interest payment where certain prescribed conditions have been met. It is based on sections 477A(1) and (2) and 480B(1) to (3) of ICTA.

2579. As part of the process of enacting some of the building society regulations, the wide powers provided in section 477A(1) of ICTA have been replaced with specific regulation making powers. See *Change 126* in Annex 1 and the overview commentary for this Chapter.

2580. Regulations have been made under sections 477A(1) and 480B of ICTA which allow UK resident individuals to certify that they are not liable to income tax so that they may be paid gross.

2581. The regulations concerned are the Income Tax (Deposit-takers) (Interest Payments) Regulations 1990 (SI 1990/2232), and the building society regulations. The relevant parts of these regulations will continue to have effect under the general continuity of law provisions included in this Act.

Section 853: Meaning of "deposit-taker"

2582. This section defines "deposit-taker". It is based on section 481(2) of ICTA.

2583. Article 39 of the FISMA (Consequential Amendments) (Taxes) Order 2001 (SI 2001/3629) (FISMA(CA)(T)O), amends the definition of deposit-taker in section 481(2) of ICTA. This amendment has been reflected in the rewritten legislation and consequently article 39 is revoked (see Schedule 3 to this Act).

2584. The persons prescribed as deposit-takers by orders made under the power in section 481(2)(f) of ICTA, namely firms with European Economic Area (EEA) passport rights and certain dealers in financial instruments, have also been included here. The two orders concerned (the Income Tax (Prescribed Deposit-takers) Order 1992 (SI 1992/3234) and the Income Tax (Prescribed Deposit-takers) Order 2002 (SI 2002/1968)) will be revoked (see Schedule 3 to this Act). See *Change 126* in Annex 1.

Section 854: Power to prescribe persons as deposit-takers

2585. This section provides that the Treasury may make orders prescribing persons or a member of a class of persons receiving deposits in the course of business or activities to be treated as a deposit-taker. It is based on sections 481(2)(f) and 482(10) of ICTA.

2586. The following Statutory Instruments made under section 481(2)(f) of ICTA are spent or obsolete and are revoked (see Schedule 3 to this Act):

- the Income Tax (Prescribed Deposit-takers) (No 1) Order 1984 (SI 1984/1801), which included the British Railways Board in the definition of deposit-taker; and

- the Income Tax (Composite Rate) (Prescribed Deposit-takers) Order 1985 (SI 1985/1696), which listed various local authorities as being included in the definition of deposit-taker. The bodies referred to in this Order (and which are still in existence) are covered in the definition of "local authority" in section 999. As local authorities are already included in section 853(4), this Order is obsolete.

Section 855: Meaning of "investment" and "deposit"

2587. This section defines "investment" and "deposit" in preparation for the sections setting out which investments are, or are not, relevant investments. It is based on section 480A(1) and 481(3) of ICTA and regulations 2 and 3 of the building society regulations.

2588. This section also makes clear that, whether or not a deposit bears interest, it will still be treated as a deposit (although deduction of tax will be necessary only where interest is paid). As part of the alignment of the two regimes, the definition of deposit now also applies in relation to building societies.

2589. Under paragraph 6 of Schedule 2 to FA 2005, alternative finance arrangements are treated as if they were deposits for the purposes of the deposit-taker regime. A similar result is achieved for building societies through the operation of paragraph 5 of Schedule 2 to FA 2005.

2590. The alignment of the two regimes (so that the building society gross payment category rules are similar to deposit-takers, see *Change 127* in Annex 1 and the overview commentary for this Chapter), has prompted amendments of Schedule 2 to FA 2005 (see Schedule 1 to this Act).

Section 856: Investments which are relevant investments

2591. This section sets out the main rules about which investments are relevant investments. It is based on section 481(4) of ICTA and parts of regulations 3 and 4 of the building society regulations. See *Change 127* in Annex 1, and the overview commentary on this Chapter, for the effects of the alignment of the regimes.

2592. *Subsection (1)* sets out the four categories of investments which are relevant investments for the purposes of this Chapter. *Subsection (2)* makes clear that subsection (1) is subject to the general rules in sections 858 to 870 about when an investment will not be treated as a relevant investment.

2593. *Subsections (3)* to *(6)* set out the detail of the conditions governing the four categories of relevant deposits.

2594. With the exception of the personal representative category, each category is separate and does not overlap. Consequently, an investment will only be a relevant investment where *all* the persons entitled to the interest payment are either:

- individuals (*subsection (3)*),
- a Scottish partnership where all the partners are individuals (*subsection (4)*), or
- trustees of a discretionary or accumulation settlement (*subsection (6)*).

2595. Where a personal representative (*subsection (5)*) is entitled to *any* interest on the investment, the whole investment will be a relevant investment. So, where a personal representative is entitled to part of the interest on a joint account, all interest will be subject to deduction, unless a declaration has been made in accordance with the regulations made under section 852 in respect of the part of the investment which does not vest in the personal representative.

2596. Section 481(4)(c) of ICTA refers to a person receiving interest "as a personal representative [and] in his capacity as such." As there is no distinction between a person receiving interest *as* a personal representative, and doing so in his capacity as such, the section simply refers to receiving interest "in that capacity". This is in line with the approach used in relation to trustees.

2597. As a result of aligning the gross payment category rules for building societies with the deposit-taker rules and defining relevant investment by reference to the *beneficial* owner of the payment, many of the gross payment categories in regulation 4 of the building society regulations do not need to be rewritten. This is because certain of those payments do not fall within any category of relevant investment in the first place. See *Changes 127* and *128* in Annex 1.

Section 857: Investments to be treated as being or as not being relevant investments

2598. This section sets out the rules governing when deposit-takers and building societies should treat investments as relevant (depending on the information they hold). It is based on section 482 of ICTA and regulation 11(4) of the building society regulations.

2599. *Subsection (1)* states that deposit-takers and building societies must treat an investment as a relevant investment unless they are satisfied that it is not a relevant investment.

2600. As part of the alignment of the two regimes, building societies will no longer need to obtain declarations from persons previously falling under the gross payment categories mentioned in regulation 4(1)(d) to (g), (k) and (r) of the building society regulations in order that payment can be made gross. See *Change 129* in Annex 1.

Section 858: Declarations of non-UK residence: individuals

2601. This section applies to investments satisfying the individual interest condition set out in section 856(3). It is based on sections 481(5) and 482(2), (2A) and (6) of ICTA and regulations 2, 4(1)(a) and (b) and 11 of the building society regulations.

2602. The section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (*subsection (2)*). See *Change 130* in Annex 1.

2603. The section also makes clear that payments will be made gross only where all the individuals are non-UK resident. See *Change 127* in Annex 1.

Section 859: Declarations of non-UK residence: Scottish partnerships

2604. This section applies to investments satisfying the Scottish partnership condition set out in section 856(4). It is based on sections 481(5) and 482(2), (2A) and (6) of ICTA and regulations 2(1), 4(1)(a) and (b) and 11 of the building society regulations.

2605. This section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (see *subsection (2)*). See *Change 130* in Annex 1.

2606. The section also ensures that a deposit will not be a relevant investment unless *all the partners* of the Scottish partnership are not ordinarily resident in the United Kingdom. See *subsection (3)* and *Changes 127* and *131* in Annex 1.

Section 860: Declarations of non-UK residence: personal representatives

2607. This section applies to investments satisfying the personal representative condition set out in section 856(5). It is based on sections 481(5) and 482(2) and (6) of ICTA and regulations 2(1), 4(1)(c) and 11 of the building society regulations.

2608. The section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (see *subsection (2)*). See *Change 130* in Annex 1.

Section 861: Declarations of non-UK residence: settlements

2609. This section applies to investments satisfying the settlement condition set out in section 856(6). It is based on sections 481(5) and 482(2) and (6) of ICTA and regulations 2(1), 4(1)(bb) and 11 of the building society regulations.

2610. The section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (see *subsection (2)*). See *Change 130* in Annex 1.

2611. See *Change 131* in Annex 1 and the commentary on section 859 for information on changes made in respect of Scottish partnerships in *subsections (2)* to *(4).*

Section 862: Inspection of declarations

2612. This section gives an officer of Revenue and Customs power to inspect any declarations which have been made to the deposit-taker or building society. It is based on section 482(3) and (4) of ICTA and regulation 11(5) and (6) of the building society regulations.

2613. Regulation 8 of the Income Tax (Deposit-takers) (Non-residents) Regulations 1992 (SI 1992/14) and regulation 11(7) of the building society regulations provide a two year time limit for the retention of declarations.

2614. For deposit-takers, this section is a minor change in law, as the source legislation in section 482(3) of ICTA does not give flexibility in the selection of declarations to be inspected: it is all or none. See *Change 132* in Annex 1.

Section 863: General client account deposits

2615. This section provides that general client account deposits will not be treated as relevant investments and defines the circumstances in which an investment will be treated as a "general client account deposit". It is based on section 481(5) and 482(6) of ICTA and regulations 2(1) and 4(1) of the building society regulations.

Section 864: Qualifying uncertificated eligible debt security units

2616. This section provides that an investment will not be treated as a relevant investment if a "qualifying uncertificated eligible debt security unit" has been issued in respect of the investment. It is based on section 481(5)(a) of ICTA and regulation 4(1)(j) of the building society regulations.

2617. References to deposit rights in sections 349(4), 477A and 481(5A) of ICTA and regulation 4(1)(j) of the building society regulations have not been rewritten as they are obsolete. See *Change 133* in Annex 1.

Section 865: Qualifying certificates of deposit

2618. This section provides that an investment will not be treated as a relevant investment if a "qualifying certificate of deposit" has been issued in respect of the investment. It is based on section 481(5)(a) of ICTA and regulation 4(1)(j) of the building society regulations.

Section 866: Qualifying time deposits

2619. This section provides that an investment will not be treated as a relevant investment if the deposit is a "qualifying time deposit". It is based on sections 481(5)(a) and 482(6) of ICTA and regulation 4(1)(j) of the building society regulations.

Section 867: Lloyd's premium trust funds

2620. This section provides that if an investment forms part of a Lloyd's premium trust fund it will not be treated as a relevant investment. It is based on section 481(5) of ICTA, sections 183(2) and 184(1) of FA 1993 and regulations 2(1) and 4(1) of the building society regulations.

2621. *Subsection (1)* refers to a "premium trust fund" rather than a "premiums trust fund", as per the source legislation (section 481(5)(f) of ICTA and regulation 4(1)(o) of the building society regulations). This new defined term follows the amendment made to section 184 of FA 1993 by articles 75 and 79 of FISMA(CA)(T)O, effective from 1 December 2001.

2622. The new definition of "premium trust fund" used in the main Lloyd's legislation (section 184 of FA 1993) is applied by *subsection (2)*. This means that new rules relating to the Sourcebook made by the Financial Services Authority under FISMA will have effect for the purposes of defining a "premium trust fund" in respect of this Chapter.

Section 868: Investments held outside the United Kingdom

2623. This section sets out when an investment held outside the United Kingdom will not be treated as a relevant investment. It is based on sections 481(5)(h) and (j) and 482(7) of ICTA and regulation 4(1)(s) of the building society regulations.

2624. For the purposes of the section, *subsection (4)* sets out when an investment is to be treated as being held at a branch. As the source legislation does not define when an investment will be treated as being held at a branch for the purposes of building societies, subsection (4) has been extended to apply to building societies to clarify what is meant.

Section 869: Sale and repurchase of securities

2625. This section ensures that, in relation to building societies, certain investments arising in the context of sale and repurchase transactions are not treated as relevant investments. It is based on regulation 4(1)(t) and (u) of the building society regulations.

2626. The section does not apply in relation to deposit-takers. In the case of s*ubsection (1)* this is because loans do not fall within the definition of "deposit" (see section 855). So interest paid by deposit-takers on such loans is not subject to the duty to deduct under this Chapter.

2627. In the case of s*ubsection (2)* it is because the source legislation about deposit-takers does not exempt interest payments made in respect of cash payments made as security for the performance of the sale and repurchase agreements from the duty to deduct tax. Where interest is paid by deposit-takers on such deposits to individuals, Scottish partnerships, personal representatives or trustees of discretionary or accumulation settlement, it will be subject to the duty to deduct under this Chapter.

Section 870: Other investments

2628. This section collects together the remaining instances where an investment is not to be treated as a relevant investment.

2629. *Subsection (1)* sets out various investments with deposit-takers which are not relevant investments. It is based on section 481(5)(b), (c), and (d) of ICTA.

2630. *Subsection (2)* sets out various investments with building societies which are not relevant investments. It is based on section 477A(1A) and (10) of ICTA and regulations 3(2) and 4(1)(h) of the building society regulations.

2631. For the purposes of the section, bank is defined by reference to section 991 which is based on section 840A of ICTA. In the building society regulations, the reference to "bank" in regulation 4(1)(h) is not defined. In order to clarify the position for building society legislation, the definition of "bank" has been extended to apply to building societies.

Section 871: Power to make regulations to give effect to Chapter

2632. This section gives the Commissioners for Her Majesty's Revenue and Customs power to make regulations in relation to providing information, inspection of records by officers of Revenue and Customs, and generally giving effect to the Chapter. It is based on sections 477A, 482(11), (11A) and (12) of ICTA.

2633. As a number of the building society regulations will be enacted, the wide powers provided in section 477A(1) of ICTA have been replaced (in part) with specific regulation making powers. See *Change 126* in Annex 1.

2634. *Subsection (2)* has been aligned to the wording of similar provisions. In particular it now includes a reference to supplemental and transitional provision and savings.

Section 872: Power to make orders amending Chapter

2635. This section gives the Treasury power to provide that certain investments are or are not relevant investments. It is based on sections 477A(1), (1A) and (2) and 481(6) and 482(12) of ICTA.

2636. As a number of the building society regulations will be enacted, the wide powers provided in section 477A(1) of ICTA have been replaced (in part) with specific order making powers. The order making power in this section takes the place of the power in section 477A(1) of ICTA in relation to building societies. See *Changes 126* and*127* in Annex 1.

2637. *Subsection (2)* allows the Treasury, in the case of deposit-takers, to specify which deposit-takers an order under this section will apply to.

2638. *Subsection (4)* gives the Treasury power to amend all sections of the Chapter except section 852 (power to disapply section 851).

Section 873: Discretionary or accumulation settlements

2639. This section makes provision about when a settlement is to be regarded as a discretionary or accumulation settlement, and when a person is to be regarded as a beneficiary of such a settlement, for the purposes of the Chapter. It is based on sections 481(4A) and 482(5A) of ICTA and regulation 2 of the building society regulations.

2640. *Subsection (2)* ensures that the section applies in the same way that section 481(4A) of ICTA did before 6 April 2006. See *Change 85* in Annex 1.

2641. In regulation 2(1) of the building society regulations, part of the definition of discretionary and accumulation trust (which, following the enactment of paragraph 37 of Schedule 13 to FA 2006, is now a reference to "settlement") refers to "income of the settlor applied in defraying expenses of the trustees". These words have not been included as they are obsolete.

Chapter 3: Deduction from certain payments of yearly interest

Overview

2642. This Chapter requires the deduction of sums representing income tax from certain payments of yearly interest. It is based on section 349(2) and (3) of ICTA.

2643. Many yearly interest payments are not subject to deduction under this Chapter, either because they are subject to different rules (eg those for deposit-takers and building societies in Chapter 2) or because of exceptions (eg those for certain payments made between companies in Chapter 11). Others are excluded from the duty to deduct by sections 875 to 888.

Section 874: Duty to deduct from certain payments of yearly interest

2644. This section sets out the basic duty to deduct sums representing income tax from certain payments of yearly interest. It is based on sections 4 and 349 of ICTA.

2645. This section does not apply to interest paid by building societies. See the commentary on section 875 and *Change 134* in Annex 1.

2646. *Subsection (1)(d)* concerns payments made to persons whose "usual place of abode" is outside the United Kingdom.

2647. The term "usual place of abode" also occurs:

- in section 887 in this Chapter (industrial and provident societies);
- in section 906 (certain royalties etc); and
- in section 971 (non-resident landlords).

2648. The term "usual place of abode" is consciously retained, because it is a technical term, distinct from residence.

2649. The duty to deduct in *subsection (2)* applies to any yearly interest arising in the United Kingdom, subject to the exceptions mentioned in *subsections (3)* and *(4)*.

2650. The source legislation in section 349(2) of ICTA identifies yearly interest by referring both to interest falling within Chapter 2 of Part 4 of ITTOIA (income tax) and Case III of Schedule D (corporation tax). But before the amendment to section 349(2) was made by ITTOIA, the yearly interest concerned was identified simply by reference to section 18(3)(a) of ICTA (the income tax definition of interest chargeable under Case III of Schedule D).

2651. Here, in rewriting section 349(2) of ICTA, the opportunity is taken to revert to this single test, which amounts to the requirement that the income arises in the United Kingdom. The reference to "Schedule A" in section 18(3)(a) of ICTA is not included as this applied only to annual payments.

2652. Subsection (2) also makes it explicit that the rate at which deduction must be made is the savings rate, that being the rate applicable to income within Chapter 2 of Part 4 of ITTOIA.

Section 875: Interest paid by building societies

2653. This section provides an exception from the duty to deduct under this Chapter when interest is paid by a building society. It is based on section 349(2) of ICTA.

2654. This section removes a drafting defect in section 349(2) of ICTA. It reflects the fact that all duties to deduct sums representing income tax from payments made by building societies are dealt with in Chapters 2 and 4 of this Part (based on sections 349(3A) and

(3B) of ICTA and regulations made under section 477A(1) of ICTA). See *Change 134* in Annex 1.

Section 876: Interest paid by deposit-takers

2655. This section provides an exception from the duty to deduct under this Chapter when interest is paid by a deposit-taker and there is a duty to deduct tax under Chapter 2 of this Part, or there would have been such a duty to deduct but for regulations made under section 852 (no liability to income tax), or the exceptions contained in sections 858 to 861 (non-UK resident declarations). It is based on section 349(3) of ICTA.

Section 877: UK public revenue dividends

2656. This section provides an exception from the duty to deduct under this Chapter for payments of UK public revenue dividends (although there may be a duty to deduct under Chapter 5 of this Part). It is new.

Section 878: Interest paid by banks

2657. This section provides an exception from the duty to deduct under this Chapter for interest paid by a bank in the ordinary course of its business. It is based on section 349(3) and (3AA) of ICTA.

2658. But this does not override any duty to deduct under Chapter 2 of this Part.

2659. Broadly, all interest is paid in the ordinary course of its business (see *subsection (1)*) unless:

- the borrowing relates to the capital structure of the bank; or
- the characteristics of the transaction giving rise to the interest are primarily attributable to an intention to avoid United Kingdom tax.

See in particular Statement of Practice 4/96.

Section 879: Interest paid on advances from banks

2660. This section provides an exception from the duty to deduct under this Chapter for interest payable to a bank in respect of an advance from that bank, if the person entitled to the interest (whether or not the bank itself) is within the charge to corporation tax. It is based on section 349(3), (3AA) and (3AB) of ICTA and articles 3 and 4 of the European Investment Bank (Designated International Organisation) Order 1996 (SI 1996/1179).

2661. If the advance is from the European Investment Bank there is no duty to deduct whether or not the payer is within the charge to UK corporation tax. This provision enacts article 4 of the Order. See *Change 135* in Annex 1. See also section 991 (which enacts article 3 of the Order).

2662. More generally, the section provides that the powers under section 991(2)(e) may, in designating an international organisation as a bank, modify this section. In particular, such an organisation may not be within the charge to UK corporation tax, but a designation may still result in there being no duty to deduct from interest on advances from that organisation.

Section 880: Interest paid on advances from building societies

2663. This section provides an exception from the duty to deduct under this Chapter for interest paid on an advance from a building society. It is based on section 477A(7) of ICTA.

Section 881: National Savings Bank interest

2664. This section provides an exception from the duty to deduct under this Chapter for interest on deposits with the National Savings Bank. It is based on section 349(3) of ICTA.

Section 882: Quoted Eurobond interest

2665. This section provides an exception from the duty to deduct under this Chapter for interest on quoted Eurobonds. It is based on section 349(3) of ICTA.

Section 883: Interest on loan to buy life annuity

2666. This section provides an exception from the duty to deduct under this Chapter for interest subject to the regime in section 369 of ICTA. It is based on section 349(3) of ICTA.

Section 884: Relevant foreign income

2667. This section provides an exception from the duty to deduct under this Chapter for interest which is chargeable to income tax as relevant foreign income. It is based on section 349(3) of ICTA.

Section 885: Authorised persons dealing in financial instruments

2668. This section provides an exception from the duty to deduct under this Chapter for a person authorised under FISMA whose business wholly or mainly involves dealing in financial instruments as principal. It is based on section 349(3) of ICTA.

Section 886: Interest paid by recognised clearing houses etc

2669. This section provides an exception from the duty to deduct under this Chapter for certain payments of interest made by recognised clearing houses (RCH) and recognised investment exchanges (RIE), as defined in FISMA. It is based on section 349(3) and (6) of ICTA.

2670. In relation to such payments of interest, two conditions have to be met.

2671. The first condition (*subsection (1)(a)*) requires that the RCH or RIE carry on the business of providing a service whereby there are contracts between each of the parties to a transaction and the RCH or RIE, instead of contracts directly between the parties. Such a service is called a “central counterparty clearing service” (as defined in *subsection (3)*).

2672. The second condition (*subsection (1)(b)*) requires that the payment is made in the ordinary course of that business to users of the service in respect of margin or other collateral deposited with the payer.

2673. *Subsection (2)* concerns cases where an RCH or RIE may be a party to contracts involving the sale and repurchase of securities, with or without a put option. In such cases the margins between the sale price and the repurchase price are treated for tax purposes as payments of interest, which may (or may not) be yearly interest.

Section 887: Industrial and provident society payments

2674. This section provides an exception from the duty to deduct under this Chapter where an interest payment is made by registered industrial and provident society to a person whose usual place of abode is in the United Kingdom, and a related requirement to make returns of such payments. It is based on section 486(2), (3), (6) and (12) of ICTA.

2675. For discussion of “usual place of abode”, see the commentary on section 874.

Section 888: Statutory interest

2676. This section provides an exception from the duty to deduct under this Chapter where statutory interest is paid under the Late Payment of Commercial Debts (Interest) Act 1998. It is new.

2677. Tax Bulletin 42 (August 1999) indicated that where statutory interest is paid, it would not be regarded as yearly and would not therefore be subject to deduction of tax under section 349(2) of ICTA. See *Change 136* in Annex 1.

Chapter 4: Deduction from payments in respect of building society securities

Overview

2678. This Chapter requires building societies to deduct sums representing income tax from payments of dividends and interest on certain securities which are listed or capable of being listed on a recognised stock exchange.

2679. Other payments of dividends and interest made by building societies are dealt with in Chapter 2 of this Part.

Section 889: Payments in respect of building society securities

2680. This section sets out the duty to deduct sums representing income tax from payments made in respect of certain building society shares or securities which are listed or capable of being listed on a recognised stock exchange. It is based on sections 4(1A) and (2) and 349(3A), (3B) and (4) of ICTA.

2681. *Subsection (3)* provides that qualifying certificates of deposit, qualifying uncertificated eligible debt security units and quoted Eurobonds are not subject to the duty to deduct under this Chapter.

2682. The references to qualifying deposit right in section 349(3A) and (4) of ICTA have not been rewritten as they are obsolete. See *Change 133* in Annex 1.

2683. *Subsection (4)* provides the duty to deduct a sum representing income tax, and makes it explicit that the rate at which tax is to be deducted is the savings rate, that being the rate applicable to income within Chapter 2 of Part 4 of ITTOIA.

2684. *Subsection (7)* defines “dividend” as including any distribution and defines “security” as including a share, including in particular a “permanent interest bearing share” as defined in section 117 of TCGA.

Chapter 5: Deduction from payments of UK public revenue dividends

Overview

2685. This Chapter requires the deduction of sums representing income tax from payments of UK public revenue dividends. It is based on sections 4, 50 to 51AA, 349(3C) and (4), 350 and 350A of ICTA.

Section 890: Overview of Chapter

2686. This section provides an overview of the Chapter. It is new.

Section 891: Meaning of “UK public revenue dividend”

2687. This section defines “UK public revenue dividend” as being any income from securities which is paid out of the public revenue of the United Kingdom or Northern Ireland, but excludes interest on local authority stock. It is based on section 349(4) of ICTA.

2688. The reference to "Northern Ireland" in the definition of "UK public revenue dividend" reflects the fact that amounts paid out of the public revenue of the United Kingdom to the Northern Ireland Exchequer Consolidated Fund (from which securities may be issued under section 11(1)(c) of the Exchequer and Financial Provisions Act (Northern Ireland) 1950) are not "public revenue of the United Kingdom".

Section 892: Duty to deduct from certain UK public revenue dividends

2689. This section sets out the general duty to deduct a sum representing income tax from payments of UK public revenue dividends. It is based on sections 4, 50 and 349(3C) of ICTA.

2690. *Subsection (2)* makes it explicit that the rate at which deduction must be made is the savings rate, that being the rate applicable to income within Chapter 2 of Part 4 of ITTOIA.

Section 893: Payments of UK public revenue dividends which are payable gross

2691. This section sets out an exception to the general duty to deduct in section 892. It is based on sections 50 and 51(1) of ICTA.

2692. *Subsection (1)* provides that there is no duty to deduct if a payment of interest is made in respect of "gross-paying government securities" and no application has been made for the interest to be paid net of tax.

2693. *Subsection (2)* defines "gross-paying government securities" as being "gilt-edged securities" or securities which are the subject of a Treasury direction.

Section 894: Treasury directions

2694. This section is based on sections 50, 51 and 51AA of ICTA.

2695. *Subsections (1)* and *(2)* allow the Treasury to direct that securities issued under the National Loans Acts 1939 and 1968 are "gross-paying government securities".

2696. *Subsection (3)* deals with the issue of Northern Ireland securities and allows the Treasury, at the request of the Department of Finance and Personnel, to direct that securities issued under section 11(1)(c) of the Exchequer and Financial Provisions Act (Northern Ireland) 1950 are "gross-paying government securities".

2697. Section 51(2) of ICTA sets out the provisions of section 11(1)(c) of the 1950 Act by including the words, "for money borrowed by the Department of Finance and Personnel for the purposes of making issues from the Consolidated Fund of Northern Ireland". These words have not been included as they do not alter the scope of the reference to section 11(1)(c) of the 1950 Act and are, therefore, unnecessary.

Section 895: Deduction at source application

2698. This section allows the holder of registered gross-paying government securities to make an application for the securities to be subject to deduction of a sum representing income tax under section 892. It is based on section 50 of ICTA.

2699. The application must be made to the Registrar in such form as is prescribed by the Registrar with the approval of the Treasury. It is effective one month after the application has been made and ceases to be effective when the person who made it is no longer the registered owner or when the election ceases to have effect following its withdrawal under section 896.

2700. *Subsections (4)* and *(5)* confirm that where the registered holders are trustees they can make an application for sums representing income tax to be deducted under section 892 without the consent of any other person and despite anything in the trust instrument.

2701. *Subsection (6)* defines “registered” and “the Registrar” for the purposes of the Chapter (but see also section 894(4)).

2702. The definition of “registered” has been extended to include gilts which are “recorded” in the books of the Registrar. This change provides legislative support for deduction at source applications under this section in respect of gilts held in CREST. See *Change 137* in Annex 1.

Section 896: Withdrawal of application

2703. This section is about the withdrawal of an application for net payment under section 895. It is based on section 50(5) of ICTA.

2704. The section sets out that a withdrawal of an application may be made by the registered holder of the securities only by notice to the Registrar in such form as is prescribed by the Registrar with the approval of the Treasury. Such a withdrawal will have effect one month after the date the Registrar receives the notice.

Section 897: Power to make regulations

2705. This section enables the Commissioners for Her Majesty’s Revenue and Customs to make regulations in relation to the Chapter. It is based on section 350A of ICTA.

2706. *Subsection (2)* allows regulations to be made which differentiate between different kinds of UK public revenue dividends and to make different provision for different circumstances. Subsection (2)(b) has been aligned to the wording of similar provisions. In particular it now includes a reference to incidental and consequential amendments.

2707. Section 350A(2)(b) of ICTA, which allowed regulations to be made in respect of the Bank of Ireland, has not been rewritten as it obsolete following the Bank of Ireland’s decision to discontinue its stock registration business.

2708. As a result of that decision, the United Kingdom gilts registers managed by the Bank of Ireland were closed with effect from 25 October 2002 (SI 2002/2521). The holdings were transferred to the main United Kingdom gilts register managed by the Bank of England with effect from 28 October 2002. So the specific provisions in section 350A(2)(b) are no longer necessary. If the Commissioners for Her Majesty’s Revenue and Customs were to wish to make similar provision in respect of a particular institution in future (including the Bank of Ireland) they could do so under the general power provided by section 897(2)(a).

Chapter 6: Deduction from annual payments and patent royalties

Overview

2709. This Chapter requires the deduction of sums representing income tax from certain annual payments and patent royalties. It is based on sections 4, 125, 347A, 348 and 349(1) of ICTA and section 727 of ITTOIA.

2710. These rules are coupled with those providing for relief for certain of the payments concerned in computing net income: see Chapter 4 of Part 8 and the related commentary. Together, the rewritten rules replace the scheme of the source legislation relating to charges on income (which owes its origins to the historic concept of alienation of income). See *Change 81* in Annex 1.

2711. Sections 348 and 349(1) of ICTA are at the heart of the material about deduction of tax in the source legislation and have a very long history. The basic structure is that a payment falls within section 348 if it is payable wholly out of income brought into charge on the payer, but falls within section 349(1) if it is not payable wholly out of such income. (Payments which are deductible in computing income from a given source are not made out of income charged to tax and therefore fall into section 349(1).)

2712. The main differences between those sections in relation to deduction of tax are that

- deduction is optional under section 348 of ICTA but mandatory under section 349(1) of ICTA; and
- under section 348 the tax is in effect collected as part of the tax charged on the payer's income, but under section 349(1) the tax is directly assessed (section 350 of ICTA).

2713. As a result of *Change 81* deduction is made mandatory in all cases and the machinery for collecting the sums deducted has been changed, with direct assessment applying in fewer cases.

Section 898: Overview of Chapter

2714. This section provides an overview of the Chapter. It is new.

Section 899: Meaning of "qualifying annual payment"

2715. This section defines "qualifying annual payment". It is based on sections 7(1), 125(1), 348(1A), 349(1A) and 687(1) of ICTA.

2716. Under the source legislation, for an annual payment to be within the scope of sections 348 and 349 of ICTA it had to be charged to tax:

- under Schedule D Case III;
- under Chapters 7 or 10 of Part 4, section 579, or Chapters 4 or 7 of Part 5 of ITTOIA (and not be relevant foreign income); or
- under sections 609 and 611 of ITEPA.

2717. This takes account of the amendments made by paragraph 62 of Schedule 10 to FA 2005 (pension schemes etc) with effect from 6 April 2007.

2718. *Subsection (2)* specifies that the payment must arise in the United Kingdom. This follows from the fact that historically Case III was limited to United Kingdom sources and it is necessary to introduce this specific condition because United Kingdom sources and foreign sources are dealt with together in ITTOIA.

2719. *Subsection (3)* addresses the case where the recipient is a person other than a company and identifies all the provisions in ITEPA and ITTOIA under which annual payments formerly within Case III may be chargeable.

2720. *Subsection (4)* addresses the case where the recipient is a company. If the company is liable to income tax then the income must be within the provisions set out in subsection (3). But if the company is liable to corporation tax Case III still applies.

2721. *Subsection (5)* excludes a number of types of payment from the provisions in this Chapter.

2722. Payments treated as made to unit holders from unauthorised unit trusts are not specifically excluded here. That is because they are dealt with in Chapter 13 of this Part and, following the approach adopted in Chapter 10 of Part 4 of ITTOIA, such amounts are no longer treated as annual payments. So it is irrelevant to consider whether they are "qualifying".

2723. If an annual payment is made by a building society, it is subject to the rule that payment includes crediting: see the Income Tax (Building Societies) (Annual Payments) Regulations 1991 (SI 1991/512).

Section 900: Deduction from commercial payments made by individuals

2724. This section requires that individuals deduct sums representing income tax from qualifying annual payments made for commercial reasons. It is based on sections 4, 347A(2), 348(1) and 349(1) of ICTA and sections 727 and 728 of ITTOIA.

2725. These are the only qualifying annual payments made by individuals not taken out of taxation by section 347A(2) of ICTA and section 727 of ITTOIA.

2726. The section makes deduction mandatory and provides for the tax to be collected as part of the individual's self-assessment (see Chapter 17), so there will be no direct assessments in such cases in future. See *Change 81* in Annex 1.

2727. It is made explicit that the rate at which deduction must be made is the basic rate.

2728. It is also provided that the basic rate concerned is to be the basic rate for the year of payment. See *Change 138* in Annex 1, which also affects sections 901, 902 and 903.

2729. The source legislation differentiates between cases where the individual is "liable to make the payment", and cases where payments are made on behalf of someone else (through the formula "the person by or through whom the payment is made"). Since the tax in respect of all payments by individuals will in future be accounted for through the individual's own self-assessment, this section simply says "the individual must, on making the payment, …".

2730. ESC A16 gives relief to a payer who fails to make a payment from which tax was deductible in the year in which it was due to be paid (and in which the payer had income to at least partly cover the payment), but who makes the payment in a later year. This gave rise to an assessment under section 350 of ICTA. The concession will be amended to reflect the new legislative structure relating to annual payments.

Section 901: Deduction from annual payments made by other persons

2731. This section requires persons other than individuals to deduct sums representing income tax from annual payments. It is based on sections 4, 347A(3), 348(1) and 349(1) of ICTA and sections 727 to 728 of ITTOIA.

2732. For persons other than individuals the range of payments within sections 348(1) and 349(1) of ICTA is wider than it is for individuals because the provision that certain payments are not to be charges on income (section 347A(1) of ICTA and section 727 of ITTOIA) applies only to payments by individuals. Accordingly, while section 900 applies only to commercial payments, this section applies to any annual payment that is a qualifying annual payment within section 899.

2733. This section does not apply to a payment made by an individual's personal representatives unless it would have constituted a commercial payment within section 900 if paid by the individual before the individual's death.

2734. *Subsections (3)* to *(5)* set out the conditions that determine which method is used to collect the tax. Deduction at the applicable rate (see the commentary on section 902) is mandatory in all cases, but the method of recovery depends on whether the payer does, or does not, have any modified net income in the year in which payment is made.

2735. If the payer has some modified net income, then the tax is collected as part of the payer's self-assessment by virtue of Chapter 17. If the payer has no modified net income, then the tax is collected under Chapter 15 if the payer is a UK resident company, and otherwise under Chapter 16. See *Changes 81* and*138* in Annex 1 and the commentary on section 900.

2736. Where the payer is not an individual and will not be accounting for the tax under Self Assessment, the term "the person by or through whom the payment is made" has been retained.

Section 902: Meaning of "applicable rate" in section 901

2737. This section defines "applicable rate" in section 901. It is based on section 4 of ICTA.

2738. Payments within section 900 are all subject to deduction at the basic rate. Deductions from annual payments made by persons other than individuals are also normally at the basic rate. The only exceptions, where the savings rate applies instead, are certain payments under purchased life annuities, namely those charged to tax under Chapter 7 of Part 4 of ITTOIA.

2739. *Subsection (4)(b)*, which is based on section 4(1A) of ICTA, caters, for example, for the case where the recipient is a company within the charge to corporation tax.

2740. This section is subject to provisions requiring or permitting deduction at special rates - see Chapter 8 of this Part. It is also subject to regulation 3 of the Double Taxation Relief (Taxes on Income) (General) Regulations 1970 (SI 1970/488) which provides for a different rate of tax to be deducted from a gross payment if a notice under regulation 2(2) has been given.

2741. In all cases, the rate is determined by the year in which the payment is made. See *Change 138* in Annex 1 and the commentary on section 900.

Section 903: Deduction from patent royalties

2742. This section requires the deduction of sums representing income tax from patent royalties. It is based on sections 4, 7, 125, 348(2) and 349(1) of ICTA.

2743. In addition to annual payments, deduction applies to any royalty or other sum in respect of the use of a patent under sections 348(2) and 349(1)(b) of ICTA.

2744. If a payment in respect of a patent is also a qualifying annual payment then this section does not apply (*subsection (2)(a)*). This clarifies that deduction does not apply to a patent royalty which is an annual payment and is paid by an individual otherwise than in connection with the individual's trade. See *Change 139* in Annex 1.

2745. In the case of annual payments, the source legislation states explicitly that to be caught by the deduction rules a payment has to be assessable under Schedule D Case III. That rule carries with it the requirement that the payment should arise in the United Kingdom. There is no such explicit statutory rule covering patent payments that are not annual payments. Normally those payments are not assessable under Case III. But in practice it has always been the case that, for such a payment to be subject to the deduction rules, it must arise in the United Kingdom. *Subsection (3)* makes this explicit.

2746. *Subsection (4)* makes explicit that deduction is to apply only where the payment is charged to income or corporation tax. See *Change 140* in Annex 1.

2747. This section applies to payments by any person, but otherwise largely follows the format of section 901. If the payer is an individual or has some modified net income, then the tax is collected as part of the payer's self-assessment under Chapter 17. If the payer is not an individual and has no modified net income, then the tax is collected under Chapter 15 if the payer is a UK resident company, and under Chapter 16 otherwise. See *Changes 81* and *138* in Annex 1 and the commentary on section 900.

Section 904: Annual payments for dividends or non-taxable consideration

2748. This section provides a definition of "annual payment for dividends or non-taxable consideration". It is based on section 125 of ICTA.

2749. With certain exceptions, *subsection (3)* has the effect of excluding from the duties to deduct under this Chapter any annual payment that is made for consideration that is either:

- for a dividend or the right to receive a dividend; or
- not taxable.

2750. The exceptions to that general rule are given in *subsections (4)* to *(7)*.

2751. The source legislation specifies that the payment must not be interest (section 125(2)(a) of ICTA). Annual payments within *subsection (2)* do not include interest, so this does not need to be stated explicitly. In addition, no specific reference is made to annuities (also mentioned in the source legislation) as these are simply one type of annual payment.

Section 905: Interpretation of Chapter

2752. This section clarifies that the references to an individual in this Chapter include a Scottish partnership if at least one partner is an individual. It is based on section 347A(6) of ICTA.

Chapter 7: Deduction from other payments connected with intellectual property

Overview

2753. This Chapter requires the deduction of sums representing income tax from certain payments connected with intellectual property. It is based on sections 4, 349(1), 349ZA, 524(3), 532, 533 and 536 to 537B of ICTA.

2754. The payments concerned are:

- royalties or periodical payments in respect of copyright and design rights, and payments in respect of public lending rights ("relevant intellectual property rights") where the usual place of the owner or seller is outside the United Kingdom; and
- proceeds of sale by a non-UK resident of patent rights, if the proceeds of sale are, or include, a capital sum.

Section 906: Certain royalties etc where usual place of abode of owner is abroad

2755. This section requires the deduction of sums representing income tax from certain payments in respect of a "relevant intellectual property right" (see section 907). It is based on sections 4(1) and (2), 536(1) and (2), 537 and 537B(1) and (2) of ICTA.

2756. *Subsection (1)(b)* makes explicit that deduction is to apply only where the payment is charged to income or corporation tax. See *Change 140* in Annex 1.

2757. The payments concerned are those where the owner of the intellectual property right, or a past owner who has assigned the right but receives payments in respect of it, has a usual place of abode outside the United Kingdom.

2758. For discussion of "usual place of abode", see the commentary on section 874.

2759. But the duty to deduct does not apply in cases where the payment is for copies of works or articles that have been exported from the United Kingdom for distribution elsewhere.

2760. *Subsection (5)* makes it explicit that the rate at which deduction must be made is the basic rate and imposes the duty to deduct on the person by or through whom the payment is made. But see the commentary on section 908 for special rules affecting some paying agents.

Section 907: Meaning of "relevant intellectual property right"

2761. This section defines "relevant intellectual property right" for the purposes of section 906. It is based on sections 536(1) and (2), 537 and 537B(1) and (2) of ICTA.

2762. *Subsection (2)* qualifies the basic categories by excluding copyrights in films and expanding the definition of "right in a design" to reflect the fact that although *registered* designs were protected in UK law from 1949, by the Registered Designs Act 1949, "design rights" in *unregistered* designs were not protected until Part III of the Copyright, Designs and Patents Act 1988 came into force in 1989.

Section 908: Royalty payments etc made through UK resident agents

2763. This section addresses issues that arise when a payment is made, not by the owner of the right, but by an agent who in turn is entitled to deduct a commission from the payment. It is based on sections 536(3) and (4) and 537B(3) and (4) of ICTA.

2764. The normal rule is that the payment is to be reduced by the amount of commission before calculating the amount that is to be deducted.

2765. But if the agent does not know the amount of commission, or does not know that it is payable, the sum representing income tax must be calculated on the gross amount of the payment, and that amount must be accounted for.

Section 909: Royalty payments: further provision

2766. This section supplements the provisions in section 906. It is based on sections 536(1), (5) and (6) and 537B(1), (5) and (6) of ICTA.

Section 910: Proceeds of a sale of patent rights: payments to non-UK residents

2767. This section requires the deduction of sums representing income tax from the proceeds of sale of patent rights where the seller is non-UK resident and the proceeds are, or include, a "capital sum". It is based on sections 4, 349(1), 349ZA, 524(3), 532 and 533 of ICTA.

2768. Section 524(3) of ICTA will continue to apply for corporation tax.

2769. *Subsections (2)* and *(3)* give details of the duty to deduct, and make it explicit that the rate at which deduction must be made is the basic rate. Expenses of the sale, if deducted before payment is made, reduce the amount of the proceeds, as does any element of those proceeds not consisting of a capital sum. The income tax must then be calculated on the amount of the proceeds, as so reduced.

2770. *Subsection (4)* extends the provisions of this section to licences connected with patents, and rights to acquire future patent rights. This subsection is based on the interpretative provisions of section 533 of ICTA.

2771. *Subsection (5)* defines "capital sum" by reference to section 4 of CAA. It does not include any sum that is taken into account in computing trading profits or that constitutes earnings from an employment or office.

2772. Under section 588 of ITTOIA a seller of patent rights who originally paid a capital sum on acquisition of those rights (the capital sum on acquisition) can deduct it from the capital sum on which income tax is charged on the sale. But under section 595 of ITTOIA, when computing the amount of income tax to be deducted from the capital sum on sale, the capital sum on acquisition cannot be deducted from it (*subsection (6)(a)*).

2773. Nor is the amount of income tax to be deducted affected by the provisions about spreading of the capital sum, and payment of it by instalments, under section 524(9) of ICTA (*subsection (6)(b)*).

Chapter 8: Chapters 6 and 7: Special provision in relation to royalties

Overview

2774. This Chapter deals with two international aspects relating to the deduction of sums representing income tax from royalties paid by companies. It is based on section 349E of ICTA and section 101 of FA 2004.

2775. The first aspect concerns double tax arrangements (as defined in section 1023), whose provisions may lay down a rate other than the basic rate as the one to be applied to such payments. The Chapter provides that the paying company may deduct a sum representing income tax at the treaty rate (which in some cases is 0%) if it reasonably believes that the payee (as defined in section 913(2)) is entitled to double taxation relief on the payment.

2776. The second aspect concerns the provisions implementing the European Union Savings and Royalties Directive (Council Directive 2003/49/EC) in sections 757 to 767 of ITTOIA. These provide that a UK resident company, or a UK permanent establishment of a European Union company, may pay without deduction if it reasonably believes that the income arising from the payment will be exempt under section 758 of ITTOIA.

Section 911: Double taxation arrangements: deduction at treaty rate

2777. This section sets out the conditions under which a company may deduct sums representing income tax on the royalty payment at the treaty rate. It is based on section 349E(1), (2) and (5) of ICTA.

2778. *Subsection (3)* states that if, despite the reasonableness of the company's belief, the payee is not in fact entitled to double tax relief, the right to deduct at the treaty rate is treated as never having existed.

Section 912: Power to make directions disapplying section 911

2779. This section gives power to an officer of Revenue and Customs, if not satisfied that the payee will in fact be entitled to double taxation relief on a royalty payment, to direct that section 911 is not to apply. It is based on section 349E(3) and (4) of ICTA.

2780. If an officer so directs, the paying company will then have to deduct a sum representing income tax at the basic rate as required under Chapter 6 or 7.

2781. The reference in the source legislation to "the Board" is replaced with a reference to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 913: Interpretation of sections 911 and 912

2782. This section gives interpretations of "royalty" and "payee" in relation to sections 911 and 912. It is based on section 349E(1) and (5) of ICTA.

2783. *Subsection (1)* defines "royalty" widely, including in particular any proceeds of a sale of patent rights.

Section 914: EU companies: discretion to make payment gross

2784. This section provides that, if the paying company reasonably believes that section 758 of ITTOIA (exemption for certain interest and royalty payments) applies to the payment, it may pay without deducting a sum representing income tax. It is based on section 101(1) and (2) of FA 2004.

2785. Section 758 of ITTOIA gives exemption in respect of royalty payments by UK resident companies, or by a UK permanent establishment of a European Union company, to a European Union company (see sections 757 to 767 of ITTOIA).

2786. *Subsection (3)* states that if, despite the reasonableness of the company's belief, the payment is not in fact exempt under section 758 of ITTOIA, the right to pay without deduction is treated as never having existed.

Section 915: Power to make directions disapplying section 914

2787. This section gives power to an officer of Revenue and Customs, if not satisfied that payments will in fact be exempt under section 758 of ITTOIA, to direct that section 914 is not to apply. It is based on section 101(3) and (4) of FA 2004.

2788. If an officer so directs, the paying company will then have to deduct a sum representing income tax if this is required under sections 903(7) or 906.

2789. The reference in the source legislation to "the Board" is replaced with a reference to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 916: Duty of payee to notify if payment not exempt

2790. This section imposes a duty on the payee to notify an officer of Revenue and Customs and the paying company if it becomes aware that a condition for exemption under section 758 of ITTOIA is no longer met. It is based on section 101(5) of FA 2004.

2791. The reference in the source legislation to "the Board" is replaced with a reference to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 917: Supplementary

2792. This section supplements the provisions in sections 914 to 916. It is based on section 101(8) and (9) of FA of 2004.

Chapter 9: Manufactured payments

Overview

2793. This Chapter deals with deduction of income tax at source from manufactured property income dividends, manufactured interest and manufactured overseas dividends (MODs). It is based on paragraphs 3 to 4 of Schedule 23A to ICTA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

Section 918: Manufactured dividends on UK shares: Real Estate Investment Trusts

2794. This section imposes an obligation to deduct income tax at source on payers of manufactured dividends (manufactured property income dividends or MPIDs) which are representative of dividends (property income dividends or PIDs) paid by Real Estate Investment Trust companies or by principal companies of Real Estate Investment Trust groups. It is based on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

2795. *Subsection (1)* sets the conditions for the section to apply. First, the person must pay a "manufactured dividend" as mentioned in section 573. Second, the manufactured dividend must be representative of a PID.

2796. A dividend may be partly but not wholly a PID. *Subsection (2)* provides that the section applies only so far as the manufactured dividend is representative of a PID.

2797. *Subsection (3)* ensures that, if the payer of the MPID is either UK resident or paying the MPID through a UK branch or agency, the rules on deducting income tax at source from PIDs apply, with any necessary modifications, to the MPID.

2798. *Subsections (4)* and *(5)* enable regulations to be made subjecting MPIDs, if they fall outside subsection (3) to a reverse charge. This provision is analogous to sections 920 and 923, which impose reverse charges on manufactured interest on UK securities and MODs and are discussed in detail below.

2799. *Subsections (6)* and *(7)* provide that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the payment had been an actual PID.

Section 919: Manufactured interest on UK securities: payments by UK residents etc

2800. This section imposes an obligation on payers of manufactured interest to deduct income tax at source. It is based on section 4(1A) of, and paragraph 3 of Schedule 23A to, ICTA.

2801. It is the first of a group of sections about manufactured interest on UK securities (sections 919 to 921).

2802. *Subsection (1)*sets out three conditions for the section to apply. First, the person must pay "manufactured interest" as defined in section 578. Second, the manufactured interest must be paid in the circumstances set out in section 578(1). Third, the payer must be either (a) UK resident or (b) paying the manufactured interest in the course of a trade carried on in the United Kingdom through a branch or agency.

2803. *Subsection (2)* is based on paragraph 3(2) of Schedule 23A to ICTA. Paragraph 3(2)(a), so far as relevant, provides that "the manufactured interest shall be treated … as if it (i) were an annual payment to the recipient, but (ii) were neither yearly interest nor an amount payable wholly out of profits or gains brought into charge for income tax." This deeming provision brings the manufactured interest within section 349(1)(a) of ICTA.

2804. Section 349(1)(a) of ICTA is rewritten in Chapter 6 of this Part (deduction from annual payments and patent royalties). But paragraph 3 of Schedule 23A to ICTA applies section 349(1)(a) to manufactured interest with important modifications: see paragraph 3(2)(b), (4) and (5). This Chapter therefore rewrites paragraph 3 of Schedule 23A separately from Chapter 6.

2805. This is done without the use of deeming. Subsection (2) spells out that the payer of the manufactured interest must, on making the payment, deduct from the gross amount of the manufactured interest a sum representing income tax on it.

2806. The rate applicable under subsection (2) is the savings rate in force for the tax year in which the payment is made (and not, as in Chapter 6, the basic rate). This follows from section 4(1A) and (2)(b) of, and paragraph 3(2)(b)(ii) of Schedule 23A to, ICTA.

2807. *Subsection (3)* defines the "gross amount" of manufactured interest.

2808. *Subsection (4)* explains that this section is subject to certain other provisions:

- sections 583 and 585 in Part 11 (Manufactured payments and repos);
- section 921 (cases where interest on underlying securities paid gross) in this Chapter; and
- Chapter 11 of this Part (payments between companies etc: exception from duties to deduct) – see section 930(2)(g), which is based on section 349A(3) of ICTA.

2809. *Subsection (5)* is a signpost to the collection provisions. If the payer has to deduct tax from the manufactured interest under section 349(1)(a) of ICTA, and the payer is a company, the tax is collected under section 350(4) of, and Schedule 16 to, ICTA. Under paragraph 3(7) of Schedule 23A to ICTA, this applies whether or not the company is UK resident. These provisions are rewritten in Chapter 15 of this Part. Chapter 15 includes some minor changes to the law which are potentially relevant to payments within section 919:

- *Change 143* makes it clear that a return need be submitted only where a relevant payment was made in that particular return period. It also clarifies related points.

- *Change 144* brings into line the information required to be included on a return where a payment is made otherwise than in an accounting period with the information which is required where the payment is made in an accounting period.
- *Change 147* removes the charging provision in section 350(1) of ICTA, to bring this legislation into line with the approach taken in other legislation about collection of income tax deducted at source. So a person will not be chargeable in cases falling within Chapters 3 to 7, 10, 12, 13 and 18 of this Part.

2810. If the payer is not a company, the tax is collected under section 350(1) of ICTA, which is rewritten in Chapter 16 of this Part. Chapter 16 also includes *Change 147*.

Section 920: Foreign payers of manufactured interest: the reverse charge

2811. This section imposes an obligation on certain recipients to account for and pay income tax on manufactured interest received. It is based on paragraphs 3 and 3A of Schedule 23A to ICTA.

2812. By analogy with section 8 of the Value Added Tax Act 1994, specialists refer to this obligation as the reverse charge. This expression does not appear in the legislation itself but is commonly used. So it has been included in the sidenote to this section.

2813. Although this section is not about deduction of income tax at source, it is included in this Chapter because it applies in circumstances in which there would be a requirement to deduct income tax at source if the payer was UK resident.

2814. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay "manufactured interest" as defined in section 578. Second, the manufactured interest must be paid in the circumstances set out in section 578(1). These conditions are identical to those in section 919(1). The third condition contrasts with the third condition in section 919(1): the payer must be non-UK resident and not paying the manufactured interest in the course of a trade carried on in the United Kingdom through a branch or agency.

2815. If these conditions are satisfied, *subsection (2)* sets out the circumstances in which the recipient must account for and pay income tax in respect of the manufactured interest.

2816. *Subsection (3)* provides that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the case had been within section 919.

2817. *Subsection (4)* provides that, if the payer would not have been required to deduct any sum under section 919, the recipient is not required to account for and pay any income tax under subsection (3). For the convenience of users, *subsection (5)* highlights important cases in which subsection (4) applies.

2818. The collection rule for all recipients, whether or not they are companies and whether or not they are UK resident, is given by secondary legislation: regulation 3(1) and (2) of SI 1997/992, made under paragraph 8 of Schedule 23A to ICTA. The relevant provisions of paragraph 8 are rewritten in section 586, which refers to this Chapter.

Section 921: Cases where interest on underlying securities paid gross

2819. This section is an exception to the withholding provisions of sections 919 and 920. It is based on paragraphs 1 and 3A of Schedule 23A to ICTA. Broadly speaking, if the interest itself mentioned in *subsection (1)* is payable gross, the manufactured interest representative of it is also payable gross.

Section 922: Manufactured overseas dividends: payments by UK residents etc

2820. This section imposes an obligation on the payer of a MOD to deduct income tax from the gross amount of the MOD. It is based on paragraphs 4(1) and 4(2) of Schedule 23A to ICTA. It is the first of a group of sections concerned with MODs (sections 922 to 925).

2821. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay a MOD as defined in section 581. Second, the MOD must be paid in the circumstances set out in section 581(1). Third, the payer must be either (a) UK resident or (b) paying the MOD in the course of a trade carried on through a branch or agency in the United Kingdom.

2822. Paragraph 4(2) of Schedule 23A to ICTA deems the MOD to be an annual payment within section 349 of ICTA. This section avoids the use of deeming. *Subsection (2)* spells out that the payer of the MOD must, on making the payment, deduct from the gross amount of the manufactured overseas dividend a sum equal to the relevant withholding tax on the gross amount.

2823. *Subsection (3)* explains that this section is subject to certain other provisions. Unlike section 919, this section is not subject to Chapter 11 of this Part (payments between companies etc: exception from duties to deduct), because section 349A(4)(b) of ICTA excludes MODs from the provisions of sections 349A to 349D of that Act.

2824. *Subsection (4)* is a signpost to the powers in sections 586 and 925 to make regulations about collection of tax. The collection rules about MODs, and the rules about tax vouchers for MODs, are given by secondary legislation: regulations 11 and 15 respectively of SI 1993/2004, made under paragraph 8 of Schedule 23A to ICTA. The relevant provisions of paragraph 8 are rewritten in section 586.

Section 923: Foreign payers of manufactured overseas dividends: the reverse charge

2825. This section imposes an obligation on certain recipients to account for and pay income tax on MODs received. It is based on paragraphs 4 and 3A of Schedule 23A to ICTA. By analogy with section 8 of the Value Added Tax Act 1994, specialists refer to this as the reverse charge. This expression does not appear in the legislation itself but is commonly used. So it has been included in the sidenote to this section.

2826. Although this section is not about deduction of income tax at source, it is included in this Chapter because it applies in circumstances in which there would be a requirement to deduct income tax at source if the payer was UK resident.

2827. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay a MOD as mentioned in section 581. Second, the MOD must be paid in the circumstances set out in section 581(1). These conditions are identical to those in section 922(1). The third condition contrasts with the third condition in section 922(1): the payer must be non-UK resident and not paying the MOD in the course of a trade carried on in the United Kingdom through a branch or agency.

2828. If these conditions are satisfied, *subsection (2)* sets out the circumstances in which the recipient must account for and pay income tax in respect of the MOD.

2829. *Subsection (3)* provides that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the case had been within section 922.

Section 924: Power to reduce section 923 liability

2830. This section supplements section 923. It is based on paragraph 4(3B) of Schedule 23A to ICTA.

Section 925: Power to provide set-off entitlement

2831. This section is a power to make regulations dealing with the interaction between Chapter 9 and double taxation relief. It is based on paragraph 4(3), 4(7) and 4(7AA) of Schedule 23A to ICTA.

2832. This section also brings into line with practice the law on the periods by reference to which overseas dividend manufacturers may set amounts of overseas tax off against their UK tax liabilities. See *Change 141* in Annex 1.

2833. This section uses the labels "relevant amounts of tax suffered" and "relevant tax liabilities". These labels are defined in *subsections (3)* and *(4)* respectively.

2834. *Subsection (5)* makes it clear that the credit mentioned in *subsection (1)* which a person can claim includes credit against corporation tax. So paragraph 4(7) and (7AA) of Schedule 23A to ICTA are repealed.

Section 926: Interpretation of Chapter

2835. This section provides that expressions used both in this Chapter and in Chapter 2 of Part 11 (manufactured payments and repos: manufactured payments) have the same meaning in this Chapter as they do in the earlier Chapter, so avoiding the need to duplicate definitions. It is based on paragraphs 1(1), 2(1), 3(1) and (10), 4(1) and (2A) and 7(1) of Schedule 23A to ICTA and section 153(2) of FA 2003.

2836. *Subsection (2)* provides that references in this Chapter to a trade carried on through a branch or agency are to be read, in relation to a company, as references to a trade carried on through a permanent establishment. This may make a difference in some cases as it is possible for a non-UK resident company to be trading in the UK through a branch or agency but not through a permanent establishment.

Section 927: Regulation-making powers: general

2837. This section provides that regulations under this Chapter may make different provision for different cases. It is based on paragraph 8(4) of Schedule 23A to ICTA.

Chapter 10: Deduction from non-commercial payments by companies

Section 928: Chargeable payments connected with exempt distributions

2838. This section requires the deduction of sums representing income tax from chargeable payments connected with exempt distributions. It is based on sections 4, 214(1) and 349(1) of ICTA.

2839. Section 214(1) of ICTA makes provision concerning payments made by a company after an exempt distribution (such as a demerger that meets the conditions in section 213 of ICTA). The other provisions of sections 213 and 214 of ICTA are basically concerned with corporation tax.

2840. The section makes it explicit that the rate at which deduction must be made is the basic rate.

Chapter 11: Payments between companies etc: exception from duties to deduct

Overview

2841. This Chapter allows "excepted payments" made by companies, local authorities and "qualifying partnerships" to be made without deducting a sum representing income tax. It is based on sections 349A to 349D of ICTA.

2842. Power is given to officers of Revenue and Customs to reimpose a duty to deduct if they have reasonable grounds for believing that the conditions for payment to be made without deduction are not met. The Chapter also provides that, if a paying company reasonably believes that a payment is excepted but that proves not to be true, the duty to deduct is treated as always having existed.

Section 929: Overview of Chapter

2843. This section provides an overview of the Chapter. It is new.

Section 930: Exception from duties to deduct sums representing income tax

2844. This section disapplies various duties on companies, local authorities and qualifying partnerships to deduct sums representing income tax if they reasonably believe that the payments concerned are "excepted payments". It is based on section 349A of ICTA.

Section 931: Power to make directions disapplying section 930

2845. This section gives power to an officer of Revenue and Customs to direct that section 930 is not to apply if the officer has reasonable grounds for believing that the payment will be an excepted payment. It is based on section 349C of ICTA.

2846. The reference in the source legislation to "the Board" is replaced by a reference to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 932: Meaning of "qualifying partnership"

2847. This section defines "qualifying partnership" for the purposes of the Chapter. It is based on sections 349A(6), 349C(4) and 349D(2) of ICTA.

Section 933: UK resident companies

2848. This section is the first of a number of sections setting out those payments which are excepted payments and provides that a payment is an excepted payment if the beneficiary is a UK resident company. It is based on section 349B(1) of ICTA.

Section 934: Non-UK resident companies

2849. This section states the conditions under which a payment to a non-UK resident company is an excepted payment. It is based on section 349B(2) of ICTA.

Section 935: PEP and ISA managers

2850. This section provides that a payment to a plan manager of a personal equity plan or an individual savings account, or to the manager's nominee, is an excepted payment if it is received in respect of investments under the plan. It is based on section 349B(4) of ICTA.

Section 936: Recipients who are to be paid gross

2851. This section provides that payments to various specific types of recipient are excepted payments. It is based on section 349B(3) and (8) of ICTA.

2852. The Treasury may by order amend the list of such recipients.

Section 937: Partnerships

2853. This section sets out the conditions under which payments made to certain partnerships are excepted payments. It is based on section 349B(6), (7) and (8) of ICTA.

2854. The Treasury may by order vary the types of recipient covered by this section, other than those mentioned in section 936 (which is covered by the power provided in that section).

Section 938: Consequences of reasonable but incorrect belief

2855. This section provides that if, despite the reasonableness of the payer's belief, the payment is not an excepted payment at the time it is made, the right to pay without deduction is treated as never having existed. It is based on section 349D of ICTA.

Chapter 12: Funding bonds

Overview

2856. This Chapter adapts the requirement to deduct sums representing income tax from certain payments of interest to deal with cases where the debtor has issued securities ("funding bonds") instead of paying the interest. It is based on section 582 of ICTA.

2857. Sections 582(1) of ICTA and 380 of ITTOIA provide that the recipient of such bonds is treated as receiving an amount of interest equal to the market value of the bonds. This Chapter deals with the effect of that provision on the duty to deduct at source. This is usually to require the debtor to retain bonds to cover the amount of the deduction. But if that is impracticable, there is alternative provision.

Section 939: Duty to retain bonds where issue treated as payment of interest

2858. This section requires a debtor who issues funding bonds to retain bonds instead of deducting sums representing income tax. It is based on section 582(2), (2A) and (4) of ICTA.

2859. *Subsection (2)* makes it explicit that the rate by reference to which bonds are to be retained is the savings rate. The debtor is then treated as having complied with the duty to deduct at source (*subsection (3)*).

2860. The bonds themselves may be tendered in satisfaction of any income tax due from the debtor under Chapter 15 or 16 of Part 15 of this Act. Because the source legislation links into the deduction and collection requirements of sections 349 and 350 of ICTA, this provision is affected by the removal of the charge to income tax in section 350(1) of ICTA. See *Change 147* in Annex 1 and the commentary on section 963.

Section 940: Exception from duty to retain bonds

2861. This section makes provision for cases where it is impracticable for the debtor to retain bonds. It is based on section 582(2) of ICTA.

2862. The duty to deduct (which under section 939 becomes a duty to retain bonds) does not apply if the debtor notifies the Commissioners for Her Majesty's Revenue and Customs of the details required by *subsection (2)*.

Chapter 13: Unauthorised unit trusts

Overview

2863. This Chapter provides the rules about deduction of tax at source in relation to distributions treated as made from unauthorised unit trusts (UUTs) to their unit holders. It is based on sections 348, 349(1) and (1A) and 469 of ICTA.

2864. A unit trust is "unauthorised" if it does not have authorisation under FISMA to seek investment directly from members of the public. Nor is such a trust regulated under FISMA. "Unauthorised unit trust" is defined in section 989.

2865. The rules for UUTs differ from the rules relating to annual payments (with which they are related in the source legislation) in that the amount shown by the trust's accounts as income for a distribution period is treated as having been paid to unit holders on the date prescribed by Chapter 10 of Part 4 of ITTOIA, regardless of whether it has been so paid in whole or in part. Any actual payments to unit holders are ignored.

2866. Chapter 10 of Part 4 of ITTOIA does not deal with these amounts treated as paid to unit holders by charging them as a type of annual payment. Instead, that Act imposes a separate charge to income tax on the unit holder. In accordance with that approach, Chapter 9 of Part 9 of this Act gives relief to the trustees of the UUT for such amounts.

2867. This Chapter deals with the payments treated as having been made as regards the deduction at source rules. In particular, such amounts are treated as having been paid under deduction of a sum representing income tax at the basic rate for the applicable tax year; there is no actual duty to deduct as in other Chapters of this Part.

2868. This Chapter also requires the tax to be collected under Self Assessment. Since the trustees of the UUT will have obtained relief by deduction from their taxable income for the amount of any grossed-up amounts treated as paid to unit holders, this tax will normally be most of the tax that they have to pay.

2869. Additionally, if the deemed payments in a tax year cannot be fully relieved because their taxable income is insufficient, there is provision for the trustees to take account of any excess of modified net income (defined in section 1025) in earlier tax years over the payments they are treated as having made in those years.

Section 941: Deemed payments to unit holders and deemed deductions of income tax

2870. This section sets out the framework of the deduction at source regime for UUTs. It is based on sections 348(1A), 349(1A) and 469 of ICTA.

2871. If the unit holder is subject to income tax, the section:

- treats as a payment by the UUT trustees to the unit holder any grossed-up amount (for which see section 548 of ITTOIA) which is charged to tax on the unit holder under Chapter 10 of Part 4 of ITTOIA (*subsection (2)*); and
- treats the trustees as having deducted, at the basic rate for the tax year, a sum representing income tax (*subsection (3)*).

2872. If the unit holder is subject to corporation tax, the section treats the trustees as having deducted, at the basic rate for the year, a sum representing income tax from the deemed annual payment to the unit holder (see section 469(4A) to (4D) of ICTA, inserted by Schedule 1 to this Act) (*subsections (4)* and *(5)*).

Section 942: Income tax to be collected from trustees

2873. This section sets out the method of collection, and the amount of income tax to be collected. It is based on sections 348(1), 349(1), and 469(5A) and (5B) of ICTA.

2874. *Subsection (2)* requires the tax to be collected through the self-assessment tax return of the trustees of the UUT. The source legislation refers (section 469(5A)(a) of ICTA) to a charge under section 350 of ICTA. But in practice the tax is collected through the trustees' self-assessment return, and the law is now brought into line with that practice, in keeping with the approach in relation to charges on income generally. See *Change 81* in Annex 1.

2875. So, where the source legislation provides for the amount to be charged under section 350 of ICTA, this and the following sections are drafted in terms of an amount of income tax to be collected.

2876. The default rule is that the amount to be collected under Self Assessment is the amount treated as deducted under section 941, which refers to the formula given in section 548(2) of ITTOIA.

2877. *Subsections (4)* and *(5)* deal with the adjustment for the "income pool". This applies when, in a tax year, the gross amounts of the payments treated as made exceed the trustees' modified net income (so that, under the source legislation, not all the tax treated as deducted could be retained by way of relief under section 348 of ICTA).

2878. In that case, the income pool as at the start of the tax year (for the computation of which see section 943) is deducted from the total of the amounts treated for the tax year as having been paid to unit holders, but not so as to reduce it below the amount of the trustees' modified net income. The resulting amount is then multiplied by the basic rate of income tax for the year, and that constitutes the amount of income tax payable by the trustees.

Section 943: Calculation of trustees' income pool

2879. This section prescribes the method of calculating the "income pool", which is to be applied in any tax year in which the grossed-up amounts treated as paid to unit holders by the trustees exceed their modified net income. It is based on section 469(5C) of ICTA.

2880. An income pool consists of a running total of the amount by which, taking one tax year with another, the trustees' modified net income has exceeded the grossed-up amounts treated as paid by them. In each tax year when this has occurred, the amount of any such excess is to be calculated. And if in any tax year the amounts treated as paid exceed the modified net income, any such excess must be deducted from the income pool.

2881. So the income pool as at the start of any tax year ("the current tax year") is calculated according to whether in the previous tax year the trustees' modified net income exceeded the amounts treated as paid (*Case 1*), was less than them (*Case 2*) or equalled them (*Case 3*).

2882. The amount so calculated is available to set against any excess of payments treated as made over modified net income in the current tax year.

2883. *Subsections (2)* and *(3)* deal with cases where the UUT trustees have been non-UK resident. For any year of non-residence there may be modified net income, but there is no adjustment to the income pool.

2884. Subsection (3) also provides that the income pool is nil as at the start of the tax year in which a UUT is established.

Chapter 14: Tax avoidance: directions for duty to deduct to apply

Section 944: Directions for deduction from payments to non-UK residents

2885. This section enables HMRC to require certain payments to non-UK residents to be paid under deduction of basic rate income tax. It is based on section 777(9) of ICTA.

2886. In Pardoe v Entergy Power Development Corporation (2000), 72 TC 617 ChD[13], the High Court held that a direction under section 777(9) of ICTA could be given if, and only if, at the time of the direction, HMRC were satisfied that there was a present entitlement to a relevant payment; a direction could not be given where there was only a prospect (however imminent) of future entitlement.

2887. But, following Pardoe, it is still open to HMRC to give a direction under section 777(9) of ICTA in a case in which a non-UK resident is entitled to payment of consideration by instalments. It is therefore rewritten in this Part.

2888. Section 777(9) of ICTA deems the payment in question to be an annual payment within section 349(1) of ICTA. This section spells out the implications of this.

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13 [2000] STC 286.

2889. This section replaces the references to "the Board" with a reference to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2890. The HMRC Business Income Manual tells officers (BIM 60390):

"No attempt to invoke [section 777(9) of ICTA] in a working case should be made without prior specific reference to Business Tax (Technical), who will consider such cases on an individual basis and decide whether to seek a direction from the Board.

2891. *Change 5* will have no effect on this practice.

2892. The collection mechanisms of section 350(1) of, and Schedule 16 to, ICTA apply to tax deducted at source under section 349(1) of that Act from payments subject to section 777(9) directions. Schedule 16 and section 350(1) are rewritten in Chapters 15 and 16 respectively of this Part, and *subsection (5)* gives signposts to those Chapters.

2893. In rewriting Schedule 16, Chapter 15 makes some minor changes to the law. Three of them are potentially relevant to the collection of tax deducted at source under section 777(9) directions:

- *Change 143* makes it clear that a return need be submitted only where a relevant payment was made in that particular return period. It also clarifies related points.
- *Change 144* brings into line the information required to be included on a return where a payment is made otherwise than in an accounting period with the information which is required where the payment is made in an accounting period.
- *Change 147* removes the charging provision in section 350(1) of ICTA, to bring this legislation into line with the approach taken in other legislation about collection of income tax deducted at source. So a person will not be chargeable in cases falling within Chapters 3 to 7, 10, 12, 13 and 18 of this Part.

Chapter 15: Collection: deposit-takers, building societies and certain companies

Overview

2894. This Chapter provides for the collection of income tax deducted at source from the payments listed in section 946. It is based on sections 350, 477A and 480A of, and Schedules 16 and 23A to, ICTA, Schedule 11 to FA 1991 and regulation 10 of the Income Tax (Building Societies) (Dividend and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations).

2895. See Schedule 1 to this Act for commentary explaining why paragraph 8 and part of paragraph 10(2) of Schedule 16 to ICTA are otiose and have accordingly not been rewritten.

Section 945: Overview of Chapter

2896. This section provides an overview of the Chapter and also defines "section 946 payments". It is new.

Section 946: Payments within this section

2897. This section sets out which payments are subject to the collection mechanism described in this Chapter. It is based on sections 350, 477A(1) and 480A of, and Schedules 16 and 23A to, ICTA and regulation 10 of the building society regulations.

2898. As part of the alignment of the building society and deposit-taker regimes for deduction of tax at source, various regulations in the building society regulations are enacted. See *Change 126* in Annex 1 and the overview commentary on Chapter 2 of this Part.

2899. Under the provisions of this Act, tax deducted from certain annual payments and other patent royalty payments made by individuals will be collected through the individual's self-assessment return (see Chapter 17 of this Part), rather than by direct assessment (see Chapter 16 of this Part, based on section 350(1) of ICTA). See in particular the commentary on section 900. As a result, where such payments are made by companies on behalf of individuals they will not be subject to collection under the provisions of this Chapter. See *Change 81* in Annex 1 and the overview commentary on Chapter 4 of Part 8 of this Act.

2900. Because the source legislation links into the collection requirements of section 350 of ICTA, this provision is affected by the removal of the charge to income tax in section 350(1) of ICTA. See *Change 147* in Annex 1 and the commentary on section 963.

Section 947: Return periods

2901. This section sets out the return periods which fall into an accounting period by reference to "quarter dates". It is based on paragraph 2(2) of Schedule 16 to ICTA, paragraph 3(1) of Schedule 11 to FA 1991 and regulation 10(3) of the building society regulations. See *Change 126* in Annex 1 and the overview commentary on Chapter 2 of this Part.

2902. The quarter dates are the last days of March, June, September and December except where the payer is a building society, in which case they are the last days of February, May, August and November.

2903. Under the source legislation, all section 946 payments made by building societies are accounted for by reference to the February, May, August or November quarter dates by virtue of paragraph 3(1) of Schedule 11 to FA 1991 (in respect of payments caught by section 350(4) of ICTA) and regulation 10 of the building society regulations (in respect of payments caught by section 477A of ICTA).

2904. In keeping with the alignment of the rules on deduction of tax at source for deposit-takers and building societies, *subsections (2)* to *(4)* embrace building societies. See *Change 142* in Annex 1 and the overview commentary on Chapter 2 of this Part.

Section 948: Meaning of "accounting period"

2905. This section defines "accounting period" for deposit-takers who are not companies. It is based on section 480A(4) of ICTA.

Section 949: Payments in an accounting period

2906. This section contains the main provisions regarding the delivery of returns for section 946 payments made in an accounting period. It is based on paragraphs 2 and 3 of Schedule 16 to ICTA.

2907. This section sets out when a return needs to be delivered and the information which must be included (the amount of any section 946 payment and the amount of income tax payable).

2908. This section clarifies that a return needs to be delivered for a return period only when a section 946 payment is made in the return period. See *Change 143* in Annex 1.

2909. As part of this change, other sections clarify when and how a set-off claim can be made (see sections 952 and 953), when an assessment may be made (see section 957(1)) and when the payer is under a duty to correct a return (see section 958(1)).

Section 950: Payments otherwise than in an accounting period

2910. This section contains the main provisions regarding section 946 payments made otherwise than in an accounting period. It is based on paragraphs 3 and 9 of Schedule 16 to ICTA.

2911. *Subsection (3)* specifies the information required to be included in such a return, bringing this requirement into line with the position for returns where a section 946 payment is made in an accounting period. See *Change 144* in Annex 1.

Section 951: Collection and payment of income tax

2912. This section sets out when income tax is due and that the amount is payable without the making of an assessment. It is based on paragraphs 4(1) and 9 of Schedule 16 to ICTA.

Section 952: Conditions for a set-off claim

2913. This section sets out the conditions for a claim to be made to set off income tax suffered by deduction at source against income tax payable under this Chapter. It is based on paragraph 5 of Schedule 16 to ICTA and paragraph 4 of Schedule 11 to FA 1991.

2914. *Subsection (2)* clarifies that in order for a set-off claim to be made at the end of a return period, the payer must have either made a section 946 payment or received a payment on which it has suffered deduction of income tax during the return period. Under the source legislation it is unclear whether a set-off claim can only be made when a section 946 payment has been made in the return period concerned. See *Change 143* in Annex 1 and the commentary on section 949.

2915. Further, at the end of the return period, there must be both a net amount of income tax suffered and a net amount of income tax payable in order for a set-off claim to be made.

2916. There is a net amount of income tax suffered or payable if, on a cumulative basis running from the beginning of the accounting period to the end of the return period in question, there is an excess amount of one over the other. *Subsections (4)* and *(5)* explain how to calculate the net amounts.

Section 953: How a set-off claim works

2917. This section sets out the effects of a claim to set off income tax suffered against income tax payable. It is based on section 480A(3) and (4) of, and paragraphs 5 and 7 of Schedule 16 to, ICTA, and paragraph 4 of Schedule 11 to FA 1991.

2918. *Subsection (2)* confirms that, to the extent of the set-off, income tax which has been suffered is treated as repaid. This ensures that the amount of income tax suffered and used in the set-off claim cannot be used again in another claim. Further, to the extent of the set-off, income tax payable is treated as paid.

2919. *Subsection (3)* sets out further results of any set-off claim. Where a claim is allowed, the liability to pay income tax treated as paid is discharged. Where income tax has already been paid and the set-off is allowed, the amount will be repaid.

2920. *Subsections (4)* and *(5)* require the claim to be made on a return for the return period under section 949 whether or not a section 946 payment has been made in the return period in question. See *Change 143* in Annex 1 and the commentary on section 949.

2921. *Subsection (7)* confirms that a claim for set-off by a deposit-taker can be made only where the claimant is subject to corporation tax. So set-off claims cannot be made by deposit-takers who are not companies.

Section 954: Proceedings begun after a set-off claim is made

2922. This section makes provision about what happens when proceedings for collection of income tax are brought after a set-off claim is made. It is based on paragraph 6 of Schedule 16 to ICTA.

Section 955: Proceedings begun before a set-off claim is made

2923. This section makes provision about what happens when proceedings for collection of income tax or interest are brought before a set-off claim is made. It is based on paragraph 6 of Schedule 16 to ICTA.

Section 956: Assessments where section 946 payment included in return

2924. This section allows assessments to be made where income tax has not been paid by the date by which the return must be delivered. It is based on paragraph 4(1) of Schedule 16 to ICTA.

2925. *Subsection (3)* confirms that an assessment may be made whether or not the tax due has been paid by the time the assessment is made.

Section 957: Assessments in other cases

2926. This section deals with assessments made because of incomplete or incorrect returns. It is based on paragraph 4(2) of Schedule 16 to ICTA.

2927. *Subsection (1)* makes it clear that an assessment may be made in relation to any returns made under the Chapter (including returns made only in order to make a set-off claim). See *Change 143* in Annex 1 and the commentary on section 949.

Section 958: Payer’s duty to deliver amended return

2928. This section sets out the payer’s duty to deliver an amended return when an error is discovered. It is based on paragraph 7A of Schedule 16 to ICTA.

2929. *Subsection (1)* clarifies the point that the payer is under a duty to correct all returns made under the Chapter for a return period, including those made only in order to make a set-off claim. See *Change 143* in Annex 1 and the commentary on section 949.

2930. Subsection (1)(c) goes further than paragraph 7A of Schedule 16 to ICTA, so that it applies to any return made under the Chapter, rather than just those relating to return periods. See *Change 145* in Annex 1.

Section 959: Application of Income Tax Acts provisions about time limits for assessments

2931. This section confirms that, for the purposes of the time limits set out in the Income Tax Acts applying to assessments, assessments made under this Chapter should be treated as made for the tax year in which the return period ends or, in the case of payments made outside an accounting period, the date on which the payment is made. It is based on paragraphs 10(1) and 11 of Schedule 16 to ICTA.

2932. Paragraph 10(1) of Schedule 16 to ICTA contained a specific reference to section 36 of TMA. But this section makes no such reference. This is because the reference has been unnecessary since the time limit in section 36 of TMA was amended, and section 37 of TMA repealed, by FA 1989.

Section 960: Further provisions about assessments

2933. This section sets out further provisions about assessments, in particular that income tax assessed is due on the date it was due under section 951. It is based on paragraph 10 of Schedule 16 to ICTA.

Section 961: Relationship between Chapter and Income Tax Acts powers

2934. This section confirms that nothing in the Chapter affects any powers in the Income Tax Acts about the recovery of income tax. It is based on paragraph 11 of Schedule 16 to ICTA.

2935. This section applies both to the payer and the recipient. This point was confirmed in Grosvenor Place Estates Ltd v Roberts (1960), 39 TC 433 CA where it was held that the recipient could be assessed to tax where the payer failed to deduct tax, notwithstanding the express rights of Her Majesty's Revenue and Customs to assess the payer (Donovan LJ at page 453).

Section 962: Power to make regulations modifying Chapter

2936. This section allows the Commissioners for Her Majesty's Revenue and Customs to make regulations for the collection of income tax in respect of section 946 payments. It is based on sections 350 and 477A of ICTA.

2937. The section also confirms that this power applies to payments made by deposit-takers and building societies. See *Change 146* in Annex 1.

2938. *Subsection (4)* has been aligned to the wording of similar provisions. In particular it now includes a reference to incidental and consequential amendments.

Chapter 16: Collection: certain payments by other persons

Overview

2939. This Chapter provides the main collection procedure for income tax deducted at source by persons other than those catered for by Chapter 15.

Section 963: Collection of income tax on certain payments by other persons

2940. This section is based on section 350 of ICTA.

2941. The source legislation makes payers "assessable and chargeable". But charging a payment is a step that many other collection mechanisms for income tax deducted at source, such as PAYE, do not use. This charge to tax has been removed to bring this provision into line with parallel collection mechanisms. See *Change 147* in Annex 1.

2942. *Subsection (2)* requires the payer to give details of the payment to an officer of Revenue and Customs. There is no authorised return form on which the details are to be supplied. The subsection also requires the account of the payment to be delivered "without delay". This corresponds to "forthwith" in the source legislation.

2943. Section 350(2) of ICTA has not been rewritten. That subsection makes provision about the cases in which a payment is, or is not, made out of taxed income, in order to impose a duty on the Crown to deduct income tax in appropriate cases. It was introduced by section 39 of FA 1960 to deal with a lacuna which came to light in CIR v Whitworth Coal Co Ltd (1959), 38 TC 531 HL. Under the approach adopted in relation to the provisions about charges on income (see *Change 81* in Annex 1), it is no longer necessary.

Chapter 17: Collection through self-assessment return

Overview

2944. This Chapter provides for collection of income tax, in certain cases, through the self-assessment return of the person making the payment concerned.

Section 964: Collection through self-assessment return

2945. This section is based on sections 348 and 350 of ICTA.

2946. The section arises as a direct result of *Change 81* in Annex 1. See the commentary on Chapter 6 of this Part.

2947. See also *Change 147* in Annex 1 and the commentary on section 963.

2948. The amount to be collected is equal to the sums required to be deducted under the provisions referred to in *subsections (1)(b)* and *(2)*.

2949. *Subsections (3)* to *(5)* make related provision to ensure that TMA provisions apply as necessary to support this.

2950. The liability does not arise in respect of a person's own income tax affairs, but in relation to sums representing income tax deducted from payments a person makes. That is why, as indicated in *subsection (4)*, it does not form part of the calculation of a person's own liability to income tax as such.

Chapter 18: Other regimes involving the deduction of income tax at source

Overview

2951. This Chapter deals with three further deduction of income tax at source regimes.

2952. The first provides for a duty to deduct and account for "sums representing income tax" from certain prescribed payments and transfers to non-UK resident entertainers, sportsmen and sportswomen. It is based on sections 555 and 558 of ICTA. The Income Tax (Entertainers and Sportsmen) Regulations 1987 in SI 1987/530 have been made under these sections.

2953. The second enables the Commissioners for Her Majesty's Revenue and Customs to make regulations providing for the collection, assessment and recovery of "prescribed amounts of income tax" in respect of Schedule A and UK property business income of persons whose usual place of abode is outside the United Kingdom. It is based on section 42A of ICTA. The Taxation of Income from Land (Non-residents) Regulations 1995 (SI 1995/2902) have been made under this section.

2954. The third enables the Treasury to make regulations providing for the assessment, collection and recovery of income tax from distributions made by a Real Estate Investment Trust in respect of a property rental business. It is based on sections 105, 122, 134 and 144 of, and paragraphs 3, 19 and 32 of Schedule 17 to, FA 2006. The Real Estate Investment Trusts (Assessment and Recovery of Tax) Regulations 2006 (SI 2006/2867) were made on 1 November 2006 and are effective for accounting periods beginning on or after 1 January 2007.

Section 965: Overview of sections 966 to 970

2955. This section gives an overview of sections 966 to 970, which provide for the payment of sums representing income tax to the Commissioners for Her Majesty's Revenue and Customs where certain payments and transfers are made in connection with United Kingdom performances by non-UK resident entertainers, sportsmen and sportswomen (visiting performers).

2956. Following the House of Lords decision in Agassi v Robinson [2006 UKHL 23][14], Schedule 1 to this Act amends section 556 of ICTA and section 13 of ITTOIA to make explicit that these sections will have effect regardless of whether there is a duty to deduct income tax under section 555 of ICTA. See *Change 156* in Annex 1.

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2957. Section 48(2)(b) of ITEPA has been amended by Schedule 1 to this Act to make it explicit that a transfer which is subject to deduction under the rules about visiting performers, is not also subject to the rules about the provision of services through intermediaries in Chapter 8 of Part 2 of ITEPA. See *Change 161* in Annex 1.

Section 966: Duty to deduct and account for sums representing income tax

2958. This section sets the general duty to deduct and account for sums representing income tax where a payment or transfer is made in connection with a "relevant activity" carried out by a prescribed visiting performer. It is based on section 555(1), (2), (3) and (6) of ICTA.

Section 967: Calculation of sums representing income tax

2959. This section sets out how to calculate the sums which are required to be deducted and or accounted for under section 966. It is based on sections 555(4) and 558(2) and (3) of ICTA.

2960. *Subsection (2)* provides that the sums cannot exceed a maximum proportion equivalent to basic rate income tax.

2961. *Subsections (3)* and *(4)* allow the Treasury to make regulations in order to calculate the value of a transfer to which section 966 applies. In particular, the regulations may provide for that amount to be treated as a net amount corresponding to a gross amount from which income tax at the basic rate has been deducted.

Section 968: Treatment of sums representing income tax

2962. This section sets out the income tax treatment of any sums paid to the Commissioners for Her Majesty's Revenue and Customs under section 966(3) or (4). It is based on section 555(8) to (11) of ICTA.

2963. *Subsections (2)* and *(3)* confirm that any payment made to the Commissioners is treated as made on account of the liability of another person to income tax or corporation tax and that the liability and the other person are to be found in accordance with prescribed rules.

2964. The regulations (regulation 12(1) of SI 1987/530) provide that the other person is the recipient of the payment or transfer. But where the recipient is of a "prescribed description" (for example the recipient is connected with the performer, see regulation 7 of SI 1987/530) then, under section 13(5) of ITTOIA, the other person will be the performer.

2965. *Subsection (4)* confirms that if the sum paid to the Commissioners exceeds the liability of the other person, then the Commissioners will repay so much of the amount as is appropriate to the other person. Again, the regulations provide that the other person is the recipient of the payment or transfer or, if the recipient is connected with the performer, the other person is the performer.

2966. *Subsections (5)* and *(6)* confirm that if there is no liability to make a payment under section 966 then the Commissioners will repay the sum to the recipient of the payment or transfer.

Section 969: Regulations

2967. This section provides that the Treasury may make various regulations regarding the sums to be paid, in particular provision for information, collection, assessment and recovery. It is based on sections 555(7) and 558(5) of ICTA.

Section 970: Supplementary

2968. This section sets out various supplementary provisions and is based on sections 555(5) and 558(1), (4), and (6) of ICTA.

2969. *Subsections (2)* and *(3)* state that an officer of Revenue and Customs may disclose certain information to others, without being precluded from doing so by any obligation as to secrecy.

2970. Under the source legislation (section 558(4) of ICTA) it is "the Board" who must decide whether to make any disclosure. But in practice it is an officer of Revenue and Customs who takes the decision. The references in section 558(4) of ICTA to "the Board" (and to "authorised" officer) have therefore been omitted. See *Change 5* in Annex 1.

Section 971: Income tax due in respect of income of non-resident landlords

2971. This section enables regulations to be made about the collection of "prescribed amounts of income tax" in relation to "non-resident landlord income". It is based on section 42A(1) to (3) of ICTA.

2972. *Subsection (1)* allows the Commissioners for Her Majesty's Revenue and Customs to make regulations for the collection, assessment and recovery of "prescribed amounts of income tax" from "non-resident landlord representatives" in respect of "non-resident landlord income". Regulation 8 of SI 1995/2902 provides that the amount is to be calculated at the basic rate of tax.

2973. *Subsection (2)* defines "non-resident landlord income" as income of a person whose usual place of abode is outside the United Kingdom, which is or may be chargeable to corporation tax under Schedule A or to income tax as profits of a UK property business under Chapter 3 of Part 3 of ITTOIA. This section applies regardless of whether any payment is actually made to the non-resident landlord.

2974. As the tax deducted will, in all cases, be income tax, all these regulation-making powers have been rewritten together, in this Act.

2975. Currently the regulations in SI 1995/2902 do not provide for payments to be made to the Commissioners in respect of Schedule A income (see regulations 8(3) and 9(3)). If in the future regulations were to be made, requiring amounts to be paid to the Commissioners in respect of Schedule A income, the amount paid would be a "prescribed amount of income tax" and would be capable of being set off against the non-resident landlord's corporation tax liability by virtue of section 11(3) of ICTA.

2976. The source legislation makes reference to the charging of prescribed amounts. This reference to charging is removed to bring the rewritten version of section 42A of ICTA into line with other collection mechanisms. See *Change 147* in Annex 1 and the commentary on section 963.

2977. For discussion of "usual place of abode", see the commentary on section 874.

Section 972: Regulations under section 971

2978. This section makes further provisions about the regulations which can be made. It is based on section 42A(4) to (7) of ICTA.

2979. *Subsection (3)(b)* has been aligned to the wording of similar provisions. In particular it now includes a reference to savings.

Section 973: Income tax due in respect of distributions

2980. This section enables the Treasury to make regulations about the assessment, collection and recovery of income tax where a distribution is made by Real Estate Investment

Trusts in respect of property rental business. It is based on sections 105, 122 and 134 of, and paragraphs 2, 3, 19 and 32(8) of Schedule 17 to, FA 2006.

Section 974: Regulations under section 973

2981. This section makes further provision about the regulations which can be made under section 973. It is based on sections 122 and 144 of, and paragraph 19 of Schedule 17 to, FA 2006.

2982. *Subsection (1)(a)* provides that regulations may be made requiring Real Estate Investment Trusts to deduct sums representing income tax at the basic rate.

2983. Paragraph 19(2) of Schedule 17 to FA 2006 has not been rewritten as it is unnecessary. Paragraph 19(2) modifies section 122(2) of FA 2006. Since this section is purely illustrative of the extent of the powers provided by section 973 (based on section 122(1) of FA 2006) it is not necessary to expand the provisions in this section.

2984. Previously, the power to make regulations in respect of a principal company was in Schedule 17 to FA 2006 (not in section 122). But as all the regulation making powers have been rewritten in one place (in section 973) it is not necessary to have a specific reference to a principal company of a group in this section. By not including a specific reference to the principal company (in this section), the power to make regulations in respect of such principal companies (under section 973) will not be limited.

Chapter 19: General

Overview

2985. This Chapter brings together a number of supplementary provisions relating to deduction at source, and gives definitions of certain terms used in this Part.

Section 975: Statements about deduction of income tax

2986. This section imposes a duty on certain persons who are required to make payments under deduction of income tax to provide, on request, a statement of the gross amount of the payment, the sum deducted and the net amount paid. It is based on section 352 of, and paragraph 3(8) and (9) of Schedule 23A to, ICTA.

2987. The section brings the rules for statements about manufactured interest on UK securities into line with the rules for statements about actual interest on UK securities. See *Change 148* in Annex 1.

2988. The section also contains specific provisions of a similar nature relating to unauthorised unit trusts.

2989. *Subsection (5)* requires that the statement be in writing. Electronic statements are provided for by regulations 3 and 4 of the Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) Regulations 2003 (SI 2003/3143).

2990. Section 352 of ICTA is theoretically capable of applying to MODs within paragraph 4(2) of Schedule 23A to ICTA, as they are treated as annual payments within section 349 of ICTA. But specific rules for statements about MODs are given by regulation 15 of the Income Tax (Manufactured Overseas Dividends) Regulations 1993 (SI 1993/2004). So this section has not been extended to cover payments within section 922, which rewrites paragraph 4(2). See the commentary on that section.

Section 976: Arrangements for payments of interest less tax or at specified net rate

2991. This section clarifies how a provision for the payment of interest “less tax” is to be interpreted if there is no duty to deduct a sum representing income tax. It is based on section 818 of ICTA.

2992. In this section the word "provision" relates to arrangements for the payment of interest as well as to any other context. It applies very widely to primary and secondary legislation, contracts, wills, deeds and any other arrangements, whether in writing or not.

2993. If any such provision is for the payment of interest "less tax", the words "less tax" are to be ignored.

2994. If the provision is for payment of interest chargeable as mentioned in *subsection (6)*, any provision that purports to require grossing up from a prescribed net rate of interest is to be interpreted as requiring payment at the "gross rate".

Section 977: Payments to companies

2995. This section provides that, even if the payment is not chargeable to income tax in a company's hands, this does not affect whether a payment to a company should be subject to deduction of a sum representing income tax. It is based on section 7(1) and (4) of ICTA.

2996. *Subsection (2)* clarifies that receipt by another person on behalf of, or in trust for, the company is to be treated as receipt by the company. Conversely, if a company receives a payment on behalf of, or in trust for another person, that does not require that the payment be treated as received by that company. If company A receives a payment on behalf of company B, the payment is treated as received by company B.

Section 978: Application to public departments

2997. This section ensures that the rules in this Part regarding deduction at source and collection of income tax apply to payments made by United Kingdom government departments. It is based on section 829(1) and (3) of ICTA.

2998. Without this section, the principle of Crown exemption would apply so that annual payments by UK government departments would not be subject to the provisions of this Part.

2999. *Subsection (2)* ensures that the section is limited to United Kingdom government departments.

3000. Section 829(2) of ICTA has not been rewritten. That subsection was only necessary because section 829(1) was widely drafted and could have imposed liability on income received by a department. As this section is restricted to annual payments made by departments, section 829(2) of ICTA is unnecessary and is repealed.

3001. No deduction is required from annual payments by one government department to another. In the source legislation, section 829(2) of ICTA addressed this point. But specific provision is not necessary.

3002. Crown exemption does not apply if it is clear from the legislation in question that the provisions concerned do apply to the Crown. For example, it is clear from the legislation about PAYE that the Crown must operate PAYE. Accordingly, section 829(2A) of ICTA is unnecessary and is repealed.

Section 979: Designated international organisations: exceptions from duties to deduct

3003. This section provides that certain payments made by international organisations which are designated by the Treasury are not subject to deduction at source under this Part. It is based on section 582A ICTA.

3004. This section applies to:

- payments of yearly interest under section 874 by such a designated organisation or a partnership of which such an organisation is a member;
- annual payments, patent royalties and other payments connected with intellectual property under Chapters 6 or 7 of this Part (see *Change 81* in Annex 1);
- payments under Chapter 14 of this Part (tax avoidance); and
- payments of manufactured interest or overseas dividends under sections 919(2) and 922(2).

Section 980: Derivative contracts: exception from duties to deduct

3005. This section provides that nothing in this Part imposes a duty on a company to deduct at source if it is making a payment under certain derivative contracts. It is based on paragraph 51 of Schedule 26 to FA 2002.

3006. The derivative contracts concerned are those to which the calculation rules in Schedule 26 to FA 2002 apply, which are those the company either enters into or acquires. See paragraph 53 of that Schedule.

Section 981: Foreign currency securities etc: exception from duties to deduct

3007. This section provides that nothing in this Part imposes a duty to deduct at source on interest payments within section 755(1) of ITTOIA. It is based on section 581A of ICTA.

Section 982: Income tax is calculated by reference to gross amounts

3008. This section provides that the amount on which tax is to be calculated is the gross amount in each case. It is new.

Section 983: Meaning of "deposit"

3009. This section defines the meaning of "deposit" for the purposes of this Chapter. It is based on section 481(3) of ICTA.

3010. Section 481(3) of ICTA applies to deposit-takers and is also rewritten in Chapter 2 of this Part (deduction by deposit-takers and building societies). By including the definition of "deposit" in this Chapter the application of the definition has been extended to building society deposits. This will ensure that the definitions of "qualifying certificate of deposit" (section 985) and "qualifying uncertificated eligible debt security unit" (section 986) are the same for deposit-takers and building societies.

Section 984: Meaning of "financial instrument"

3011. This section gives the definition of "financial instrument" which occurs in the context of this Part in relation to persons authorised under FISMA who deal in financial instruments as principal. It is based on section 349(5) and (6) of ICTA.

Section 985: Meaning of "qualifying certificate of deposit"

3012. This section defines "qualifying certificate of deposit". It is based on sections 349(4) and 482(6) of ICTA.

3013. Interest (and, in the case of building societies, dividends) paid by a deposit-taker or building society in respect of a deposit in respect of which a "qualifying certificate of deposit" has been issued is payable gross (see sections 865 and 889).

3014. In order for a "certificate of deposit" (defined in section 1019) to be a "qualifying certificate of deposit", the certificate must require the issuer to pay an amount of at least

£50,000 (or equivalent if made in a foreign currency) at a specified time within five years of the deposit being made.

3015. The definition of "qualifying certificate of deposit" has been aligned to the wording of the definition of "qualifying time deposit" (see section 866) so that it is clear that a "qualifying certificate of deposit" can only be paid in one tranche "at a specified time". See *Change 149* in Annex 1.

Section 986: Meaning of "qualifying uncertificated eligible debt security unit"

3016. This section defines "qualifying uncertificated eligible debt security unit". It is based on sections 349(4) and 482(6) of ICTA and section 552(2) of ITTOIA.

3017. Interest (and, in the case of building societies, dividends) paid by a deposit-taker or building society in respect of qualifying uncertificated eligible debt security units is payable gross. See sections 864 and 889.

3018. For an uncertificated eligible debt security to be "qualifying" there has to be a right to receive an amount of at least £50,000 (or equivalent if made in a foreign currency) at a specified time within five years of the deposit being made.

3019. The definition of "qualifying uncertificated eligible debt security unit" has been aligned to the wording of the definition of "qualifying time deposit" (see section 866) so that it is clear that a "qualifying uncertificated eligible debt security unit" can only be paid in one tranche "at a specified time". See *Change 149* in Annex 1.

3020. *Subsection (4)* defines various terms in the definition of "uncertificated eligible debt security units" by reference to the Uncertificated Securities Regulations 2001 (SI 2001/3755).

Section 987: Meaning of "quoted Eurobond"

3021. This section defines "quoted Eurobond". It is based on the definition in section 349(4) of ICTA.

3022. Interest on a quoted Eurobond is not subject to deduction at source. See sections 882 and 889.

Part 16: Income Tax Acts definitions etc

Overview

3023. This Part sets out definitions and related material applying for the purposes of the Income Tax Acts generally. It is mainly based on provisions in Part 19 of ICTA.

3024. Many of these definitions apply in relation to corporation tax as well as income tax. Some of them also apply to capital gains tax, or in relation to capital allowances, either by cross-reference or by virtue of parallel provision.

3025. The definitions have been rewritten for income tax using the following principles:

- if definitions are relatively short or straightforward, they are duplicated in the legislation about each of the taxes to which they apply;
- if a definition is longer and more complicated, and is mainly concerned with one tax, it is set out in full in the legislation about that tax and defined by cross-reference for the purposes of any other taxes that are relevant;
- if a definition is longer and more complicated and is made substantial use of in relation to more than one tax, it is normally duplicated.

3026. As a result, the rewrite of the definitions in these sections is closely bound up with the related consequential amendments in Schedule 1.

Chapter 1: Definitions

Overview

3027. This Chapter contains definitions which apply for the purposes of the Income Tax Acts, except where the context otherwise requires.

Section 988: Overview of Chapter

3028. This section provides an overview of the Chapter. It is new.

3029. Section 989 sets out the terms which are defined, and either contains or sign-posts the definitions concerned.

3030. Some definitions do not apply for the purposes of specified provisions. And some definitions only have effect for the purposes of specified provisions.

Section 989: The definitions

3031. This section sets out the definitions in alphabetical order. It is based on section 832 of ICTA and a variety of other provisions.

3032. Section 832 of ICTA, and other provisions, consequentially amended, continue to provide parallel definitions for corporation tax purposes.

3033. The definition of "capital allowance" no longer makes reference to allowances under enactments which under ICTA are treated as contained in CAA. This is because the only such enactment is section 532 of ICTA, and the only provision to which it remains potentially relevant (section 527 of ICTA) is rewritten in section 461 of this Act.

3034. The definition of "interest" (as including yearly interest and interest other than yearly interest) has been omitted, both from this section and from the amended section 832, as it adds nothing to the general meaning of "interest". It was originally enacted in paragraph 20 of Schedule 13 to FA 1969.

3035. The definition of "personal representatives" is new. It follows the approach adopted in ITTOIA. See *Change 150* in Annex 1.

3036. The definition of "trade" has been streamlined in line with the drafts included as clause 3.1.4 of ED1 (July 1997) and clause 3.1.5 in Exposure Draft No 10 (May 2000). Adopting this approach in this Act, rather than in ITTOIA, has enabled it to be done for all income tax purposes at the same time.

3037. Parallel definitions of "tax year" and "year of assessment" are provided, in order to support those provisions of the Income Tax Acts, including those in TMA, that have not been rewritten.

3038. Section 832(5) of ICTA is not rewritten in this Act, or retained in ICTA in relation to corporation tax, as this provision has been overtaken by the Adoption and Children Act 2002 (if it was not redundant before). See *Change 151* in Annex 1.

Section 990: Meaning of "Act"

3039. This section is based on section 832(1) of ICTA.

3040. The reference to Northern Ireland legislation has been updated. See *Change 152* in Annex 1.

3041. See also section 1018, about the meaning of references to Northern Ireland and Scottish legislation in provisions in this Act, and the commentary on that section.

Section 991: Meaning of "bank"

3042. This section is based on section 840A of ICTA.

3043. The definition operates only where it is specifically applied.

3044. In *subsection (2)*, Article 3 of the European Investment Bank (Designated International Organisation) Order SI 1996/1179 has been enacted. See *Change 135* in Annex 1 and the commentary on section 879.

3045. Section 840A of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 992: Meaning of "company"

3046. This section is based on section 832(1) and (2) of ICTA.

Section 993: Meaning of "connected" persons

3047. This section is based on section 839 of ICTA.

3048. The definition operates only where specifically applied.

3049. Section 839 of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

3050. Section 575 of CAA defines "connected" by cross-reference to section 839. CAA is important both in the income tax and corporation tax contexts. Rather than continuing to operate by cross-reference to section 839 or to this section, this Act amends section 575 of CAA so that it contains the text of the definition. See Schedule 1.

Section 994: Meaning of "connected" persons: supplementary

3051. This section is based on section 839 of ICTA.

Section 995: Meaning of "control"

3052. This section is based on section 840 of ICTA.

3053. The definition operates only where specifically applied. The drafting has largely followed the approach adopted in section 574 of CAA.

3054. Section 840 of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 996: Meaning of "farming" and related expressions

3055. This section defines "farming" and "market gardening" and clarifies the meaning of "forestry" and "woodlands". It is based on sections 397(5) and 832(1) of ICTA, section 154(1) and (3) of FA 1995 and section 876 of ITTOIA.

3056. Section 876 of ITTOIA provides a definition for the purposes of that Act. This section follows the pattern of section 876 of ITTOIA but applies for the purposes of the Income Tax Acts. So section 876 of ITTOIA is no longer needed and this Act repeals it.

3057. *Subsection (3)* provides that the cultivation of short rotation coppice is to be regarded as husbandry. In strictness this means that the cultivation must involve the occupation of land to be regarded as farming. But as it is impossible to cultivate short rotation coppice without occupying land the cultivation will also be regarded as farming.

3058. As with section 876 of ITTOIA there is no territorial restriction in the definitions in this Act. This means that there is no need to apply the definition of farming to activities outside the United Kingdom in the rewrite of section 397 of ICTA as section 67. Also, the cultivation of short rotation coppice on land outside the United Kingdom will be regarded as husbandry and therefore as farming.

3059. Again following the pattern in ITTOIA if a territorial restriction is required it is applied to a particular section. So *subsection (7)* restricts the definitions to farming or market gardening in the United Kingdom in the rewrite of section 297(2) of ICTA as section 192(1) and paragraph 4(2) of Schedule 28B to ICTA as section 303(1).

Section 997: Meaning of "generally accepted accounting practice" and related expressions

3060. This section is based on the definition of "for accounting purposes" in section 832(1) of ICTA and on section 50 FA 2004.

3061. Those sections, consequentially amended, continue to provide the definitions for corporation tax purposes.

Section 998: Meaning of "grossing up"

3062. This section is new.

3063. The section follows the pattern of section 877 of ITTOIA which (along with similar existing provisions) is repealed now that there is a general definition for the purposes of the Income Tax Acts.

Section 999: Meaning of "local authority"

3064. This section is based on section 842A of ICTA.

Section 1000: Meaning of "local authority association"

3065. This section is based on sections 519(3) and 832(1) of ICTA.

Section 1001: Meaning of "offshore installation"

3066. This section is based on section 837C of ICTA.

3067. Section 837C of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 1002: Regulations about the meaning of "offshore installation"

3068. This section is based on section 837C(5) and (6) of ICTA.

Section 1003: Meaning of "oil and gas exploration and appraisal"

3069. This section is based on section 837B of ICTA.

3070. Section 837B of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 1004: Meaning of "property investment LLP"

3071. This section is based on sections 832(1) and 842B of ICTA.

3072. Section 842B of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

3073. Section 842B, as amended, does not contain a definition of "investment LLP" because the term is not used in corporation tax legislation. This section does not contain such a definition either, because section 399 of this Act contains the only reference to it in income tax legislation.

Section 1005: Meaning of "recognised stock exchange"

3074. This section is based on section 841(1) and (2) of ICTA.

3075. The corporation tax definition in section 841 of ICTA, consequentially amended, operates by cross-reference to this definition. This guards against any risk of orders being made which might inadvertently result in the two definitions getting out of step.

Section 1006: Meaning of "research and development"

3076. This section is based on section 837A of ICTA.

3077. Section 837A of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes. And it ensures that any regulations made for income tax purposes are also taken account of for corporation tax purposes.

Section 1007: Meaning of "unit trust scheme"

3078. This section is based on sections 469(7) and (8) and 832(1) of ICTA.

3079. The corporation tax definition is located in section 832(1) of ICTA, as consequentially amended.

Chapter 2: Other Income Tax Acts provisions

Overview

3080. This Chapter contains provisions (other than definitions) which apply for the purposes of the Income Tax Acts.

Section 1008: Scotland

3081. This section is based on sections 363(3) and 832(1) of ICTA and section 879 of ITTOIA.

Section 1009: Sources of income within the charge to income tax or corporation tax

3082. This section is based on section 832(1) of ICTA.

Section 1010: Application of Income Tax Acts to recognised investment exchanges

3083. This section is based on section 841(3) of ICTA.

3084. Section 841(3) of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 1011: References to married persons, or civil partners, living together

3085. This section is based on section 282 of ICTA.

3086. It explains that married couples and civil partners are treated as living together unless they are separated under a court order, under a deed of separation or in fact separated in circumstances where the separation is likely to be permanent.

3087. This rule applies in particular in relation to married couple's allowance (Chapter 3 of Part 3) and to jointly held property (Chapter 3 of Part 14).

Section 1012: Relationship between rules on highest part of total income

3088. This section brings together a number of provisions about the relationship between the rules about which particular income is to be treated as the highest part of a person's total income. It is based on sections 1A(6) and 833(3) of ICTA.

3089. These rules affect section 16 and a number of provisions inserted by this Act including section 404A of ITEPA and section 465A of ITTOIA.

3090. The section remedies an omission in section 833(3) of ICTA by providing a rule as to which of section 404A of ITEPA and section 465A of ITTOIA takes the very highest slice in a case where both are present. In practice, if both arise it will be to the taxpayer's advantage if the chargeable event gains are treated as the very top slice. Accordingly, section 404A of ITEPA defers to section 465A of ITTOIA. See *Change 153* in Annex 1.

3091. *Subsection (5)* makes it clear that the rules in this section override any other provision that purports to treat a given type of income as the top slice. The effect is that the income concerned will simply form the top slice of income within its category of savings, dividend or other income.

Section 1013: Territorial sea of the United Kingdom

3092. This section is based on section 830(1) of ICTA.

Section 1014: Orders and regulations

3093. This section is based on section 828 of ICTA.

Section 1015: Territorial scope of charges under certain provisions to which section 1016 applies

3094. This section is based on section 827A of ICTA.

Section 1016: Table of provisions to which this section applies

3095. This section is based on section 836B of ICTA.

3096. The table in section 836B of ICTA includes two provisions (section 804(5B)(a) of ICTA and paragraph 11(3) of Schedule 20 to FA 1994) which are in substance about the recovery of double taxation credit relief that has been over-allowed, although both operate by converting the tax to be recovered to an amount charged to income tax at the basic rate.

3097. Amounts charged under those two provisions are not regarded as income for any other purpose and none of the other provisions which invoke the table (for example, to utilise losses under section 152 of this Act) could have any application in relation to these amounts. As it is misleading for them to be included in the table, they have been omitted.

3098. Amendments are made to both provisions by Schedule 1 so that they operate as charges to amounts of income tax.

Part 17: Definitions for purposes of Act and final provisions

Overview

3099. This Part sets out definitions which are specific to this Act and a number of other supplementary and general provisions.

Section 1017: Abbreviated references to Acts

3100. This section lists the abbreviated references to other Acts. It is new.

Section 1018: "Act" to include Scottish and Northern Ireland legislation in some cases

3101. This section defines "Act" for the purposes of certain provisions of this Act. It is based on section 832(1) of ICTA.

3102. The definition means that "Act" includes Scottish and Northern Ireland legislation in the provisions concerned. See *Change 152* in Annex 1.

3103. See also section 990 and the commentary on that section, in relation to the meaning of "Act", and in particular the updating of references to Northern Ireland legislation, in other provisions of the Income Tax Acts.

Section 1019: Meaning of "certificate of deposit"

3104. This section defines "certificate of deposit" for the purposes of this Act. It is based on sections 56(5), 349(4) and 482(6) of ICTA and section 552(2) of ITTOIA.

Section 1020: Claims and elections

3105. This section provides a general rule concerning the making of claims and elections. It is based on section 42(11) of TMA and paragraphs 1 and 2 of Schedule 1A to TMA.

3106. In the source legislation some provisions specify that a claim or election has to be in writing while others are silent. But the effect of paragraph 2(3) to (5) of Schedule 1A to TMA is that a claim or election has to be in writing (unless a specific provision says otherwise).

Section 1021: Application of definitions of "connected" persons and "control"

3107. This section applies these definitions for the purposes of the Act. It is based on a variety of provisions in the source legislation.

3108. The application of the definition of control in section 995 in relation to section 560(8) is new and arises as a consequence of including detailed provisions on approved charitable investments in Part 10. See *Change 100* in Annex 1 and the commentary on section 560.

Section 1022: Meaning of "debenture"

3109. This section defines "debenture" for the purposes of certain provisions of this Act. It is based on sections 312(1) and 481(5) of, and paragraph 13(1) of Schedule 28B to, ICTA.

Section 1023: Meaning of "double taxation arrangements"

3110. This section defines "double taxation arrangements". It is new.

Section 1024: Meaning of "gilt-edged securities"

3111. This section defines "gilt-edged securities". It is based on sections 50(7) and 722A(5) of, and paragraph 3A(2) of Schedule 23A to, ICTA.

Section 1025: Meaning of "modified net income"

3112. This section explains how the amount of a person's "modified net income" is calculated for the purposes of certain provisions of this Act. It is based on sections 348(1) and (2) and 349(1) of ICTA.

3113. The provisions concerned are those providing for:

- certain adjustments in calculating gift aid relief under Chapter 2 of Part 8;
- the deduction allowed for annual payments and patent royalties under Chapter 4 of Part 8; and
- the similar deduction allowed to the trustees of an unauthorised unit trust for payments treated as made by them, under Chapter 9 of Part 9.

3114. The way in which tax deducted from payments within Chapter 4 of Part 8 is recovered sometimes depends on whether the payer has any modified net income in the year in which the payment is made. See *Change 82* in Annex 1.

3115. *Subsections (2)* to *(4)* provide the details of the calculation of the amount of a person's modified net income. Starting with net income, the following items are to be excluded:

- any non-qualifying income included in the person's charged income. See section 1026, which details the types of income that in the source legislation are to be regarded as being paid "out of" income not brought into charge to income tax;
- any relief due under Chapter 4 of Part 8 (annual payments and patent royalties); and
- reliefs or adjustments that, under Schedule 1B to TMA, are stated to "relate to a later year".

See *Change 154* in Annex 1.

3116. Similar calculations also must be made for the purposes of gift aid. See section 427 (meaning of "charged amount"). Gift aid is not given as a deduction from total income, so the deduction for annual payments and patent royalties takes priority. So for those purposes subsection (2)(c) is ignored (*subsection (3)*).

3117. Trustees of unauthorised unit trusts are treated under the source legislation as making annual payments equal to the grossed-up amount of their income. In this Act this is a separate relief under Chapter 9 of Part 9. So in this case that relief is substituted for the relief for annual payments and patent royalties (*subsection (4)*).

Section 1026: Meaning of "non-qualifying income" for the purposes of section 1025

3118. This section sets out the types of income that are "non-qualifying income" for the purposes of section 1025. It is based on sections 348(4) and 804(6) of ICTA. See *Change 82* in Annex 1.

Section 1027: Minor and consequential amendments

3119. This section gives effect to Schedule 1.

Section 1028: Power to make consequential provision

3120. This section confers power on the Treasury to make consequential amendments, additional to those contained in Schedule 1 to this Act. It is new.

3121. The scope of the power is in substance the same as that in section 882 of ITTOIA.

3122. As with that power, it is intended that this power will not be exercised without the agreement of the Tax Law Rewrite project's Consultative and Steering Committees.

3123. *Subsection (2)* provides that the power may not be used after 5 April 2010. There was no provision of this kind in section 882 of ITTOIA, but it is sensible to enable additional consequential amendments to be made in this way only over a limited period, and it would in any case become progressively more difficult to do so accurately as subsequent Finance Bills are enacted. The date of 5 April 2010 takes account of this while giving a reasonable amount of time for missed consequential amendments to come to light.

3124. *Subsection (4)* provides that the power may contain provision having retrospective effect, making explicit something which was implicit in relation to the power in section 882 of ITTOIA. As the power can be used only to make provision in consequence of this Act, any retrospective effect is limited to provision having effect from the date the Act comes into force.

Section 1029: Power to undo changes

3125. This section confers power on the Treasury to undo changes in the law made by the Act, for the purpose of restoring the effect of the law to what it was immediately before 6 April 2007 (the date on which this Act will come into effect). It is new.

3126. The power will make it possible for any errors made in rewriting the source legislation to be corrected without recourse to a Finance Bill.

3127. The power provided by this section will, in particular, enable errors in making consequential amendments to be corrected.

3128. For example, had ITEPA contained such a power, it would have been possible to use it to reverse its mistaken repeal of section 108 of FA 1995. In the absence of such a power, it was necessary for the error made by ITEPA to be corrected in a Finance Act (see paragraph 6 of Schedule 17 to FA 2004).

3129. Depending on the nature of the error, corrections made to restore the effect of the pre-6 April 2007 law could be taxpayer-favourable or taxpayer-adverse.

3130. *Subsection (2)* provides that the power may not be used after 5 April 2010. It is sensible to enable errors to be corrected in this way only over a limited period, and it would in any case become progressively more difficult to do so accurately as subsequent Finance Bills are enacted. The date of 5 April 2010 takes account of this while giving a reasonable amount of time for errors to come to light.

3131. *Subsection (4)* provides that the power may contain provision having retrospective effect. Whether that was appropriate would need to be considered on a case-by-case basis.

3132. As with the power in section 1028, it is intended that this power will not be exercised without the agreement of the Tax Law Rewrite project's Consultative and Steering Committees.

Section 1030: Transitional provisions and savings

3133. This section gives effect to Schedule 2 and confers power on the Treasury to make transitional or saving provisions additional to those contained in that Schedule.

3134. *Subsection (2)* is in substance the same as section 883(5) of ITTOIA.

3135. *Subsection (3)* provides that the power may contain provision having retrospective effect. As there is likely to be only a short period between the date on which the Act receives Royal Assent and the date on which it comes into force, it is possible that the need for additional transitional provision will not have come to light before the Act comes into force. Subsection (3) therefore ensures that the power can be exercised after the Act comes into force.

3136. As with the power in section 883(5) of ITTOIA, it is intended that this power will not be exercised without the agreement of the Tax Law Rewrite project's Consultative and Steering Committees.

Section 1031: Repeals and revocations

3137. This section gives effect to Schedule 3.

Section 1032: Index of defined expressions

3138. This section gives effect to, and introduces, Schedule 4.

Section 1033: Extent

3139. This section ensures that the Act applies to the whole of the United Kingdom.

Section 1034: Commencement

3140. This section provides for the commencement of the Act.

3141. *Subsection (1)* deals with the position both for income tax and corporation tax. This Act is in substance an income tax only Act. But it makes many consequential amendments to corporation tax legislation. Those consequential amendments also require a commencement provision.

3142. *Subsection (3)* deals with the enterprise investment scheme (EIS). EIS has some distinctive features which could result in very complicated transitional and savings provisions. In contrast to venture capital trusts (VCTs) where there are two sorts of investments, those made in the VCT and those made by the VCT, in EIS there is no intermediate investor. This makes it possible for EIS to have the different commencement basis, expressed in terms of "shares issued", provided in this subsection.

3143. These features are:

- many of the conditions on which eligibility for relief hinge need to be met for the whole of the period prescribed for that particular requirement;
- the commencement date for that period is dependent on the date when shares are issued; and
- EIS relief is given in the tax year in which the shares are issued and, if the relief is reduced or withdrawn, it is that year which is affected.

3144. It may not be clear in relation to all the sections in Part 5, that the commencement provision in section 1034(1) applies only to new share issues. So section 1034(3) provides that Part 5 does not have effect in relation to shares issued before 6 April 2007.

3145. This means, for instance, that it will be necessary to refer to the provisions of ICTA to determine whether and to what extent relief is to be withdrawn or reduced on a disposal on or after 6 April 2007 of shares acquired before that date.

3146. Section 1034(3) also extends to consequential amendments and repeals. For this reason both Schedules 1 and 3 have a separate Part which has effect in relation to EIS shares issued on or after 6 April 2007.

3147. Section 1034(3) is subject to the general provisions in Part 1 of Schedule 2 (Transitionals and savings). Also there is a specific transitional provision in Part 7 of Schedule 2 which preserves the effect of the FA 2006 amendment of section 293(6A) of ICTA.

Section 1035: Short title

3148. This section specifies the short title of the Act.

Schedule 1: Minor and consequential amendments

Overview

3149. This Schedule makes consequential amendments.

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

Part 1: Income and Corporation Taxes Act 1988

Section 9

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

Section 118

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

Section 256

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

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

Section 256A

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

Section 256B

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

Sections 257BA, 257BB, 257C and 265

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

Section 266

3158. Section 266(6) and (6A) of ICTA are repealed, as they are obsolete. The Association of Friendly Societies have confirmed that no such policies have been written for many years and that all such existing policies have been converted to "paid-up". They agree that the provision is no longer needed.

Section 278

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

Section 312(2A)

3160. Section 1034(3) of this Act provides that the enterprise investment scheme (EIS) sections in Part 5 of this Act do not have effect in relation to shares issued before 6

April 2007. Since it is helpful to apply *Change 56* in Annex 1 to such shares when this Act comes into effect, there is a consequential amendment to section 312(2A) of ICTA. This applies the new interpretation of an administration reflected in section 252(2) of this Act to shares issued before 6 April 2007. The amendment will have effect where the administration commences on or after 6 April 2007 in accordance with the commencement provision in section 1034(1).

Section 349(3A) and (4)

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

Section 353

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

Section 368

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

Sections 459 to 461B

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

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

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

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

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

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

Section 467

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

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

Section 469

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

Section 477A

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

Section 481(5A)

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

Section 515

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

Section 519A

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

Section 556

3177. Following the House of Lords decision in Agassi v Robinson [2006 UKHL 23][15], section 556 of ICTA has been amended to make clear that when a payment or transfer of the type referred to in section 555 of ICTA is made, no liability to corporation tax will arise regardless of whether there is a duty to deduct income tax under section 555 of ICTA. See *Change 156* in Annex 1.

Section 571

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

Section 573

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

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

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

Section 575

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

Section 576

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

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

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

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

3187. Section 576(4) defines a "qualifying trading company" in terms of its being an "eligible trading company" and having been such for a specified continuous period. Section 576(4A) defines an "eligible trading company" by applying the requirements of section 293 and other provisions of Chapter 7 of Part 3 of ICTA (enterprise investment scheme) with modifications. Section 134 of this Act avoids the double layer of definition in section 576(4) and omits the concept of an "eligible trading company".

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

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

Section 576A

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

Section 576B

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

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

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

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

Section 576C

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

Section 576D

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

Section 576E to 576I

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

Section 576J

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

3199. It does not, however, include in *subsection (3)* any cross-reference to section 575(2) of ICTA as it is beyond the scope of this Act to make an amendment to section 575(2) of ICTA for corporation tax purposes corresponding to the amendment to the provisions of that subsection made for income tax purposes in section 136(2) of this Act. See *Change 24* in Annex 1.

Section 576K

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

Section 576L

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

Sections 587B, 587BA and 587C

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

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

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

Sections 710 to 727A

Section 728

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

Section 737E

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

Section 742

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

Section 746

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

Section 780

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

Section 781

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

Section 789

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

Section 798C

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

Section 804

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

Section 807

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

Section 823

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

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

Section 832

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

Sections 835 and 836

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

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

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

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

Section 840A

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

Schedule 16

Paragraph 8

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

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

Paragraph 10(2)

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

3226. The background is as follows.

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

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

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

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

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

Part 2: Other enactments

Taxes Management Act 1970

Section 17

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

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

Section 37A

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

Section 55(1)(c)

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

Section 87

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

Section 98

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

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

Section 99B

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

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

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

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

Finance Act 1988

Section 130

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

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

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

Finance Act 1989

Section 151

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

Finance Act 1991

Section 53

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

Taxation of Chargeable Gains Act 1992

Sections 4 and 6

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

Section 11

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

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

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

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

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

Section 105A

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

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

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

Section 119

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

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

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

Section 125A

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

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

Sections 150A and 150B

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

Sections 151BA to 151BC

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

Section 151BA

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

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

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

Section 151BB

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

Section 151BC

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

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

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

Section 231

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

Sections 256 to 256B

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

Section 257

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

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

Sections 261B and 261C

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

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

Sections 261D to 261E

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

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

Section 263ZA

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

Section 271

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

Section 285A

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

Schedule 5B

Paragraph 13C

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

Paragraph 19

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

Schedule 5C

Paragraph 3

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

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

Finance Act 1994

Schedule 20

Paragraph 11

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

Finance Act 1998

Section 161

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

Finance Act 2000

Section 44

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

Schedule 15

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

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

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

Capital Allowances Act 2001

Section 570B

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

Sections 575 and 575A

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

Finance Act 2002

Schedule 16

3293. Part 7 of this Act, based on Schedule 16 to FA 2002, provides for individuals to obtain income tax reductions for investments in community development finance institutions

(CDFIs). That Schedule continues in force so far as it provides for companies to obtain relief against corporation tax for such investments. The relief is referred to as CITR.

Paragraphs 4 to 7

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

Paragraph 12

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

Paragraphs 40 and 41

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

Paragraph 47

3297. There are two amendments to paragraph 47.

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

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

Paragraph 48

3300. This amendment omits the reference to capital gains tax and corporation tax on chargeable gains in paragraph 48(2). Section 151BC(5) of TCGA, introduced by this Schedule, is based on that sub-paragraph so far as it has effect for those purposes (see the commentary on that new section of TCGA). That sub-paragraph continues to apply for the purposes of CITR for companies. Section 379(2), based on that sub-paragraph, applies for the purposes of CITR for individuals.

Proceeds of Crime Act 2002

Schedule 10

Paragraph 4

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

Income Tax (Earnings and Pensions) Act 2003

Section 48

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

Section 404A

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

Section 476

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

Schedule 5

Paragraph 11(10)

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

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

Finance Act 2004

Section 102

3307. Section 102 of FA 2004 provides that where a payee has suffered deduction on a payment that was in fact exempt under section 758 of ITTOIA, a claim for relief can be made to the Board. This provision has not been rewritten. As a result such claims will be made to an officer of Revenue and Customs. See *Change 5* in Annex 1.

Section 189

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

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

Income Tax (Trading and Other Income) Act 2005

Section 13

3310. Following the House of Lords decision in Agassi v Robinson [2006 UKHL 23][16], section 13 of ITTOIA has been amended to make clear that when a payment or transfer of the type referred to in section 555 of ICTA is made, a liability to income tax will arise regardless of whether there is a duty to deduct income tax under section 555 of ICTA. See *Change 156* in Annex 1.

Section 51

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

Section 108

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

Section 272

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

Section 457

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

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

Section 465A

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

Section 467

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

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

Section 535

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

Section 539

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

Section 619A

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

Section 620

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

Section 624

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

Section 628

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

Section 646A

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

Section 680A

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

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

Section 682

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

Schedule 2

Paragraph 109

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

Finance Act 2005

Schedule 2

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

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

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

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

Finance (No 2) Act 2005

Section 7

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

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

Chapter 3 of Part 7

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

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

Schedule 2: Transitionals and savings

Overview

3337. This Schedule provides transitionals and savings.

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

Part 1: General provisions

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

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

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

Part 2: Changes in the law

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

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

Part 3: Rates at which income tax is charged

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

Part 4: Personal reliefs

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

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

Trade loss relief against general income

Early trade losses relief

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

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

Sideways relief: trade leasing allowances given to individuals

3348. This paragraph relates to an individual who makes a loss for tax year 2006-07 and is denied relief under ICTA for trade leasing allowances because the individual fails to meet the tests concerning the period for which the individual carries on the trade or devotes most of his or her time to it. That person is not to be denied relief for trade leasing allowances in 2007-08 purely because this Act looks to different periods for these tests than would have been the case under ICTA. See *Change 10* in Annex 1.

Reliefs for limited partners not to exceed contribution to the firm

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

Members of LLPs: carry-forward of losses

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

Non-active partners: carry-forward of losses

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

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

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

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

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

Application of existing regulations under sections 114 and 802

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

Loss relief against miscellaneous income: Case VI losses

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

Part 6: Losses on disposal of shares

3355. The transitional provisions in this Part relate principally to the provisions of Chapter 3 of Part 7 of ICTA which are applied, with modifications, by cross-reference for the purpose of the definition of eligible trading company in section 576(4A) of that Act. Section 576(4A) of ICTA was introduced with effect from 6 April 1998 in relation to shares issued on or after that date. The majority of those provisions of Chapter 3 of Part 7 of ICTA, as modified, have been included in full in sections 137 to 146 of this Act for the purposes of share loss relief.

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

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

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

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

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

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

Qualifying trading companies

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

Disposals of new shares

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

The trading requirement

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

The control and independence requirement

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

Relief after an exchange of shares for shares in another company

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

Excluded activities: wholesale and retail distribution

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

Excluded activities: leasing of ships

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

Excluded activities: provision of services or facilities for another business

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

Meaning of company being "in administration"

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

Part 7: Enterprise investment scheme

3371. Part 5 of this Act deals with the enterprise investment scheme (EIS). It has effect only in relation to shares issued on or after 6 April 2007. See the commentary on section 1034(3). One of the effects of section 1034(3) is that the Changes in Annex 1 relating to sections in Part 5 apply only to shares issued on or after 6 April 2007. There is an exception in the case of *Change 56*. See the consequential amendment to section 312(2A) of ICTA, explained in the commentary on that section in Schedule 1.

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

The gross assets requirement

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

Part 8: Venture capital trusts

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

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

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

Part 9: Other reliefs

Interest: loans for investing in co-operatives

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

Gift aid: restrictions on associated benefits

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

Qualifying maintenance payments: maintenance assessments

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

Part 10: Special rules about settlements and trustees

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

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

Discretionary payments: trustees' tax pool

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

Part 14: Tax avoidance

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

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

Individuals in partnership: recovery of excess relief

Individuals claiming relief for film related trading losses

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

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

Part 15: Deduction of income tax at source

Deduction by deposit-takers: discretionary or accumulation settlements

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

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

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

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

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

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

Deduction from certain UK public revenue dividends

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

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

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

Schedule 3: Repeals and revocations

Part 1: Repeals and revocations: general

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

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

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

Schedule 4: Index of defined expressions

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

HANSARD REFERENCES

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

Stage	***Date***	***Hansard or other Parliamentary reference***
House of Commons		
Introduction	7 December 2006	Vol 454 Col 463
Second Reading Committee	17 January 2007	
Second Reading (formal)	22 January 2007	Vol 455 Col 1258
Joint Committee on Tax Law Rewrite Bills		
First Report of Session 2006-2007	8 February 2007	HL 36 2006-07
		HC 268 2006-07
House of Commons		
Third Reading	20 February 2007	Vol 457 Cols 209 to 222
House of Lords		
Introduction	21 February 2007	Vol. 689 Col 1071
Second and third readings	19 March 2007	Vol 690 Cols 1084 to 1094
Royal Assent – 20 March 2007		House of Lords Hansard Vol 690 Col 1135
		House of Commons Hansard Vol 458 Col 683

ANNEX 1:: MINOR CHANGES IN THE LAW MADE BY THE BILL

CHANGE 1: RATES OF TAX: STOCK DIVIDENDS AND RELEASE OF LOANS: SECTION 13

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

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

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

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

In ITEPA and ITTOIA references to “an inspector” in the source legislation which were converted to “the Inland Revenue” (meaning any officer) were also identified as a change. But references to an inspector are treated by section 50(2) of CRCA as references to an officer of Revenue and Customs. It follows that it is no longer appropriate to identify the conversion of such references as a change.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

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

This change gives statutory effect to ESC A86.

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

ESC A86 states that:

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

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

Section 38(4) gives effect to this concession.

THIS CHANGE IS IN TAXPAYERS’ FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

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

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

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

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

The change is taxpayer-adverse in that when calculating whether the taper applies to reduce entitlement to married couple's allowance under section 257AB, it is required that income is determined before the deduction of personal allowance (and if appropriate blind person's allowance and certain life insurance related reliefs). But making this change will bring the law into line with what it was understood was being achieved when the Tax and Civil Partnership Regulations were made.

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

For example, the accounts of the trade could show a loss for the year from 1 July 2003 to 30 June 2004. So the basis period would cover the same period. But the individual must carry on the trade for a continuous period of at least six months in the tax year ending 5 April 2005 and substantially the whole of the individual's time throughout the year ending 5 April 2005 must be given to carrying on the trade.

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

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

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

"(a) the trade is carried on by him for a continuous period of at least six months in, or beginning or ending in, the year of loss as defined in that section; and

(b) he devotes substantially the whole of his time to carrying it on throughout that year or if it is set up or permanently discontinued (or both) in that year, for a continuous period of at least six months beginning or ending in that year.

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

The change also makes it clear that:

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

THIS CHANGE IS IN PRINCIPLE ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

This change provides that for limited partners etc:

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

THE AMOUNT THAT MAY BE TREATED AS A CAPITAL LOSS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

THE RELIEFS TO TAKE INTO ACCOUNT IN DECIDING HOW MUCH OF A TRADING LOSS CAN BE USED AGAINST OTHER INCOME

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

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

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

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

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

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

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

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

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

THE CONDITIONS FOR RECOVERY OF EXCESS RELIEF

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

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

The effect of the change is, broadly, to allow claims for unpaid debts released under arrangements or compromises of a kind corresponding to those covered within the meaning of the former definition, but taking effect under or by virtue of the law of a country or territory outside the United Kingdom. This broadens the scope for taxpayers to make claims and is therefore taxpayer-favourable.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL

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

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

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

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

THIS CHANGE IS IN PRINCIPLE AND IN PRACTICE ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS. IT ALSO AFFECTS WHEN TAX IS PAID AND ADMINISTRATIVE REQUIREMENTS. BUT THE NUMBERS AFFECTED ARE EXPECTED TO BE FEW AND THE AMOUNTS INVOLVED SMALL.

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

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

CONTRIBUTION TO THE FIRM

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

By contrast, for individuals who are limited partners or non-active partners (who are not also members of LLPs), the source legislation restricts sideways or capital gains relief for trading losses by reference to the individual's *contribution to the trade* (see sections 117(3)(a) and 118ZG(2) and (3) of ICTA).

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

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

FIRM CARRIES ON MORE THAN ONE TRADE

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

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

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

As noted earlier, for LLPs a member's contribution is already in terms of the contribution to the LLP. But the source legislation does not explicitly deal with the possibility that an LLP might carry on more than one trade. Therefore to ensure that a consistent policy is applied throughout the sections (ie the relief available is restricted to the amount at risk), the restriction mentioned in the preceding paragraph has been explicitly applied in relation to members of LLPs as well. This is in principle taxpayer-adverse in the case of members of LLPs. See sections 104(7), 105(10), 107(8), 110(7), 111(10), 792(6), 794(6), 800(9) and (10) and 803(4) and Schedule 2 Part 5 (restriction on relief for non-active partners: pre-10 February 2004 events).

POWERS TO MAKE REGULATION IN RELATION TO CONTRIBUTIONS AND REGULATIONS ALREADY MADE

In the case of firms (not LLPs) the powers, in section 118ZN of ICTA and section 122A of FA 2004, are to make provisions excluding amounts from an individual's contribution to the trade.

Consequent on the move to “contribution to the firm”, this Act provides powers that operate in relation to an individual’s contribution to the firm.

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

CONTRIBUTION TO AN LLP

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

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

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

PROFITS OR LOSSES IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRACTICE

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

CAPITALISED PROFITS

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

CONTRIBUTIONS TO A FIRM — TRADING PROFITS NOT DRAWN

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

for both income tax and corporation tax:

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

and for corporation tax only:

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

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

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

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

Case law (Berry v Warnett (1982), 55 TC 92 HL[17] and Bullivant Holdings Limited v CIR (1998), 71 TC 22 ChD[18]) confirms that a bargain may be made at arm's length if a full and fair price is paid. Whether the price is full and fair is to be determined by reference to the circumstances of the disposal and it is clear that the price paid may be full and fair notwithstanding that it is substantially below open market value.

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

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

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

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

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

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

THIS CHANGE IS IN THE TAXPAYER'S FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

The cases in question are those involving:

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

17 [1982] STC 396
18 [1998] STC 905

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

Section 576(5) of ICTA provides that:

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

"before the issue of the new shares the Board have, on the application of the new company or the old company, notified that company that the Board are satisfied that the exchange of shares-

(i) will be effected for bona fide commercial reasons, and

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

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

For capital gains tax purposes, where shares are pooled in a section 104 holding (see section 104 of TCGA) or a 1982 holding (see section 109 of TCGA), the total consideration given for all the shares in the pool is averaged across the shares. This means that, when there is a part disposal of shares out of the holding, a proportion of this consideration is deducted in computing the chargeable gain pro-rata to the number of shares disposed of over the total number of shares in the pool. This may result in an allowable loss on the disposal of such shares being greater than it would have been if the shares had not been pooled.

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

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

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

- where the qualifying shares in a company are treated by virtue of section 127 of TCGA for the purposes of capital gains tax as the same asset as other shares in the same company that are not capable of being qualifying shares or as debentures of the same company (subsections (5) and (6)).

The section has the following effects:

- Subsections (1) and (2) rewrite the provision in section 576(1) of ICTA with two changes.
- The first change is that subsection (2) only applies to shares which are pooled in a section 104 holding or a 1982 holding. It requires the allowable deductions for the qualifying shares to be re-calculated as if the qualifying shares did not form part of the section 104 holding or the 1982 holding. But it does not affect the calculation of the allowable deductions in any other way. For example, if there has been an issue of corresponding bonus shares in respect of original qualifying shares, the re-calculated allowable deductions will be apportioned in the usual way across the original shares and the corresponding bonus shares.
- The second change is that subsection (2) expressly applies if an individual disposes of all the shares in the section 104 holding or the 1982 holding and at some time those shares and other shares which have been disposed of earlier formed part of the same holding (see subsection (1)(b)(ii)). This deals with the effect on the pool allowable cost where the other shares were acquired at a different price from that of the shares now being disposed of. It is a clarification of the scope of the provision in section 576(1) of ICTA.
- Subsections (3) to (6) are new. They are limited to mixed holdings (see the commentary on section 148 and *Change 27*) and deal with the residual situations where the cost of shares which are not within a section 104 holding or a 1982 holding are still averaged. The general provision in subsection (1) is not required for shares which do not form part of a pool. It is only in the case of shares in such a holding that acquisitions and disposals of other shares which at any time formed part of the holding will affect the allowable cost of the qualifying shares disposed of.
- Subsections (3) and (4) deal with the circumstances where the cost of qualifying shares and shares that are not capable of being qualifying shares acquired on the same day are subject to averaging.
- Subsections (5) and (6) ensure that the limit is calculated separately in relation to the qualifying shares in the case of a reorganisation, such as a rights issue, involving qualifying shares and shares that are not capable of being qualifying shares or debentures. In those circumstances, the allowable deductions by reference to which the limit is to be calculated in accordance with this subsection are likely to differ from the cost of acquisition of the qualifying shares calculated in accordance with section 129 of TCGA.

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

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

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

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

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

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

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

At the time of the introduction of this provision by section 37 of FA 1980 and of its consolidation in 1988 as section 576(1) of ICTA, share pooling applied generally for the purposes of capital gains tax. Under share pooling, shares of the same class acquired by the same person in the same capacity are regarded as indistinguishable parts of a single asset. Thus, the consideration given for the shares in the pool is spread evenly across the shares and there is no need for capital gains tax purposes to identify the specific shares disposed of.

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

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

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

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

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

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

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

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

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

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

"Any question as to#

(a) which of any shares acquired by an individual at different times a disposal relates to, being shares to which relief is attributable, or

(b) whether a disposal relates to shares to which relief is attributable or to other shares,

shall for the purposes of capital gains tax be determined as for the purposes of section 299 of [ICTA]…

Section 299(6A) of ICTA provides that:

"Where shares of any class in a company have been acquired by an individual on the same day, any of those shares disposed of by him shall be treated for the purposes of this section as disposed of in the following order, namely—

(a) first any to which neither relief under this Chapter nor deferral relief is attributable;

(b) next any to which deferral relief, but not relief under this Chapter, is attributable;

(c) next any to which relief under this Chapter, but not deferral relief, is attributable; and

(d) finally any to which both relief under this Chapter and deferral relief are attributable;

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

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

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

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

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

- the time at which the gross assets requirement is to be met in accordance with section 293(6A) of ICTA as so applied.

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

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

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

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

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

THESE CHANGES ARE ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT THEY ARE EXPECTED TO HAVE NO PRACTICAL EFFECT AS THEY ARE IN LINE WITH CURRENT PRACTICE.

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

ALTHOUGH THIS CHANGE IN PRINCIPLE AFFECTS THE TIMING OF RELIEF AND COULD BE FAVOURABLE TO SOME TAXPAYERS AND ADVERSE TO OTHERS, IT IS ENTIRELY IN LINE WITH CURRENT PRACTICE AND SO WILL HAVE NO PRACTICAL EFFECT.

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

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

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

Section 289A of ICTA says:

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

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

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

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

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

MULTIPLE ISSUES

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

""the issue" and "and claims EIS relief"

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

RESTRICTED CLAIMS ON A SINGLE ISSUE OF SHARES

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

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

"the amounts subscribed by the individual for each issue.

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

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

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

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

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

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

"all or some of the shares included in the issue

permit a restricted claim.

CONSEQUENTIALS OF RESTRICTED CLAIMS

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

Thus section 201(2) refers to the amounts:

"claimed by the individual in respect of each issue.

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

"subscribed by the individual for each issue.

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED ARE LIKELY TO BE SMALL.

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

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

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

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

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

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

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

and section 291B(5) of ICTA:

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

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

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

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

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

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

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

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

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

represent a change in accordance with this policy and practice.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

"…is eligible for relief… if…

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

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

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

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

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

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

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

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

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

EIS

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

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

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

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

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

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

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

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

"…the holding and managing of property used by a group company for the purpose of research and development from which it is intended -

(i) that a qualifying trade to be carried on by a group company will be derived, or
(ii) that a qualifying trade carried on or to be carried on by a group company will benefit.

VCT

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

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

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

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

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

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

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

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

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

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

“…the holding and managing of property used by a group company for the purpose of research and development from which it is intended—

(i) that a qualifying trade to be carried on by a group company will be derived, or

(ii) that a qualifying trade carried on or to be carried on by a group company will benefit.

SHARE LOSS RELIEF

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

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

THIS CHANGE IS IN TAXPAYERS’ FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

There are three aspects to this change.

THE CHANGE IN SECTION 179(7)

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

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

"In this Chapter "qualifying business activity", in relation to a company, means—

(a) the company or any qualifying 90% subsidiary of that company—

(i) …

(ii) preparing to carry on, or carrying on, a qualifying trade which, on that date, is intended to be carried on wholly or mainly in the United Kingdom by the company *or any such subsidiary* and which is begun to be carried on by the company *or any such subsidiary* within two years after that date,

…, or

(b) the company *or any qualifying 90% subsidiary* of that company carrying on research and development—

(i) which, on the date the shares are issued, the company *or any such subsidiary* is carrying on or which the company *or any such subsidiary* begins to carry on immediately afterwards, and

(ii) from which it is intended that a qualifying trade which the company *or any such subsidiary* will carry on wholly or mainly in the United Kingdom will be derived,…

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

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

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

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

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

THE CHANGE IN SECTION 181(7)

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

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

(a) …

(b) the holding and managing of property used by the company or any of its subsidiaries for the purposes of—

(i) research and development from which it is intended that a qualifying trade to be carried on by the company *or any of its subsidiaries* will be derived; or …

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

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

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

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

THE CHANGE IN SECTION 181(3)

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

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

"The company must throughout the relevant period be -

(a) a company which exists wholly for the purpose of carrying on one or more qualifying trades….or

(aa) the parent company of a trading group.

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

"For the purposes of this section a company is the parent company of a trading group if—

(a) it has one or more subsidiaries;

(b) each of its subsidiaries is a qualifying subsidiary of the company; and

(c) the requirements of subsection (3B) below are fulfilled by what would be the business of the company and its subsidiaries if all the activities, taken together, of the company and its subsidiaries were regarded as one business.

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

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

"If the company intends that one or more other companies should become its qualifying subsidiaries with a view to their carrying on one or more qualifying trades—

(a) the company is treated as a parent company for the purposes of subsection (2)(b), and

(b) the reference in subsection (2)(b) to the group includes the company and any existing or future company that will be its qualifying subsidiary after the intention in question is carried into effect.

This subsection does not apply at any time after the abandonment of that intention.

NOTE

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

VCT (THE VENTURE CAPITAL TRUST SCHEME)

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

SHARE LOSS RELIEF

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

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

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

EIS

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

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

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

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

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

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

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

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

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

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

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

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

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

VCT

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

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

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

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

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

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

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

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

In principle therefore when determining whether a parent company and its group meet the trading requirement, a trade of leasing ships would be an excluded activity if it failed to meet the requirements of paragraph 4(7)(a) to (d) of Schedule 28B to ICTA even if the degree of failure was insubstantial.

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

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

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

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

SHARE LOSS RELIEF

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

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

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

EIS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

SHARE LOSS RELIEF

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

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

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

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

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

EIS

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

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

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

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

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

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

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

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

The reference in this sub-paragraph to a "trade carried on by another *person*" means that section 297(2)(g) of ICTA is clearly applicable in the case where the person carrying on that trade is not a company. But it is not as clearly applicable to a non-corporate person in the particular circumstances of section 297(3)(c)(ii) of ICTA.

The rewrite of section 297(3)(c)(ii) of ICTA in section 193(5)(b) is as follows:

"a substantial proportion of those goods are held for a period which is significantly longer than the period for which the trader would reasonably be expected to hold them while trying to dispose of them at their market value.

VCT

Paragraph 4 of Schedule 28B to ICTA defines a "qualifying trade" and lists a number of activities that may prevent a trade being a qualifying trade. The list includes in paragraph 4(2)(b) the activity of:

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

Paragraph 4(3) and (4) of Schedule 28B to ICTA interpret an ordinary trade of wholesale or retail distribution. Paragraph 4(4) refers to "that person" in sub-paragraphs (a) to (h): "that person" is the person who carries on the trade. The reference in paragraph 4(4)(c) to the "case of a trade carried on by *a company*" concerns a distinct subset of "the trader".

Paragraph 4(3)(c)(ii) of Schedule 28B to ICTA is an exception to paragraph 4(4) of that Schedule because it refers to goods held by the company:

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

This wording could restrict the application of paragraph 4(2)(f) of Schedule 28B to ICTA to paragraph 4(3)(c)(ii) of that Schedule.

Paragraph 4(2)(f) of Schedule 28B to ICTA concerns the activity of:

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

The reference in this sub-paragraph to a "trade carried on by another *person*" means that paragraph 4(2)(f) of Schedule 28B to ICTA is clearly applicable in the case where the person carrying on that trade is not a company. But it is not as clearly applicable to a non-corporate person in the particular circumstances of paragraph 4(3)(c)(ii) of that Schedule.

In section 304(5)(b) of this Act the rewrite of paragraph 4(3)(c)(ii) of Schedule 28B to ICTA is as follows:

"a substantial proportion of those goods are held for a period which is significantly longer than the period for which the trader would reasonably be expected to hold them while trying to dispose of them at their market value.

SHARE LOSS RELIEF

Section 137, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576B of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, both include a definition of "excluded activities" by reference to section 192 (read with sections 193 to 199). This is identical to that applying for the purposes of section 181.

Schedule 2 Part 6 (excluded activities: wholesale and retail distribution) includes a transitional provision relating to this change in section 193 as that section applies for the purposes of section 137 of this Act and section 576B of ICTA. No such transitional provision is required for section 193 as it applies for the purposes of section 181 (see section 1034(3) for the commencement of section 193 as it applies for that purpose).

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 46: EIS and share loss relief: excluded activities: the meaning of trade in relation to the provision of services or facilities for another business: section 199 and Schedule 2Part 6 (excluded activities: provision of services or facilities for another business)

This change simplifies the application of the definition of "trade" in section 298(3) of ICTA.

EIS

Section 297 of ICTA is concerned with the meaning of a qualifying trade. Section 298 of ICTA contains provisions that supplement section 297 of that Act. In particular, section 298(3) of ICTA contains an intricate definition of trade:

"References in this section and in section 297 to a trade shall be construed without regard to so much of the definition of "trade" in section 832(1) as relates to adventures or concerns in the nature of trade; but the foregoing provisions do not affect the construction of references in section 297(2)(g) or subsection (1) above to a trade carried on by a person other than the company and those references shall be construed as including a reference to any business, profession or vocation.

Section 297(2) of ICTA lists a number of activities (called "excluded activities" in the draft rewritten sections) that may prevent a trade being a qualifying trade.

Section 297(2)(g) of ICTA concerns services provided to other businesses and the activities it refers to are:

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

Section 298(1) of ICTA gives the meaning of a controlling interest in a trade.

So the definition of trade in section 298(3) of ICTA differs depending on whether references are to "the company" or "to a person other than the company". "The company" here is the company which provides the services or facilities.

The way the definition applies has been simplified. The meaning of "trade" has been rewritten separately in section 189(2) of this Act (meaning of qualifying trade) as:

"References in this section and sections 192 to 198 to a trade are to be read without regard to the definition of "trade" in section 989.

Section 989 of this Act rewrites section 832(1) of ICTA.

Section 189(2) does not apply to section 199 which rewrites sections 297(2)(g) and 298(1) of ICTA. So section 989 applies to define the reference to "trade" in section 199(5)(b). There is no differentiation in section 199 between "a person other than the company" and "the company".

In section 199 of this Act there are consistent references to "business" rather than "trade". This includes references to "the business carried on by the company". Paragraph 33 of Schedule 15 to FA 2000 (corporate venturing scheme) has been used as a model for this.

Instead therefore of interpreting a trade as including a reference to "any business, profession or vocation", the approach in section 199(5)(b) is the other way round:

""business" includes any trade, profession or vocation.

As with the application of section 989 of this Act to "trade" in section 199(5)(b), there is here no differentiation between "the company" and "a person other than a company"; but here it is in relation to the interpretation that (in effect) trade encompasses a business, profession and vocation.

It appears that this change can have no effect. The "trade carried on by the company" in section 297(2)(g) of ICTA is the trade of providing services or facilities. In whatever way "trade" is interpreted in relation to the provider of the services or facilities in section 199 of this Act, the activity of the provider, (whether this is the issuing company or a qualifying subsidiary) is required to be a qualifying trade for the other purposes of Chapter 4 of Part 5 of this Act.

The change is similar but not identical to *Change 64* in section 310 of this Act (the venture capital trust scheme). The changes get rid of an extra layer of complexity and have little or no practical effect.

SHARE LOSS RELIEF

Section 137, relating to share loss relief under Chapter 6 of Part 4 of this Act, and new section 576B of ICTA introduced by Schedule 1, relating to share loss relief under Chapter 5A of Part 13 of ICTA, both include a definition of "excluded activities" by reference to section 192 (read with sections 193 to 199). This is identical to that applying for the purposes of section 181.

Schedule 2 Part 6 (excluded activities: provision of services or facilities for another business) includes a transitional provision relating to this change in section 199 as that section applies for the purposes of section 137 of this Act and section 576B of ICTA. No such transitional provision is required for section 199 as it applies for the purposes of section 181 (see section 1034(3) for the commencement of section 199 as it applies for that purpose).

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 47: EIS: HMRC to give notice of decisions on compliance certificates: section 204

This change requires an officer of Revenue and Customs to notify his or her decision to a company that requests permission to issue compliance certificates to investors. The change is in line with practice.

Section 306(4) of ICTA prevents a company from issuing a compliance certificate without the permission of an officer of Revenue and Customs. Section 306(10) allows the company to appeal to an independent tribunal against the refusal by an officer of Revenue and Customs to give permission. But there is nothing in section 306 of ICTA obliging an officer of Revenue and Customs to tell the company whether or not permission is given.

Section 204(5) of this Act sets out that:

"If an officer of Revenue and Customs—

(a) has been requested to give or renew an authority to issue a compliance certificate, and

(b) has decided whether or not to do so,

the officer must give notice of the officer's decision to the issuing company.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 48: EIS: "gross amount" of EIS relief used to determine whether maximum relief was obtained and adjustment where bonus shares issued: sections 210, 220 and 229

This change makes it explicit that the "gross amount" of EIS relief is used in determining whether the investor has obtained full relief on the amount subscribed for the relevant shares. That determination may affect the rate at which EIS relief is reduced because of matters such as a receipt of value by the investor.

In certain cases, section 299(4) of ICTA reduces the amount of value that is used to calculate the withdrawal or reduction of EIS relief that was obtained by an individual. The cases are where the claim for EIS relief resulted in the individual obtaining a tax reduction of less than the amount in respect of which relief was claimed, multiplied by the lower rate for the tax year in question.

Section 312(4)(a)(ii) of ICTA provides that for EIS the references to the reduction of relief attributable to any shares includes a reference:

"where no relief has yet been given, to the reduction of the amount which apart from the provision would be the relief.

Section 312(4)(a)(ii) means that EIS relief can be "netted off" in an assessment if some reduction of EIS relief occurs before the assessment is final.

For example, assume the investor is eligible for EIS relief on the issue of shares for which £20,000 was subscribed and that the investor has received value of £5,000 from the issuing company. That value of £5,000 may have been received before the investor's self-assessment (which includes a claim for EIS relief on the subscription of £20,000) is final (or even submitted). Assume also that the investor has a tax liability, ignoring the claim for EIS relief, which is greater than £20,000 multiplied by the lower rate of tax (say 20%) for the year in which the shares are issued. The investor will obtain a "net amount" of EIS relief of £3,000 in the self-assessment.

That relief is composed of a "gross amount" of relief of £4,000 (being the £20,000 subscription multiplied by 20%) less a reduction of that relief of £1,000 (being £5,000 value received multiplied by 20%). The change clarifies that it is the gross amount of £4,000 that must be considered in deciding whether the investor has had relief at the maximum rate and therefore whether section 299(4) of ICTA applies.

If it were not the case that the gross amount of relief is considered for section 299(4) of ICTA then different results could follow according to whether a receipt of value occurred before or after the investor's self-assessment was finalised.

Different results could also follow for investors in a single issue according to the dates on which their individual self-assessments were final for the year concerned.

Finally, in the example given above the 20% rate of reduction to apply to the £5,000 receipt was found by dividing the gross relief (£4,000) by the amount in respect of which relief had been given (£20,000). There would be circularity if the rate of reduction to apply depended on some figure for net relief. That is because the rate of reduction to apply to the £5,000 must be known before one can calculate any figure for net relief.

Sections 210(3), 220(2) and 229(3) of this Act make explicit that regard is to be had to the gross amount of EIS relief in deciding whether or not to multiply value-received etc by the formula

AB

in those sections.

For one special case, each of sections 210(4), 220(3) and 229(4) of this Act provide an exception to the subsection that it follows. That special case is where EIS relief attributable to the relevant shares is reduced and reattributed because of a bonus issue and not because of a receipt of value.

There are corresponding explicit provisions in Schedule 15 to FA 2000 (corporate venturing scheme) - at paragraphs 46(5) and (6) (disposal of shares), 52(2) and (3) (cases where maximum investment relief not obtained) and 56(7) and (8) (value received by other persons).

This change aligns the enterprise investment scheme more closely with the corporate venturing scheme. It will prevent future contentions that regard should be had to something other than the gross amount of EIS relief.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 49: EIS: value received or repayment of share capital reduces EIS relief that was given for two separate tax years: sections 219 and 228

This change provides detailed steps to calculate the withdrawal or reduction of EIS relief in cases where the relief being withdrawn or reduced was obtained for two separate tax years. It applies where the investor receives an amount of value or where a repayment etc of share capital is made to someone other than the investor.

RECEIPT OF VALUE BY THE INVESTOR

Section 300 of ICTA withdraws or reduces EIS relief if the investor receives an amount of value from the issuing company within a certain period. Section 300(1A)(a) says that the amount of any reduction is the amount given by section 300(1B).

The reduction given by section 300(1B) of ICTA is clear in the simplest case (i) where full EIS relief was obtained and (ii) where that EIS relief was obtained for the year in which shares were issued. In such a case, section 300(1B) effectively gives an amount of:

R x L

where

R is the value received by the investor

L is the lower rate of tax for the year in which the share issue took place.

For more complicated cases, section 300(1B) says:

“and section 299(4) above applies for the purposes of this subsection as it applies for the purposes of [section 299(2)].

Those words are clear enough to deal with the case where the investor obtains EIS relief for the year in which the shares were issued but at a rate lower than L.

But those words are not clear as to how section 300(1B) of ICTA deals with cases where EIS relief was obtained both for the tax year in which the shares were issued and for the preceding tax year (carry back cases). In carry back cases, different lower tax rates might apply for the two years involved (and the investor may not have obtained maximum relief for one or both of the years involved).

Section 300(1B) of ICTA contains one indication that it is meant to cater for carry back cases. That indication is the reference in section 300(1B) to L being the lower rate of tax for the tax year:

“for which the relief was given.

There is a second indication that section 300(1B) of ICTA is meant to cater for carry back cases. In the context of an investor treating part of a share issue as having taken place in the previous tax year, section 289B(5) of ICTA says:

"section[s] 299(4) …shall have effect as if that part and the remainder were separate issues.

That second indication is (a) the reference in section 300(1B) of ICTA (quoted earlier) to section 299(4) taken with (b) the reference in section 289B(5) of ICTA to section 299(4) applying as if the issue to the investor was two deemed separate issues in the years concerned. It is unlikely that R is to be used in the withdrawal or reduction calculation for both those deemed issues. That would double count the value received. But none of section 300(1B), section 299(4) or section 289B(5) of ICTA has an explicit apportionment of R between the two deemed issues.

Section 219 of this Act deals explicitly with cases where EIS relief, obtained for two separate years, is reduced as a result of value received in a certain period by the investor. This explicit treatment prevents an alternative construction being put forward (whether adverse or favourable to taxpayers) as to what happens in such cases.

REPAYMENT ETC OF SHARE CAPITAL TO SOMEONE OTHER THAN THE INVESTOR

Section 303 of ICTA withdraws or reduces EIS relief from the investor in cases where someone other than the investor receives certain repayments etc of share capital within a certain period.

In this case section 303(1C) also refers (like section 300(1B) of ICTA) both to:

"lower rate for the year … for which the relief was given

and:

"section 299(4) applies for the purposes of this subsection as it applies for the purposes of [section 299(2)].

Carry back cases may involve different lower tax rates for the two years for which the investor obtains EIS relief (and the investor may have not have obtained maximum relief for one or both of the years involved).

Section 228 of this Act in relation to repayments etc of share capital to someone other than the investor, also deals explicitly with carry back cases. This explicit treatment prevents an alternative construction (whether adverse or favourable to taxpayers) being put forward as to what happens in such cases.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 50: EIS: value received by other persons: prevent multiple reductions of EIS relief: section 224

This change introduces a provision reducing the chances of one receipt of value causing more than one restriction of EIS relief.

It also brings the enterprise investment scheme into closer alignment with the corporate venturing scheme in Schedule 15 to FA 2000. That is because section 224(6) of this Act is based on paragraph 58(1) of Schedule 15 to FA 2000:

"Any repayment shall be disregarded for the purposes of … to the extent to which investment relief attributable to any shares has already been reduced or withdrawn on its account.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 51: EIS: repaying share capital of nominal value equal to the authorised minimum if eligible shares are issued before registrar's certificate: section 230

This change extends the exception from reduction of EIS relief in certain cases where other persons receive value on the repayment of subscriber shares.

Section 303(9) of ICTA and paragraph 58(5) and (6) of Schedule 15 to FA 2000 (corporate venturing scheme) (CVS) provide nearly identical exceptions from section 303 of ICTA and paragraph 56 of that Schedule.

Both exceptions apply in the context of the repayment within a year of issue of shares which were issued to meet certain requirements of company law (the requirements in section 117 of the Companies Act 1985). But there is a minor difference between these two provisions relating to when eligible shares have to be issued.

Section 303(9)(b) of ICTA says (emphasis added):

"after the registrar has issued the company with a certificate under section 117, *it issues eligible shares.*

Paragraph 58(5)(b) of Schedule 15 to FA 2000 says:

"the registrar of companies issues the company with a certificate under section 117.

So paragraph 58(5)(b) can be met even if eligible shares are not issued after the registrar has issued a certificate whereas section 303(9)(b) cannot be satisfied in such a case.

There is no reason why the conditions in section 303(9)(b) of ICTA should be more restrictive than paragraph 58(5)(b) of Schedule 15 to FA 2000 (CVS). Section 230(1)(b) of this Act omits the additional requirement in section 303(1)(b) of ICTA that eligible shares be issued *after* the registrar issues the company with a certificate under section 117 of the Companies Act 1985. That marginally widens the scope of the exception in section 303(9)(b) of ICTA and brings EIS into closer alignment with CVS.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 52: EIS: cases where assessment not to be made after disposal of all shares to which EIS relief is attributable: section 238.

This change limits the shares that need to be taken into account in deciding whether an individual is protected from being assessed by reason of events happening after the individual has disposed of all the shares to which EIS relief is attributable.

Section 307(4) of ICTA says:

"Where a person has, by a disposal or disposals to which section 299(1)(b) applies, disposed of all the eligible shares issued to him by a company, no assessment for withdrawing relief in respect of any of those shares shall be made by reason of any subsequent event unless it occurs at a time when he is connected with the company within the meaning of section 291.

Section 307(4) presents no problems for the majority of cases for which it may be relevant. Those are straightforward cases of an investor whose only connection with a company is a single subscription for shares that are later sold at arm's length in a single transaction. But issues could arise in less straightforward cases.

First, the reference to "*section 299(1)(b) applies*" may suggest that all eligible shares issued to the investor must be disposed of before the end of the relevant period related to their issue (section 312(1A)(a) of ICTA). Consider a case where the investor holds one or more of those shares at the end of the relevant period in question. The investor arguably could never benefit from section 307(4) of ICTA in relation to a later issue of shares by the company concerned.

Second, "*eligible shares*" are referred to but it is not always possible to say at particular times, before the termination date, that a share is an eligible share. That is because section 289(7) of ICTA requires the shares to meet certain conditions over a period of time relating to the date on which the share was issued.

The reference to "eligible shares" might be intended to limit section 307(4) of ICTA to a consideration of just those shares on which it was possible for EIS relief to be claimed by the individual. But eligible shares issued for non-cash consideration would, for instance, not be eligible for EIS relief and could not have EIS relief attributed to them. It would therefore not be possible to dispose of such shares in a way that "*section 299(1)(b) applies*" to the disposal. It is accordingly not clear what the word "eligible" adds or that it is helpful or necessary.

Section 238(2) of this Act is a change from section 307(4) of ICTA . It ignores any shares for which period A (corresponding to the relevant period in the source legislation) has ended. It also ignores shares to which EIS relief is not attributable (whether it is because they are not eligible shares or for some other reason).

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 53: EIS: Interest and Self Assessment: section 239

This change omits provisions that do not fit with Self Assessment in relation to charging interest on assessments. The omitted provisions are sections 306(9) and 307(6)(a) and (aa) and (7) of ICTA.

Section 306(9) of ICTA says:

"For the purposes of section 86 of the Management Act (interest on overdue tax), tax charged by an assessment—

(a) shall be regarded as due and payable notwithstanding that relief from the tax (whether by discharge or repayment) is subsequently given on a claim for the relief; but

(b) shall, unless paid earlier or due and payable later, be regarded as paid on the date of the making of the claim on which the relief is given;

and section 91 of that Act (effect on interest of reliefs) shall not apply in consequence of any discharge or repayment for giving effect to the relief.

Apart from immaterial differences, section 306(9) of ICTA is the same as section 61(7) of FA 1981 (the provision from which it originates). FA 1981 was enacted approximately 15 years before Self Assessment came into force.

In 1981 it was standard practice for separate Schedular assessments (often estimated) to be made by HMRC (then the Inland Revenue). At that time, parts of the income tax liability of an individual for a single year could have different due and payable dates. Different due dates could arise because:

- of the Schedule under which parts of the individual's total income fell; and
- of the date that each part of that total income was (separately) assessed by the HMRC.

HMRC would typically make an assessment to income tax and issue a notice of that assessment to the individual showing when the assessed tax was due and payable. Interest on overdue income tax was determined by reference to the date on which the assessed tax was due and payable under the assessment.

The individual might later claim that, say, relief under Chapter 2 of Part 4 of FA 1981 (relief for investment in new corporate trades, but referred to in this note as BSS (business start-up scheme) relief) should be given. If satisfied that relief was due, HMRC might:

- send the individual notice of an amended assessment incorporating BSS relief; and
- repay the amount, if any, that had been paid by the individual in relation to the original notice of assessment but which was no longer due under the amended assessment.

HMRC were therefore heavily involved in making assessments to income tax and in giving effect to claims for relief against that tax. That meant HMRC knew from their records when:

- an assessment to income tax had been made and notice of it given to the individual;
- a claim for relief against income tax had been made;
- a revised assessment had been made to give effect to the relief; and
- a repayment had been made as a result of the revised assessment.

It is significant that section 61(1)(a) of FA 1981 then prevented claims for BSS relief during the tax year to which they related (an in-year claim). This rule meant that BSS relief was not allowed in the form of a PAYE coding adjustment either.

This prevention of in-year claims in turn raised issues related to the possibility of different payment dates existing for parts of an individual's income tax liability by reason of Schedular assessing. For instance, Schedule A assessments for a tax year normally had a payment date in the tax year (an in-year payment date). It would have been inconsistent to prevent in-year claims to relief and yet allow some individuals to achieve the same effect as an in-year claim by claiming BSS relief against, say, Schedule A assessments that had in-year payment dates.

That potential inconsistency was overcome by section 61(7) of FA 1981 providing that, despite section 91 of TMA (effect on interest of reliefs), interest would continue to be charged on tax due under an assessment until the date that a claim for BSS relief was made to HMRC.

The rule against making in-year claims was relatively short-lived. In relation to the relief in Schedule 5 to FA 1983 (business expansion scheme - BES) which replaced BSS relief, the rule was not reproduced in paragraph 13(1) of Schedule 5 (claims). And paragraph 13(7) of Schedule 5 even contemplated BES relief being given in the form of a PAYE coding adjustment.

Self Assessment made significant changes to the system that had applied in 1981. Three such changes are mentioned here:

- the individual now makes most assessments as part of the individual's tax return;
- tax payment dates no longer vary with the type of income involved; and
- much less HMRC involvement is required for claims as they can form part of the individual's self-assessment.

Section 306(9) of ICTA has not been rewritten, as it is not readily compatible with Self Assessment. Omitting this provision will result in claims for EIS relief being treated in the same way for Self Assessment as any other claim. In principle, this part of the change is favourable to taxpayers as section 91 of TMA may operate to relieve them of liabilities to interest that were not previously relievable. In practice, this change is expected to have no impact.

Section 307(6)(a) and (aa) and (7) of ICTA say:

"(6) In its application to an assessment made by virtue of this section, section 86 of the Management Act (interest on overdue tax) shall have effect as if the relevant date were—

(a) in the case of relief withdrawn by virtue of section 289(6) or 299B(1)—

(i) so far as effect has been given to the relief in accordance with PAYE regulations, 5th April in the year of assessment in which effect was so given;

(ii) so far as effect has not been so given, the date on which the relief was granted;

(aa) in the case of relief withdrawn by virtue of section 289(1)(c) or (d), the date on which the relief was granted;

(7) For the purposes of subsection (6) above the date on which the relief is granted is the date on which a repayment of tax for giving effect to the relief was made or, if there was no such repayment, the date on which the inspector issued a notice to the claimant showing the amount of tax payable after giving effect to the relief.

Section 62(6) and (7) of FA 1981 had rules about charging interest on a withdrawal of BSS relief by a separate assessment (later assessment) made after BSS relief had been given against an earlier assessment (original assessment). In most cases interest ran from the date of the event that caused the later assessment to be made.

But in one case (avoidance), the withdrawal of BSS relief was in broad terms intended to restore the position to the same as if the relief had never been given. In that case, the later assessment could not simply provide for interest to run from the normal date on which interest would have been chargeable under the original assessment. That was because interest might have been charged in relation to the original assessment up to the date that BSS relief was claimed (see earlier discussion on section 61(7) FA 1981). The later assessment had to take account of such a possibility.

So a concept of "the date on which the relief is granted" was defined and used as the date from which interest would be charged in this case. That concept naturally used typical pre-Self Assessment actions of HMRC issuing a notice of assessment giving effect to the claim or making a repayment of income tax to give effect to the claim.

Section 307(6)(a) and (aa) of ICTA set out the cases in which withdrawal of EIS relief is intended, broadly, to restore the position to the same as if the relief had never been given. And the pre-Self Assessment concept of "the date on which the relief is granted" lingers on in section 307(7) of ICTA. This concept does not fit with Self Assessment.

With the omission of section 306(9) of ICTA (see earlier) the reason for the provisions in section 307(6)(a) and (aa) and (7) of ICTA cease to exist. So the rules in section 307(6)(a) and (aa) and (7) have not been rewritten either.

This means there will be no special rule about assessments that withdraw relief in the cases set out in section 307(6)(a) and (aa) of ICTA (avoidance: pre-arranged exits and time limit for use of money). Such assessments will be dealt with under Self Assessment in the same way as any other assessments.

In principle this part of the change is unfavourable to taxpayers as it will prevent them contending that the legislation is deficient in such a way that interest should not be charged in relation to matters contemplated by section 307(6)(a) and (aa). But it is unlikely that such cases will be met.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 54: EIS: information provided by the issuing company and persons connected with the issuing company in respect of certain events: section 241

This change provides a link between (i) the requirement that the issuing company and any person connected with the issuing company provide notices of certain events and (ii) the requirement that the issuing company provides information in a compliance statement (covered by section 205) of this Act. The change also gives the issuing company a longer period to provide a notice to an officer of Revenue and Customs in one particular case.

The change aligns EIS more closely with a similar provision in the corporate venturing scheme (CVS).

Section 241 of this Act is based on section 310 of ICTA. Section 310(2) of ICTA says that:

> "(2) Where an event occurs by reason of which any relief in respect of any shares in a company falls to be withdrawn by virtue of section 289(1)(ba), (c) or (d), 293, 300, 302 or 303, or would fall to be withdrawn under section 300 were it not for the application of section 300A,—
>
> (a) the company; and
>
> (b) any person connected with the company who has knowledge of that matter;
>
> shall within 60 days of the event or, in the case of a person within paragraph (b) above, of his coming to know of it, give a notice to the inspector containing particulars of the event ...

From those words it may be thought that the company and connected person are expected to know whether an individual investor has obtained EIS relief. Alternatively it may be thought that information of the specified events must be provided to the officer of Revenue and Customs (i) whether or not any investor has obtained relief and (ii) whether or not the company has provided a statement under section 306(3) of ICTA. EIS relief cannot be obtained without the issuing company having provided a statement under section 306(3) to the officer of Revenue and Customs.

Section 241(1) of this Act resolves these difficulties by tying the requirement to provide notice of the events listed to:

- the submission by the issuing company of a compliance statement; and
- a supposition that EIS relief has been obtained.

This follows paragraph 65(1) of Schedule 15 to FA 2000 (CVS).

Section 310(2) of ICTA provides for the case of a connected person having no initial knowledge of an event. The connected person is given 60 days from when that person comes to know of the event. Section 310 does not provide for the case of an issuing company having no initial knowledge of a receipt of value, under section 300 of ICTA, from a person connected to the company.

Section 241(4)(b) of this Act provides an alternative period of notice for the issuing company if the event is a receipt of value, within section 216(2), from a person connected to the company under section 221. This follows paragraph 65(4)(b)(ii) of Schedule 15 to FA 2000 (CVS).

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 55: EIS: share transfers between spouses or civil partners: section 245

This change expands the assumptions that are made in relation to transfers between spouses or civil partners of shares to which EIS relief is attributable. Section 245(2)(b) and (d) and subsection (3) ensure that the step in shoes treatment works in all situations in relation to any subsequent event.

Section 304(2)(a) of ICTA provides that the transferee is treated as though he or she had subscribed for the shares. Section 245(2)(b) of this Act makes it explicit that the transferee is treated as having subscribed for the shares *the amount* that was subscribed by the transferor.

Section 304(2)(b) of ICTA says that the transferee's liability to income tax is treated as having been reduced for the same year as the transferor's liability to income tax was reduced. Section 245(2)(d) of this Act makes it explicit that this deemed reduction in the transferee's liability should be the same as the reduction obtained by the transferor.

Change 48 discusses the clarification of what the gross amount is in cases where, for instance, the transferor receives value from the issuing company before the transferor obtains EIS relief. Section 245(3) of this Act provides that the effect on EIS relief in these circumstances is unaffected by a transfer of shares between a husband and wife and civil partners. It does this as follows:

- Subsection (3)(a) carries over to the transferee any reduction in the EIS relief attributable to the shares in respect of the transferred shares.
- Subsection (3)(b) provides that the transferee's treatment will be the same as the transferee's would have been in cases where sections 210(3), 220(2) and 229(3) are relevant. These are concerned with the reduction of EIS attributable to relevant shares before EIS relief is obtained in cases involving disposal, the receipt of value by the investor and the receipt of value by other persons. Since these are three distinct cases, the required effect in subsection (3) is achieved by cross-referring to those provisions rather than attempting to reproduce their contents.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 56: EIS, VCT and share loss relief: the meaning of "a company being in administration": sections 252 and 331, Schedule 1 (section 312(2A) of ICTA and paragraph 11(10) of Schedule 5 to ITEPA) and Schedule 2Parts 6 and 8 (meaning of company being "in administration")

This change updates and extends the definition of administration by referring to the meaning within Schedule B1 to the Insolvency (Northern Ireland) Order 1989 (SI 1989/2405 (NI 19)) and adapting this and the meaning within Schedule B1 to the Insolvency Act 1986 to provide for a similar interpretation of an administration outside the UK. The result is that the meaning of a company "in administration" is widely drawn whichever rules on administrations apply.

The change applies to the enterprise investment scheme (EIS) and to venture capital trusts (VCT). The relevant provisions in ICTA are section 312(2A)(a) (EIS) and paragraph 11A(2)(a) of Schedule 28B (VCT). The change also applies to enterprise management incentives (EMI) under Schedule 5 to ITEPA and to share loss relief under Chapter 6 of Part 4 of this Act, because these provisions use the EIS definition of "in administration".

Paragraph 11(10) Schedule 5 to ITEPA applies section 312(2A) of ICTA to EMI.

Section 576(4A) of ICTA (share loss relief) reads across into the EIS provisions in section 293 of that Act. In rewriting that read across in Chapter 6 of Part 4 of this Act, section 138(5) applies section 252. Section 141(2) applies the definition of "qualifying 90% subsidiary" in section 190 and sections 137(7), 139(2), 140(2) and 142(4) all apply the definition of "qualifying subsidiary" in section 191. Sections 190 and 191 both in turn apply section 252.

Schedule B1 to the Insolvency (Northern Ireland) Order 1989 (SI 1989/2405 (NI 19)) was inserted by Schedule 1 to the Insolvency (Northern Ireland) Order 2005, (SI 2005/1455 (NI 10)) with a commencement date of 27 March 2006 under SR (NI) 2006 No.21 (CI). This new Schedule B1 is the equivalent to Schedule B1 to the Insolvency Act 1986 inserted by the Enterprise Act 2002. Paragraph 1(2) of both Schedules B1 provides that:

"(a) a company is "in administration" while the appointment of an administrator of the company has effect,

(b) a company "enters administration" when the appointment of an administrator takes effect.

So the references to an administration order under Part 3 of the Insolvency (Northern Ireland) Order 1989 in the definition of a company in administration in section 312(2A)(a)(i) of and paragraph 11A(2)(a)(i) of Schedule 28B to ICTA are now out of date.

To remedy this, the opening words and sub-paragraph (i) of section 312(2A)(a) of and paragraph 11A(2)(a) of Schedule 28B to ICTA are replaced in sections 252(2)(a) and 331(2)(a) of this Act by:

"A company is "in administration" if-

(a) it is in administration within the meaning of Schedule B1 to the Insolvency Act 1986 *or Schedule B1 to the Insolvency (Northern Ireland) Order 1989*

The reference to a "corresponding order" under the law of a country or territory outside the United Kingdom in section 312(2A)(a)(ii) of and paragraph 11A(2)(a)(ii) of Schedule 28B to ICTA is no longer appropriate since there is no reference to "order" in the UK context. The intention is to provide for equivalent legislation so far as this can be expressed. Sections 252(2)(b) and 331(2)(b) of this Act, therefore, provide:

"(b) There is in force in relation to it [the company] under the law of a country or territory outside the United Kingdom any appointment corresponding to an appointment of an administrator under either of those Schedules.

There is a similar example of the drafting providing for equivalent legislation outside the UK, so far as this is possible, in section 12(7ZA) of ICTA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 57: EIS: conditions to be met over a period: section 257

This change makes it explicit that EIS relief can be obtained even though future events could mean that the relief is not due. That is consistent with practice and the corporate venturing scheme (CVS).

Whether an individual is eligible for EIS relief in respect of an issue of shares normally depends on certain conditions being met for at least three years after the issue has taken place.

The framework of the EIS scheme indicates, in various places, that claims for the relief may be made even though the relief may ultimately not be available because of future events, so on a provisional basis. One example is that section 307(1) of ICTA contemplates an assessment being made to withdraw:

"relief … which is subsequently found not to have been due…

Predecessors to the EIS scheme were more explicit about the existence of a provisional basis. Thus for the business expansion scheme (BES), section 289(9) and (10) of ICTA (prior to any later amendments) read:

"(9) A claim for relief may be allowed … if the conditions for relief are then satisfied.

(10) In the case of a claim allowed before the end of the relevant period, the relief shall be withdrawn if by reason of any subsequent event it appears that the claimant was not entitled to the relief allowed.

CVS addresses this aspect by referring, where appropriate, to requirements "being met for the time being" and paragraph 102(7)(a) of Schedule 15 to FA 2000 (CVS) says:

"In the case of a requirement that cannot be met until a future date—

(a) references…to a requirement being met for the time being are to nothing having occurred to prevent its being met.

Section 257(8) of this Act is based on this extract from paragraph 102(7)(a) of Schedule 15 to FA 2000 (CVS). The wording of section 204(1)(b) (compliance certificates) and section 205(1)(a) (compliance statements) has been adapted so that section 257(8) applies: the references to requirements for EIS relief being "for the time being met". This makes explicit the operation of the provisional basis for EIS.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 58: VCT: definition of eligible shares for VCT relief: section 273 and Schedule 2Part 8 (interpretation of Chapter 2)

This change prevents the contention that section 73(1)(b) of FA 1998 was ineffective in deleting the word "preferential" from the definition of "eligible shares" in paragraph 6(1) of Schedule 15B to ICTA.

Paragraph 6(1), in common with section 842AA(14) of ICTA, originally defined "eligible shares" in terms of shares in a company which:

"carry no present or future preferential right to dividends or…assets on its winding up and no present or future *preferential* right to be redeemed.

Section 73(1)(b) of FA 1998 omitted the italicised reference to "preferential". Section 73(6) of FA 1998 provided that the omission had effect:

"for the purpose of determining whether shares or securities are, as at any time on or after 6th April 1998, to be regarded as comprised in a company's qualifying holdings…

Section 73(1)(a) of FA 1998 made a similar omission of the word "preferential" from section 842AA(14) of ICTA .

Section 73(6) of FA 1998 sits well with section 73(1)(a) because section 842AA deals with a company's qualifying holdings; but paragraph 6(1) is in Part 1 of Schedule 15B to ICTA which deals with whether or not an individual is eligible for VCT relief on particular shares.

FA 1998 also omitted the word "preferential" in relation to other provisions associated with venture capital schemes. These omissions were from:

- section 289(7) of ICTA (enterprise investment scheme);
- section 150(8A) of TCGA (business expansion scheme);
- section 150A(8A) of TCGA (enterprise investment scheme); and
- paragraph 9(2) of Schedule 5B to TCGA (enterprise investment scheme: reinvestment).

Section 74(3) of FA 1998 provided that those omissions had effect:

> in relation to shares issued on or after 6th April 1998.

It seems likely that similar wording should have been used in relation to the omission in section 73(1)(b) of FA 1998.

The words quoted earlier from section 73(6) FA 1998 are not reproduced in relation to section 273(1) of this Act. This prevents the contention that section 73(1)(b) of FA 1998 was ineffective in omitting the word "preferential" in paragraph 6(1) of Schedule 15B to ICTA.

Part 8 of Schedule 2 to this Act (interpretation of Chapter 2) ensures that this change does not apply to shares issued before 6 April 2007.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 59: VCT: conditions relating to value of investments: sections 278 and 285 and Schedule 2Part 8 (conditions relating to value of investments)

This change makes clear how the test in section 842AA(2)(d) of ICTA (referred to in this note as the 15% test) operates. It also makes clear how definitions in section 842 of ICTA apply for the purposes of 842AA(5) of that Act, which itself defines the value of a holding for the purposes of the tests in section 842AA(2) (b) to (d).

Section 842AA(11) of ICTA applies certain provisions of section 842 of ICTA to section 842AA and these have been included in the rewrite of section 842AA.

The opening words of section 842AA(11) are:

"The following provisions of section 842 shall apply for the purposes of this section as they apply for the purposes of that section,…

Section 842AA(11)(a) provides that the conditions relating to the 15% test in section 842 shall apply to the equivalent test in section 842AA(2)(d):

"subsections (1A) and (2) of that section [section 842] shall apply in relation to subsection (2)(d) above (but with the omission of subsection (2)(a) of that section) as they apply in relation to subsection (1)(b) of that section.

Section 842AA(11)(c) then further provides:

"without prejudice to their application in relation to provisions applied by paragraph (a) or (b) above, subsections (3) and (4) of that section [section 842] shall apply in relation to any reference in this section to a holding or an addition to a holding as they apply in relation to any such reference in that section.

Section 842(3) defines a holding for the purpose of section 842(2). It states that:

> ""holding" means the shares or securities (whether of one class or more than one class) held in any one company.

Section 842(3) also defines an addition to a holding and explains what happens if there is a scheme of reconstruction.

It is not clear how the definitions in section 842(3) apply to section 842AA(5). Section 842AA(5) deals with the valuation of a holding and the circumstances under which this is revalued for the purpose of the conditions in section 842AA(2)(b) to (d).

It is possible to read the definitions in section 842(3) as applying only to the 15% test in section 842AA(2)(d) since the definition is of a holding "in any one company". Section 842AA(2)(d) refers to a holding "in any company" and there are no other examples of this sort of phraseology in section 842AA. In addition the definition in section 842 is of shares or securities (*whether of one class or more than one class*) while section 842AA(5) refers to a holding "of investments *of the same description*" and additions to such holdings. Furthermore it is not obvious how both the applied provisions in section 842 and section 842AA(5) can apply to this test given the wording of section 842AA(11)(c).

But the wording of section 842AA(11)(c) "any reference in this section to a holding or an addition to a holding" suggests that there is more than one such reference to which section 842(3) applies. In addition, if section 842(3) does not apply to section 842AA(5), there is no explicit guidance on the interpretation of an addition to a holding of investments. Also section 842AA(5) applies to all the percentage tests (the 70%, 30% and 15% tests).

In practice the provisions have been interpreted on the basis that it is necessary to establish whether or not a holding has been added to in accordance with section 842(3), when an investment of any description is added to a holding of shares or securities.

Then the rules in section 842AA(5) are applied to revalue only the holding of investments of the same description as the investment added when applying the 15% test in section 842AA(2)(d).

The sections of this Act are based on this approach and remove the possible doubt about the way in which section 842 and section 842AA of ICTA interact.

Section 277 of this Act sets out the section 842 of ICTA rules about when and how the 15% test applies. (In Part 6 of this Act the 15% test is called "the 15% holding limit condition".)

In section 278 of this Act which rewrites section 842AA(5) of ICTA and is concerned with the way a holding is valued when there is an addition, the section 842(3)(b) and (c) and section 842(4) definitions are adapted to the terminology in section 842AA(5).

The effect of this is that the rules in section 278 apply to the 15% holding limit condition when there is an addition to investments of any description in the same way as they apply to the 70% qualifying holdings condition and the 30% eligible shares condition. A revaluation is required only of the holding of investments of that description. This is in line with interpretation and practice.

There is a transitional provision in Schedule 2 the purpose of which is to preserve the effect of section 842AA(11)(c) of ICTA on the 15% test where there is an addition to investments held by a company before 6 April 2007.

Section 285

This Change also has an impact on the interpretation of references to investments in section 285 of this Act.

Paragraph 8 of Schedule 14 to FA 2006 provides an interpretation of the references to a company's investments in section 842AA of ICTA. Paragraph 8(1) also provides that the interpretation applies to references to investments in section 842(2)(b) of ICTA as this provision is applied to section 842AA.

The FA 2006 provisions do not extend this interpretation explicitly to the definitions in section 842(3) of ICTA which section 842AA(11)(c) applies to section 842AA.

The interpretation of investments in section 285(4) to (6) of this Act applies to the whole of Chapter 3 of Part 6. It therefore covers the reference to investments in section 278(4), which is derived in part from section 824(3) of ICTA. This subsection provides a definition of an addition of a holding for the purposes of valuing a holding of investments of any description. Applying the interpretation to this reference accords with the intention that the FA 2006 interpretation would be applied consistently in section 842AA of ICTA.

The transitional provision for section 285 in Schedule 2 to this Act, is based on the commencement rule in paragraph 8(2) of Schedule 14 to FA 2006 and applies the interpretation from 6 April 2007.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 60: VCT: excess over the maximum qualifying amount: section 287 and Schedule 2Part 8 (the maximum qualifying investment requirement)

This change provides that an investment in excess of the maximum qualifying investment is ignored in relation to later investments in the same company.

Paragraph 7 of Schedule 28B to ICTA prevents an issue of shares or securities (the relevant holding) from being a "qualifying holding" to the extent that the "maximum qualifying investment" is exceeded for the "relevant period" at the time of the issue. Paragraph 7(2) and (5) define "maximum qualifying investment" and the beginning of the "relevant period" as follows:

"the maximum qualifying investment for any period is exceeded to the extent that the aggregate amount of money raised in that period by the issue to the trust company during that period of shares in or securities of the relevant company exceeds £1 million.

and:

"For the purposes of this paragraph the relevant period is the period beginning with whichever is the earlier of

(a) the time 6 months before the issue of the relevant holding; and

(b) the beginning of the year of assessment in which the issue of that holding took place.

The following example illustrates how paragraph 7 operates in relation to issues of shares or securities by company A to a VCT in the amounts and on the dates shown.

Relevant period starts	*Issue date*	*£ Amount raised by A from VCT on issue date*	*£ Amount(s) raised by A from VCT in relevant period*	*£ Excess of Y over maximum qualifying investment. = "excess part of X"*	*£ Amount of X within maximum qualifying investment*
		X	*Y*	*Z*	X less Z
6/4/04	31/3/05	600,000	600,000	nil	600,000
3/12/04	3/6/05	800,000	1,400,000	400,000	400,000
6/4/05	31/12/05	500,000	1,300,000*	300,000	200,000

The intention was that the cumulative amount raised (column Y in the table) should only include earlier amounts raised to the extent that those amounts had fallen within the final column. So the asterisked total in the final row should be £900,000 and all of the £500,000 raised on 31 December 2005 should fall within the final column. Practice has reflected that intention.

Section 287(3)(b) of this Act reflects the practice of not "double counting" an amount that represents an excess over the maximum qualifying investment within a relevant period.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 61: VCT: the trading requirement and the carrying on of a qualifying trade requirement: sections 290, 291 and Schedule 2Part 8 (the trading requirement and the carrying on of a qualifying activity requirement)

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

There are three aspects.

THE CHANGE IN SECTION 290(2)

Paragraph 3(2) of Schedule 28B to ICTA requires that:

"The relevant company must be one of the following -

(a) a company which exists wholly for the purpose of carrying on one or more qualifying trades….or (aa) the parent company of a trading group.

This is rewritten in section 290(1) of this Act.

The parent company of a trading group is defined in paragraph 3(6):

"For the purposes of this paragraph a company is the parent company of a trading group if—
- (a) it has one or more subsidiaries;
- (b) each of its subsidiaries is a qualifying subsidiary of the company; and
- (c) the requirements of sub-paragraph (7) are fulfilled by what would be the business of the company and its qualifying subsidiaries if all the activities, taken together, of the company and its qualifying subsidiaries were regarded as one business.

This is rewritten in section 290(3) of this Act (and in section 298, the qualifying subsidiaries requirement, and in section 332, by the definition of "parent company").

Change 61 ensures that a relevant company can qualify as a parent company if there is the intention that one or more companies will become a qualifying subsidiary.

The new provision in section 290(2) states:

"If the relevant company intends that one or more other companies should become its qualifying subsidiaries with a view to their carrying on one or more qualifying trades—
- (a) the relevant company is treated as a parent company for the purposes of subsection (1)(b), and
- (b) the reference in subsection (1)(b) to the group includes the relevant company and any existing or future company that will be its qualifying subsidiary after the intention in question is carried into effect.

This subsection does not apply at any time after the abandonment of that intention.

THE CHANGE IN SECTION 290(6)

R&D is covered by the deeming provision in paragraph 4(1) of Schedule 28B to ICTA:

"the carrying on of any activities of research and development from which it is intended there will be derived a trade … shall be treated as the carrying on of a qualifying trade.

There are no requirements in this provision as to which company carries on the trade deriving from R&D.

Paragraph 3(9)(b)(i) of Schedule 28B to ICTA says (emphasis added):

"(9) Activities of a company or of any of its qualifying subsidiaries shall be disregarded for the purposes of sub-paragraphs (6) to (8) above to the extent that they consist in—
- (a) …
- (b) the holding and managing of property used by the company or any of its qualifying subsidiaries for the purposes of—
  - (i) research and development from which it is intended that a qualifying trade to be carried on by the company *or any of its qualifying subsidiaries* will be derived; or …

The provision is rewritten in section 290(5)(d) of this Act (with "a group company" instead of "the company or any of its qualifying subsidiaries" and with the impact of *Change 41* which extends the R&D in the frame to R&D that will benefit a qualifying trade).

Section 290(6) of this Act provides an interpretation of group company (as defined in section 332), which makes it clear that here this includes future group companies:

"Any reference in sub-paragraph (i) or (ii) of subsection (5)(d) to a group company includes a reference to any existing or future company which will be a group company at any future time.

NOTE

Section 290(2) and (6) of this Act do not specify that the company that is not yet part of the group has to be a qualifying 90% subsidiary. But the relevant company in section 290 has also to comply with other requirements such as those in sections 291, 293 and 294. This will determine whether the new subsidiary is required to be a qualifying subsidiary or a qualifying 90% subsidiary.

THE CHANGE IN SECTION 291(8)

Section 291 of this Act is based on paragraph 3(3), (4), (5), (5A) and (5B) of Schedule 28B to ICTA.

Paragraph 3(3)(b) and (4)(a) of Schedule 28B to ICTA set out certain required activities for a qualifying company (emphasis added):

"(3) Subject to sub-paragraph (4) below, when the relevant holding was issued and at all times since, a qualifying company (whether or not the same such company at every such time) must have been either

…. or

(b) preparing to carry on a qualifying trade which at the time when the relevant holding was issued was intended to be carried on wholly or mainly in the United Kingdom by *a qualifying company*

(4) The requirements of sub-paragraph (3) shall not be capable of being satisfied by virtue of paragraph (b) of that sub-paragraph at any time after the end of the period of 2 years beginning with the issue of the relevant holding unless

(a) the intended trade was begun to be carried on by *a qualifying company* before the end of that period, and …

A "qualifying company" is defined in paragraph 3(5A) as:

"the relevant company or any relevant qualifying subsidiary of that company.

A relevant qualifying subsidiary is defined in paragraph 5A of Schedule 28B to ICTA. This is rewritten as a qualifying 90% subsidiary in section 301 of this Act.

There is an indication in paragraph 3(5B) of Schedule 28B to ICTA that participation as a qualifying company is not restricted to existing subsidiaries (this is in relation to the commencement of the trade in paragraph 3(4)(a) of that Schedule).

This is also the intention behind the references to a qualifying company in paragraph 3(3)(b) of Schedule 28B to ICTA, rewritten in section 291(3). This phrase includes a subsidiary that is acquired after the date the shares are issued so long as other requirements such as those in paragraph 6 (2B) to (2AG) of that Schedule, rewritten in section 294 of this Act, are met.

But, to make this clearer, section 291(8) of this Act provides an interpretation of the reference in subsection (7) to a qualifying company which is a qualifying 90% subsidiary:

"The reference in subsection (7) to a qualifying company which is a qualifying 90% subsidiary of the relevant company includes, in its application to subsection (3), a reference to any existing or future qualifying company which will be a qualifying 90% subsidiary of the relevant company at any future time.

EIS (THE ENTERPRISE INVESTMENT SCHEME) AND SHARE LOSS RELIEF

There is a parallel to these changes in Part 5 (EIS) and to the changes in section 290(2) and (6) in section 137(2) and (6) of this Act and new section 576B(3) and (7) of ICTA relating to share loss relief.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 62: VCT: trades whose carrying on by other persons prevents the relevant holding being a qualifying holding: section 294 and Schedule 2Part 8 (the relevant company to carry on the relevant qualifying activity requirement)

This change identifies more clearly the cases in which the carrying on of trades etc by other persons prevents a relevant holding from being a qualifying holding for the purposes of Chapter 3 of Part 6 (VCT approvals). The trade etc which is later carried on by other persons must be one for which money was raised by the issue of the relevant holding.

Paragraph 6(1) of Schedule 28B to ICTA (so far as relevant) provides that (emphasis added):

"The *requirements of this paragraph are* that…the money raised by the issue of the relevant holding…been employed wholly for the purposes of *the trade* by reference to which the requirements of paragraph 3(3)…are satisfied…

From paragraph 6(2) and (2AA) it is reasonably clear that *the trade* in question must either have been carried on when the relevant holding was issued or have been one for which preparations to carry it on were then being made.

There is nothing preventing the relevant company from carrying on, or preparing to carry on, more than one trade when it issues the relevant holding. In such a case, if the relevant holding is issued to raise money for one of those trades (the funded trade), that trade will be *the trade* and the other trade(s) (unfunded trade(s)) will not.

Paragraph 6(2AB) of Schedule 28B (so far as relevant) provides that (emphasis added):

"The *requirements of this paragraph are not satisfied if…the trade* by reference to which the requirements of paragraph 3(3) are satisfied, and any preparations for that trade falling within paragraph 3(3)(b)…, are carried on…by a person other than the relevant company or a relevant qualifying subsidiary of that company.

Paragraph 6(2AB) refers to *the trade* for the purpose of determining if the requirements of paragraph 6 are not met. Paragraph 6(1) refers to *the trade* for the purpose of determining if the requirements of paragraph 6 are met. There is no explicit link between the trades referred to in each of these sub-paragraphs.

So it is arguable that, under paragraph 6(2AB), the subsequent carrying on of an unfunded trade by another person (not the relevant company or a relevant qualifying subsidiary of that company) prevents the relevant holding from satisfying paragraph 6; and that this result is unaffected by the relevant company continuing to carry on the funded trade.

But, in context, it is likely that paragraph 6(2AB) is limited to cases where the trade in question is the funded trade (the one that allowed the requirement of paragraph 6(1) to be met). That appears to be the more rational result and it is how HMRC interpret paragraph 6(2AB) of Schedule 28B to ICTA.

And a broadly similar provision in section 289(1A) of ICTA (enterprise investment scheme) looks at who is carrying on the various activities for which money has been raised by an issue of shares.

Section 294(1) of this Act rewrites paragraph 6(2AB) of Schedule 28B to ICTA on the basis that its restrictions about trades etc only apply to trades etc that allow the requirement of paragraph 6(1) of Schedule 28B to ICTA to be met. That removes the possibility of HMRC contending in future that paragraph 6(2AB) was meant to operate independently of paragraph 6(1).

Part 8 of Schedule 2 to this Act (the relevant company to carry on the relevant qualifying activity requirement) provides that this change does not apply to shares or securities issued before 6 April 2007.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 63: VCT: preparing to carry on research and development (R&D) is not treated as preparing to carry on a qualifying trade: section 300 and Schedule 2Part 8 (meaning of "qualifying trade")

This change makes it clear that preparing for R&D is not a "qualifying activity".

Paragraph 3(3) of Schedule 28B to ICTA requires that a qualifying company must have been involved, at the time the relevant holding is issued and at all times since, in one of two activities. One is set out in paragraph 3(3)(a):

"carrying on a qualifying trade wholly or mainly in the United Kingdom.

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

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

This means that the carrying on of any activities of R&D can meet the requirement in paragraph 3(3)(a) of Schedule 28B.

Paragraph 3(3)(b) refers to:

"preparing to carry on a qualifying trade which at the time when the relevant holding was issued was intended to be carried on wholly or mainly in the UK by a qualifying company.

There is no explicit guidance in paragraph 3 or paragraph 4 of Schedule 28B to ICTA about *preparing* to carry on R&D. But it has not been considered that the deeming provision in paragraph 4(1)(b) extends to the requirement in paragraph 3(3)(b). So preparing to carry on R&D does not count as preparing to carry on a trade. This interpretation has been set out in the Venture Capital Schemes Manual.

In the enterprise investment scheme (EIS) and the corporate venturing scheme (CVS) the position is clearer. For EIS section 289(2)(b) of ICTA deals with R&D and in contrast to section 289(2)(a), which covers the carrying on of a qualifying trade, there is no mention of preparations. The VCT scheme was intended to follow EIS in this respect.

In paragraph 25(2) of Schedule 15 to FA 2000 (CVS) there is a deeming provision similar to the one in VCT. The final line states:

"But preparing to carry on such activities does not count as preparing to carry on a qualifying trade.

In practice there is an uncertain distinction between R&D and preparation for R&D but it seems sensible to put this matter beyond doubt and to match VCT with EIS and CVS.

Section 300(2) of this Act, (which is also subject to *Change 41*) states:

"The carrying on of any activities of research and development from which it is intended-

(a) that a trade will be derived which-

 (i) will be a qualifying trade, and

 (ii) will be carried on wholly or mainly in the United Kingdom, or

(b) that a trade will benefit which-

 (i) is or will be a qualifying trade, and

 (ii) is or will be carried on wholly or mainly in the United Kingdom,

is to be treated as the carrying on of a qualifying trade.

Section 300(3) of this Act uses the same wording as that quoted from the CVS paragraph 25(2):

"But preparing to carry on such activities does not count as preparing to carry on a qualifying trade.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 64: VCT: excluded activities: the meaning of trade in relation to the provision of services or facilities for another business: section 310 and Schedule 2Part 8 (excluded activities: provision of services or facilities for another business)

This change adapts the definition of "trade" in paragraph 5(4) of Schedule 28B to ICTA.

Paragraph 4 of Schedule 28B to ICTA is concerned with the meaning of a qualifying trade. Paragraph 5 contains provisions that interpret paragraph 4. Paragraph 5(4) contains a definition of trade:

"References in paragraph 4 above or this paragraph to a trade, except the references in paragraph 4(2)(f) to the trade for which services or facilities are provided, shall be construed without regard to so much of the definition of "trade" in section 832(1) as relates to adventures or concerns in the nature of trade; and those references in paragraph 4(2)(f) above to a trade shall have effect, in relation to cases in which it is carried on by a person other than a company, as including references to any business, profession or vocation.

Paragraph 4 of Schedule 28B to ICTA defines a "qualifying trade" and lists a number of activities (called "excluded activities" in the rewritten sections) that may prevent a trade being a qualifying trade. Paragraph 4(2)(f) concerns the activity of:

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

Paragraph 5(2) and (3) interpret a "controlling interest".

As noted, under paragraph 5(4) of Schedule 28B to ICTA the reference to the trade in paragraph 4(2)(f) is governed by the definition in section 832(1) of ICTA, *in relation to the trade for which services or facilities are provided*.

Section 989 of this Act rewrites section 832(1) for income tax. There are two references to that section in Chapter 4 of Part 6 of this Act.

First in section 300(4) (meaning of "qualifying trade"):

"References in this section to a trade are to be read without regard to the definition of "trade" in section 989.

Secondly in section 313(3) (interpretation of Chapter):

"References in sections 303 to 309 to a trade are to be read without regard to the definition of "trade" in section 989 (see also section 300(4)).

These sections do not apply to section 310 (provision of services or facilities for another business) which rewrites paragraph 4(2)(f) and paragraph 5(2) to (4). So section 989 of this Act applies to define "trade" in section 310. The interpretation applies to all the references to "business" in section 310 and not only to the business for which services or facilities are provided.

The other part of paragraph 5(4) of Schedule 28B to ICTA states that references in paragraph 4(2)(f) of that Schedule to a trade include references to any business, profession or vocation in relation to some cases. These are the cases in which *a person other than a company* carries on the trade.

In section 310 of this Act there are consistent references to “business” rather than “trade”. This includes references to the business carried on by a company. Paragraph 33 of Schedule 15 to FA 2000 (corporate venturing scheme) has been used as a model for this.

Instead of interpreting a trade as including a reference to “any business, profession or vocation”, the approach in section 310(5)(b) is the other way round. It provides:

““business” includes any trade, profession or vocation.

In effect therefore, in this section, a trade includes a business, profession or vocation, whether it is carried on by “a company” or “a person other than a company”.

The first part of the change (in relation to the definition in section 989) simplifies things. In whatever way “trade” is interpreted in relation to the provider of the services or facilities in section 310, the activity of the relevant company or a qualifying subsidiary is required to be a qualifying trade for the other purposes of Chapter 4 of Part 6 of this Act.

In theory the second part of the change extends the scope of this excluded activity to a business, profession or vocation carried out by a company for which *the services are provided*. In practice it is unlikely that the activity of this company, which constitutes an excluded activity within paragraph 4(2)(a) to (ee) of Schedule 28B to ICTA, would be other than a trade.

The change is similar but not identical to *Change 46* in section 199 of this Act (the enterprise investment scheme). The changes get rid of an extra layer of complexity and have little or no practical effect.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 65: VCT: meaning of “company” and “shares” in Part 6: section 332 and Schedule 2Part 8 (meaning of “company”, “shares” and “research and development” in Part 6)

This change provides that “company” and “shares” have the same meaning in Part 6 of this Act (Venture capital trusts) as, by section 842(4) of ICTA, they have in section 842 of ICTA (Investment trusts).

BACKGROUND

Section 842AA(11)(c) of ICTA provides that:

“without prejudice to their application in relation to provisions applied by paragraph (a) or (b) above, subsections (3) and (4) of [section 842] shall apply in relation to any reference in [section 842AA] to a holding or an addition to a holding as they apply in relation to any such reference in [section 842].

That provision is very compressed and therefore difficult to follow.

The definition of “company” in section 288(1) of TCGA (the TCGA definition), as provided for by section 842(4) of ICTA, differs from that in section 832(1) and (2) of ICTA (the ICTA definition). In broad terms the TCGA definition’s treatment of most unit trusts as companies (see section 99(1) of that Act) means that it is wider in one sense than the ICTA definition. The ICTA definition does not automatically apply for the whole of ICTA since section 832(2) provides that it does not apply where:

“the context otherwise requires because some other definition of “company” applies

The definition of “shares” in section 288(1) of TCGA and the treatment of rights of unit holders as shares in section 99(1) of TCGA has no counterpart in section 832 of ICTA. Individual provisions of ICTA give whatever meaning of “shares” is appropriate to the provision in question (section 842(4) is an example of that in relation to investment trusts).

COMPANIES INVESTED IN

It seems clear from section 842AA(11)(a) of ICTA (read with section 842(4) of ICTA) that references in section 842AA to a *holding in a company* contemplate that "company" and "shares" use the TCGA definition. And similarly from section 842AA(11)(c) it seems clear that references in section 842AA to *investments of any description*, in a company, contemplate that "company" and "shares" use the TCGA definition.

The two concepts in section 842AA of *holding in a company* and *investments of any description* relate to things in which the investing company that is, or may be, a venture capital trust has an interest. It would be reasonable from that context to suppose that "company" and "shares" in Schedule 28B to ICTA (venture capital trusts: meaning of "qualifying holding" in section 842AA) also use the TCGA definition.

The general use of the TCGA definition is probably one of the intended effects of section 842AA(11)(c) of ICTA but, as noted earlier, that provision is difficult to follow. The definition of "company" and "shares" in paragraph 17 of Schedule 33 to FA 2002 (Venture capital trusts winding up and mergers etc) appears to have proceeded on the basis that Schedule 28B of ICTA uses the TCGA definition.

INVESTING COMPANY

In the case of the investing company that is, or may be, a venture capital trust it seems to make no difference whether "company" uses the TCGA definition or the ICTA definition. The investing company must be an entity capable of having an accounting period (see section 842AA(2) of ICTA) and that requires the investing company to be a company within the meaning of ICTA (see section 12 of ICTA).

That is a characteristic shared with an investing company which is, or may be, an investment trust. Section 842(4) of ICTA uses the TCGA definition of "company" and "shares" for the investing company (or any other company).

CONCLUSION

There appears to be no reason for section 842AA of ICTA to have two different definitions of "company" and "shares".

Section 332 of this Act provides that the TCGA definition of "company" and "shares" applies in Part 6 (Venture capital trusts). That is a change because there is no such explicit provision in the source legislation.

Schedule 2 Part 8 (meaning of "company", "shares" and "research and development" in Part 6) ensures that the change will not apply to any holding of investments of a particular description held by a company at the end of 5 April 2007. But the change will apply from any later time at which the holding of investments of that particular description ceases to be held by that company.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 66: Interest relief: loans partly meeting requirements: section 386

This change introduces a rule to apportion the amount of interest paid where a mixed loan is partly repaid.

Section 367(4) of ICTA deals with a loan in respect of which only a part is used for qualifying purposes (a mixed loan). The rule is that the interest eligible for relief is the percentage of the total equal to the percentage of the mixed loan that was originally applied to qualifying purposes.

It is not made explicit in section 367(4) of ICTA how the interest should be apportioned when a mixed loan is partly repaid. Where the repayment is less than the non-qualifying part of the mixed loan, so that the reduced loan is still mixed, the original percentage is applied. The result is that the repayment is apportioned rateably between the qualifying and non-qualifying parts. But the position is uncertain where the reduced loan is less than the original qualifying part as it could be argued that the reduced loan is no longer mixed and that section 367(4) has no application.

The fairest solution appears to be that all repayments should be applied rateably between the qualifying and non-qualifying parts, so that the percentage of interest eligible for relief is fixed for that loan at the outset. Accordingly, section 386(3) and (4) provide such a rule. The rule confirms the treatment that has been applied in practice.

A different rule applies where capital has been recovered from the investment funded by the qualifying part of a loan. In such a case, by virtue of section 363(1) of ICTA, the qualifying part of the loan is treated as repaid to the extent of the recovery. A signpost to that rule, which is in section 406(5), is provided in section 386(3).

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 67: Interest relief: exclusion of double relief: finality: section 387

This change makes clear when the amount of interest allowed as a business expense is finally determined for the purposes of rewriting section 368(3) of ICTA. It corresponds to Change 12 in Annex 1 to the Explanatory Notes accompanying ITTOIA in relation to the rewrite of section 368(4) of ICTA.

Section 353 of ICTA provides for interest to be claimed as a relief. In limited circumstances that relief may also qualify as a deduction in calculating the profits of a trade or property business. Section 368(3) of ICTA provides that relief is not given under section 353 of ICTA if a deduction for the interest has been taken into account as a business expense.

Section 368(3) of ICTA is subject to section 368(6) of ICTA. Section 368(6) provides that references to an amount taken into account are references to an amount taken into account in an assessment that has been finally determined.

The term "finally determined" does not fit well with Self Assessment. Section 387(7) makes clear that it means when the interest allowed as a deduction in an assessment can no longer be varied.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 68: Interest relief: loan to buy plant or machinery for partnership use: sections 388 and 389

This change clarifies the scope of section 359(1) of ICTA as including relief for interest on a loan to a partner for capital expenditure on assets used in a property business carried on by the partnership.

Section 359(1) of ICTA provides relief for interest on a loan to a partner who invests the proceeds in assets used by a partnership which is entitled to capital allowances under section 264 of CAA in respect of them. Section 264 gives entitlement to allowances for assets used in a qualifying activity carried on by a partnership. "Qualifying activity" is defined in section 15 of CAA and extends not only to trades and professions (which are clearly within the scope of section 359(1)) but also to other activities, one of which is an ordinary property business.

On the face of it, therefore, partnerships which carry on ordinary property businesses or those other activities come within the scope of this provision. But that view does not sit comfortably with section 359(2) of ICTA, which provides for relief to be apportioned but only where the business use is for the purposes of a trade or profession, not any other activity.

In fact, the reference to section 264 of CAA was substituted by paragraph 27(1)(a) of Schedule 2 to CAA for the previous reference to section 44 of CAA 1968. That section had itself been repealed by CAA 1990, a consolidation Act, but the need to amend section 359(1) of ICTA so as to substitute a reference to CAA 1990 for the reference to CAA 1968 was overlooked. So the text remained unaltered, although the references to the provisions in CAA 1968 were to be read as references to the re-enacted provisions by virtue of section 17(2)(a) of the Interpretation Act 1978.

In this case, the re-enacted provision was section 65 of CAA 1990, which related only to partnerships carrying on a trade (although, by virtue of section 27 of CAA 1990, section 65 of CAA 1990 applied to professions too, and it is clear from the mention of professions in section 359(2) of ICTA that they are within that section). But section 28A of CAA 1990, inserted by FA 1997, treated Schedule A businesses as trades for the purposes of Part 2 of CAA 1990 (including section 65). So it is arguable that section 359(1) of ICTA then applied to assets used in Schedule A businesses.

There is, however, a contrary argument, that the reference in section 359(1) of ICTA to section 44 of CAA 1968 (and hence to section 65 of CAA 1990) should have been read without the gloss on the reference to "trade" given by section 28A of CAA 1990. In general a reference in one enactment to another is to be read as a reference to that other Act as amended or applied by a later enactment, unless there is a clear intention that it should not be so read. (See section 20(2) of the Interpretation Act 1978.)

In this case, it is possible to discern such a contrary intention; FA 1997 did not, for example, amend section 359(2) of ICTA to make it clear that Schedule A businesses were covered by it. And the fact that section 359(1) of ICTA still actually referred to section 44 of CAA 1968, rather than a provision falling into Part 2 of the CAA 1990, is another indication that no intention to gloss this reference should be inferred.

CAA amended section 359(1) of ICTA by substituting a reference to section 264 of CAA for the reference to section 44 of CAA 1968. As mentioned above, this apparently extended section 359(1) of ICTA to all qualifying activities. On either of the views about section 28A of CAA 1990 mentioned above, that would have been a change in the law. But CAA was a Tax Law Rewrite Project Act and as such the starting point must be to assume that it did not change the law, except where such changes were acknowledged. It is considered therefore that a court would lean in favour of an interpretation that did not result in any such change, and accordingly might read section 359(2) of ICTA as imposing a restriction cutting back section 359(1) to its original scope.

In practice, it appears that loans for assets used for ordinary property businesses may have been given relief in some cases, but relief has not been given where the assets are used for the other qualifying activities ostensibly included by the amendment made by CAA.

In view of the uncertainty about the current law, section 359 of ICTA has been rewritten so as to include loans for assets used for trades, professions and ordinary property businesses carried on by partnerships, but not the other qualifying activities in section 15 of CAA. See sections 388(2)(a) and (4) and 389(4).

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE, AND IS FAVOURABLE TO SOME IN PRACTICE. BUT

THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 69: Interest relief: loan to buy machinery or plant: sections 388 and 390

This change ensures that interest paid on a loan to a partner or employee to buy machinery or plant for use in a partnership or an employment is eligible for relief for so long as the machinery or plant is within the capital allowances regime.

Section 359(1) of ICTA provides relief for interest on a loan to a partner to buy machinery or plant for use in a trade or profession carried on by a partnership. Section 359(3) provides relief to an employee or office-holder to buy machinery or plant for use in an employment or office. In both cases eligibility for relief depends on the individual being "entitled to a capital allowance or liable to a balancing charge" in respect of the plant or machinery for the period of account or tax year concerned.

In any particular period while the asset continues to be used, it may be that the individual is not entitled to a capital allowance. The obvious such case is where the individual claimed a 100% first year allowance in an earlier period. In practice, loan interest relief is treated as continuing to be available in these circumstances. Sections 388(3) and 390(3) give effect to this practice by treating the individual as entitled to a capital allowance until a disposal value in respect of the asset is brought into account.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 70: Interest relief: loan to invest in partnership: meaning of "member of partnership": sections 399 and 409

This change gives statutory effect to Statement of Practice A33.

Section 362 of ICTA provides that an individual who is a member of a partnership may obtain relief for interest paid on money borrowed to invest in the partnership. In the predecessor to section 362 (section 21 of FA 1969) there was no requirement to be a partner, but only personally to act in the trade etc carried on by the partnership. The new wording, introduced by section 25 of FA 1981, was intended to relax the work condition, for example by including sleeping partners, but also raised doubts as to whether certain individuals who are not true equity partners no longer qualified.

Statement of Practice A33 addresses the eligibility of individuals who are commonly termed salaried partners. It provides:

"The Board are advised that [sections 362 and 363 of ICTA] extend to salaried partners in a professional firm who are allowed independence of action in handling the affairs of clients and generally so to act that they will be indistinguishable from general partners in their relationships with clients.

Section 399(5) gives effect to this Statement of Practice. That section is also applied by subsection (3) of section 409, which gives effect to ESC A43.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 71: Interest relief: loan to invest in co-operative: section 401 and Schedule 2Part 9 (interest: loans for investing in co-operatives)

This change omits the condition that the loan must have been made after 10 March 1981.

Section 361(2)(a) of ICTA specifies that interest on a loan which is invested in a co-operative is only eligible for relief if the loan is made after 10 March 1981. As it is considered unlikely that loans made for this purpose prior to that date still exist, this condition has not been included in the rewritten legislation. But if, exceptionally, there were such loans then this change means that relief would be due provided the other conditions for relief are met.

In addition, where an original loan invested in a co-operative has been replaced by a new loan the condition that the original loan must have been made after 10 March 1981 no longer applies. That is reflected in the provision relating to section 401 in Schedule 2.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 72: Interest relief: loan to pay inheritance tax: section 403

This change amends and simplifies the condition in section 364(1)(a) of ICTA for interest on money borrowed to pay inheritance tax to be eligible for relief.

Interest on loans to personal representatives to pay inheritance tax is eligible for tax relief subject to certain conditions. The condition in section 364(1)(a) of ICTA is that the loan to the personal representatives is to meet:

"before the grant of representation or confirmation, … inheritance tax payable on the delivery of the personal representatives' account and attributable to the value of personal property to which the deceased was beneficially entitled immediately before his death and which vests in the personal representatives or would vest in them if the property were situated in the United Kingdom.

The wording of this provision derives from the rules regarding estate duty payable in respect of personal property in the estate which the personal representatives were required to pay before they could obtain a grant of representation or confirmation. Duty on personal property was payable on death, whereas duty on real property was due on the first anniversary of the death. So relief was available on a loan to meet the tax payable before grant of representation or confirmation, but not tax payable later.

Under the inheritance tax rules, tax attributable to liquid or easily realisable assets is due six months after the end of the month in which death occurred, whereas payment of the tax attributable to other assets may be spread over ten years. Section 226(2) of IHTA requires personal representatives applying for a grant of representation or confirmation to pay all the tax for which they are liable on delivery of their account. In practice, this means all non-instalment tax and any instalments already due. So to give relief for interest on a loan to meet tax payable before grant of representation or confirmation it is only necessary to refer to tax payable under section 226(2). The reference to "personal property" is no longer apt.

Therefore section 403(2), which rewrites the condition in section 364(1)(a) of ICTA, simply refers to tax that the personal representatives are obliged to pay under section 226(2) of IHTA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 73: Interest relief: omission of section 368(2) of ICTA: section 404

This change omits the requirement under section 368(2) of ICTA that relief for interest under section 353 of ICTA is not to be given against income of a company except where the company is not UK resident and it cannot be taken into account in computing corporation tax.

Section 368(2) of ICTA contains two rules. First, it provides that no relief under section 353 of ICTA is to be given against income chargeable to corporation tax, except where the company is not UK resident and the interest cannot be taken into account in computing corporation tax.

But the only persons now entitled to claim interest relief under section 353 are individuals, except that personal representatives (PRs) may claim for relief under section 364 of ICTA (loan to pay inheritance tax). Companies acting as PRs do so in a fiduciary capacity and profits arising to companies in that capacity are liable to income tax rather than corporation tax by virtue of section 8(2) of ICTA. So if company PRs take out a loan to pay inheritance tax, the interest is a deduction in the income tax computation of the estate, not a deduction for corporation tax purposes.

The second rule in section 368(2) provides that relief under section 353 shall not be given against *any other income of a company*, (ie income not liable to corporation tax) except where the company is not UK resident and the interest cannot be taken into account in computing corporation tax.

Originally, this enabled a non-resident company receiving rents from property in the United Kingdom to obtain relief for interest on loans to acquire property in the United Kingdom, despite the fact that it could not obtain a deduction from income within Schedule A. It could also have referred to income arising to companies in their capacity as PRs or trustees (and so subject to income tax) or to income beneficially owned by the company but not chargeable to corporation tax for some reason, like distributions from UK resident companies.

As noted above, however, the rule in section 368(2) could now only be relevant in the case of company PRs borrowing to pay inheritance tax. So, the only sort of “other income of a company” that could be in point now is income arising to companies in their capacity as PRs. But there is no reason to prevent relief on such loans being given to UK resident companies, while allowing it to non-UK resident companies. And it is not thought that in practice this relief has been denied to UK resident companies acting as PRs.

Accordingly section 368(2) has not been rewritten.

THIS CHANGE IS IN TAXPAYERS’ FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 74: Interest relief: recovered capital: section 406

This change amends the rule in section 363 of ICTA about the effect on the amount of loan interest eligible for relief when capital is recovered from the business entity in which the proceeds of the loan were invested.

Section 363 of ICTA applies where the interest on a loan to an individual qualifies for relief under section 353 of ICTA because it meets the conditions in section 360 (loan to buy interest in close company), section 361 (loan to buy interest in co-operative or employee-controlled company) or section 362 (loan to buy into partnership) and subsequently the individual recovers capital in the circumstances set out in section 363(2), *but does not use that capital in repaying that amount of the loan.*

In such a case the individual is treated as if he or she had repaid the loan to the extent of the recovered capital, with the result that the interest eligible for relief is correspondingly reduced. Where only part of the loan qualified for relief, the notional repayment is set against the qualifying part.

Sections 360, 361 and 362 of ICTA each contain another provision under which relief is lost completely if the individual recovers capital that is not taken into account under section 363. (See, for example, section 362(2)(b)). It follows that if the individual has recovered capital that is in fact used to repay *part* of the loan, then, since section 363 does not apply, the individual loses relief completely. This result was not intended. The correct result is achieved if section 363 applies where any capital recovery within that section occurs, whether or not the recovered capital is used to repay the loan. Then the provisions like section 362(2)(b) only bite where capital is recovered in circumstances not within section 363.

Accordingly, section 363(1) of ICTA has been rewritten in section 406 without the words which restricted its application to cases where the recovered capital was not used in repayment of the loan. And so the rule providing for a corresponding reduction in the interest eligible for relief, where only part of the loan qualified for relief, has been modified to ensure that the reduction is made from the amount of interest that would be payable and eligible for relief if no repayment, whether deemed or actual, had been made.

There may be cases in practice in which relief has been given (wrongly in law) for interest paid where the amount recovered was used to repay part of the loan. To the extent that the recovery has been set against the qualifying part of the loan then this change legislates that practice, which is generally in taxpayers' favour.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 75: Interest relief: partnership changes and business successions: sections 409 and 410

This change gives statutory effect to ESC A43 and extends it to cover partnership changes generally.

The text of ESC A43 is as follows:

1 "Under sections 360-363, ICTA 1988, income tax relief is available for interest paid by an individual on a loan taken out to invest in, or on-lend to, a partnership, a co-operative, a close company, or an employee-controlled company. The relief is subject to various conditions, and ceases to be available when those conditions are no longer met.

2 Relief is also reduced or withdrawn (following section 363) if the borrower recovers any capital from the business without using it to repay the loan – for example by selling or exchanging the interest or shares in that business. Strictly, therefore, relief ceases to be due where:

(a) a partnership is incorporated into a co-operative, a close company, or an employee-controlled company; or

(b) shares in a co-operative, a close company, or an employee-controlled company are exchanged for, or replaced by, shares in any one of these kinds of company; or

(c) there is a partnership reconstruction involving a merger or demerger.

3 Under the terms of this concession, relief for interest on a loan to an individual will not be discontinued in the three kinds of circumstances described above where, in relation to that individual, the conditions for relief would have been met if the loan had been a new loan taken out by that person to invest in the new business entity. The rules restricting or withdrawing relief where the borrower recovers any capital from the business continue to apply in the normal way.

Paragraph 2(c) of the concession refers to a merger or demerger of a partnership, but does not attempt to define either term. The circumstances considered to be in point are set out in section 409(1). That section also allows relief to continue in cases where there are partnership changes not amounting to a merger or demerger. In practice, relief is such circumstances is also allowed on what is (in strictness) considered to amount to concessionary treatment.

Cases within paragraphs 2(a) and (b) of the concession concern other types of business succession. Section 410 gives effect to the concession by allowing relief to continue in those cases and also where the original investment was by way of loan.

If the individual recovers any capital from the business then the normal rules apply.

THIS CHANGE IS IN THE TAXPAYER'S FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 76: Gift aid: a qualifying donation cannot be a deductible expense in computing income from any source: section 416

This change clarifies that a "qualifying donation" for gift aid purposes does not include a payment that is deductible in computing an individual's income from any source.

Until the gift aid rules were introduced by FA 1990, a donation could only qualify as a charitable donation if it was an annual payment, eg under a covenant. And section 74(1)(m) of ICTA was generally taken to mean that an annual payment was not a deductible expense in computing trading income. The practical result was that, except in the case of payments falling within ESC B7 (benevolent gifts by traders), a charitable donation could not be a deductible expense of a trader.

Section 25 of FA 1990 introduced the gift aid rules. As a result, a single donation of money to a charity could be made, and give rise to an income tax repayment for the charity and relief for the donor, even if (unlike a payment under a covenant) it was not made as a result of a legal obligation.

Section 25(6) of FA 1990, in its original form, provided that the Income Tax Acts were to have effect as if such payments were covenanted payments to charity. Because such payments were not annual payments, later subsections re-enacted various operative provisions of sections 348 to 350 of ICTA to apply to gift aid payments. This legislation, with amendments, ran side by side with the rules for true covenanted payments until FA 2000. But there was no enactment in section 25 of FA 1990 that applied section 74(1)(m) of ICTA to prevent a gift aid payment from being a trading deduction. So it became theoretically possible for such a payment to be an allowable deduction, depending on the applicability of other provisions of section 74(1).

Section 39 of FA 2000 radically amended section 25 of FA 1990, in effect abolishing the old regime of covenanted annual payments and taking all charitable donations out of the ambit of sections 348 to 350 of ICTA. But, again, section 74(1)(m) was not specifically applied to gift aid payments. Further, section 74(1)(m) was not rewritten at all in ITTOIA, because it was considered to be without content.

This change restores the position in strict law to what has been established practice before and after the FA 1990 and FA 2000 changes. Double relief, under the rules for deductible expenditure and as a qualifying donation for gift aid, was never intended and has not been given in practice. It follows that, if a donation is allowable under any rule of deduction from income, it will not be a qualifying donation for gift aid purposes.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 77: Gift aid: gifts and benefits linked to periods of less than 12 months: priority between methods of calculating annualised amounts of gifts and benefits: section 419 and Schedule 2Part 9 (gift aid: restrictions on associated benefits)

This change clarifies the operation of the rules about annualising the amounts of gifts and benefits in the various different sets of circumstances which can arise, by providing a priority rule to cater for certain cases where more than one of the statutory rules could apply in relation to a given set of circumstances.

If an individual makes a donation of money to a charity, and receives a benefit in consequence of making the donation, that benefit may affect whether the donation is "qualifying" (section 416(7)). And that in turn will affect whether the individual obtains tax relief for the donation under section 414(2). It will also affect whether the charity may obtain repayment of the tax treated as deducted from the donation under section 521(1) and (4) of this Act, or under section 25(10) of FA 1990 and section 505(1)(c)(ii) of ICTA.

The source legislation (section 25(5B) to (5D) of FA 1990) contains rules to counter tax advantages from fragmentation of the time periods attaching to donations or to consequent benefits. In particular, section 25(5D) (rewritten in section 419(8) of this Act) lays down the method of annualising either the gift, or both the gift and the benefit, in different circumstances. Those circumstances are set out in section 25(5B) and (5C), rewritten in section 419(2) to (5) of this Act as Conditions A to D.

But the source legislation does not set out what is to happen if the circumstances fall within one of Conditions C and D and within one of Conditions A and B, which in theory can occur.

This change provides a priority rule to cater for such cases, which is located in Step 2 of section 419(8). It provides that, in such a case, the rule relating to Conditions C and D takes priority.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 78: Gift aid: omission of section 25(9)(c) of FA 1990: sections 423 and 425

This change clarifies the way in which the total amount of income tax and capital gains tax to which an individual is charged is calculated (amount B in section 423, adjusted to amount C in section 424).

There are two places in which the source legislation provides for the "amount of income tax and capital gains tax with which the donor is charged" to be calculated.

The first (in section 25(6)(c) of FA 1990) is used to determine whether any personal and other allowances in Chapter 1 of Part 7 of ICTA should be restricted in order to ensure that the donor is charged with an amount of tax equal to the tax treated as deducted from the gift. This is "amount B" in the rewritten legislation (section 423).

The second (in section 25(9) of FA 1990) is used to determine the amount of income tax the donor may have to pay under section 25(8), and presupposes that any restriction of personal reliefs under section 25(6)(c) has already been carried out. This is "amount C" in the rewritten legislation (section 424).

Section 25(9) of FA 1990 provides detailed rules about how this calculation is to be carried out. But there are no such explicit rules in section 25(6)(c) of FA 1990.

The change makes it clear that amounts B and C are both to be calculated following the detailed rules in section 25(9) of FA 1990, subject to taking account of any restriction of personal reliefs when calculating amount C.

In particular, this means it is not necessary to rewrite section 25(9)(c) of FA 1990. That provision was anomalous as although the tax reduction for married couples and civil partners may be restricted under section 25(6)(c), the second calculation disregards that tax reduction but without it being clear how any such restriction is to be taken into account when doing so (section 25(9)(c)).

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 79: Gift aid etc: removal of redundant references to certain charities: sections 430 and 446 and Schedule 1 (section 587B of ICTA and sections 108(4), 620(5) and 628(6) of ITTOIA)

This change omits specific references to the British Museum and the Natural History Museum from the sections treating exempt bodies as charities for the purposes of the rules about gift aid (see section 430) and gifts of shares, securities and real property to charities etc (see section 446). It also omits those references from sections 108(4), 620(5) and 628(6) of ITTOIA.

Both the gift aid rules (in section 25(12) of FA 1990) and those about gifts of shares, securities and real property to charities etc (in section 587B(9) of ICTA) define charity to include the bodies listed in section 507(1) of ICTA.

The list of bodies in section 507(1) of ICTA includes the Trustees of the British Museum and of the Natural History Museum. But the functions of both these bodies are set out in the British Museum Act 1963 and are fully charitable. (It was confirmed that the British Museum was a charity as long ago as 1891, in Special Commissioners for Income Tax v Pemsel (1891), 3 TC 53 HL.)

This does not affect the exemptions from corporation tax afforded to these bodies by section 507 of ICTA, which continue to have effect.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 80: Gifts of land to charities: qualifying interests in land held jointly: sections 442 and 443 and Schedule 1 (sections 587BA and 587C(2) and (3) of ICTA)

This change makes it clear that, in cases where land is held by owners as joint tenants or as tenants in common, the fact that one or more owners may not be eligible for relief does not deny relief to other eligible owners. In doing so it clears up a misunderstanding that could arise from section 587C(2) and (3) of ICTA.

Section 587C(2) of ICTA reads as follows:

"Where two or more persons-

(a) are jointly beneficially entitled to the qualifying interest in land, or

(b) are, taken together, beneficially entitled in common to the qualifying interest in land,

section 587B applies only if each of those persons disposes of the whole of his beneficial interest in the qualifying interest in land to the charity.

And section 587C(3) of ICTA begins with the words:

"Relief under section 587B shall be available to each of the persons referred to in subsection (2) above…

Taken together, this means that, if relief is to be given to any person in respect of the disposal, the land that is to be given to the charity must be owned only by individuals and companies that are not charities. This is not in accordance with the policy of section 587C. The intention is to give relief in such situations to those persons that are eligible, provided that all owners (whether eligible for relief or not) dispose of the whole of their beneficial interests in the land.

This change also clarifies how the relevant formula in section 434(1) or (2) of this Act (as appropriate) is to be applied. The relievable amount is first calculated under section 443(2) of this Act as if all owners (whether eligible for relief or not) were a single individual. The various amounts required by the appropriate formula, including incidental costs, benefits and notional consideration for the purposes of chargeable gains, are pooled. The share of any non-eligible person is then carved out, so that the relievable amount for the disposal does not include that share. It is then for the eligible donors to agree the allocation of that relievable amount between them.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 81: Charges on income: general approach: sections 24, 89, 425, 448, 449, 505, 900, 901, 903, 942, 946, 964 and 979 and Schedule 1 (sections 51 and 272 of ITTOIA)

INTRODUCTION

This change is about the approach adopted in rewriting the provisions about those annual payments and patent royalties which constitute charges on income. It also concerns the approach adopted in the parallel provisions about deemed payments by trustees of unauthorised unit trusts.

The change replaces the present approach to charges on income (which owes its origins to the historic concept of alienation of income) with a deduction in calculating net income, coupled with provision for deduction of tax at source from the payments involved. The tax deducted will be collected either as a specific element of the payer's tax liability under Self Assessment, or by separate assessment.

This change of approach is fundamental in principle. It changes the structure and simplifies the inner workings of the legislation, greatly reducing the extent to which these provisions, which only concern a very narrow range of payments, have a cross cutting impact across the legislation as a whole. And, by aligning the approach to patent royalties with that for annual payments, it removes the need for complex provisions about the interactions between charges on income and terminal loss relief.

But it does not affect the overall amount of tax anyone pays, and involves only very limited administrative change.

GENERAL POSITION IN THE SOURCE LEGISLATION

The main source legislation involved is in sections 3, 347A, 348, 349(1) to (1B), 350(1) and 387 of ICTA and section 51 of ITTOIA.

Sections 348 and 349(1) to (1B) of ICTA run in parallel and, supported by section 3 of ICTA, are concerned only with certain annual payments and certain patent royalties. The scope of these sections is much reduced from what it once was, now that they no longer apply to interest and given the interplay of these provisions with section 347A of ICTA.

Section 348 of ICTA applies when the payment is payable wholly out of profits or gains brought into charge to income tax and section 349 of ICTA applies when it is not so payable. Broadly, section 348 applies where the payer is subject to income tax and has sufficient income to cover the charge on income, and section 349 applies where the payer is subject to corporation tax or is exempt or, while subject to income tax, has insufficient income to cover the charge on income.

The concept of alienation of income, which lies in the background to sections 3 and 348 of ICTA, is that an amount of income equal to the amount of the charge on income is regarded as no longer being the income of the payer, but as the income of the payee instead. The tax that the payer deducts (it will always be in the payer's interest to deduct and retain the tax even though it is optional) enables the payee to be regarded as receiving the payment under deduction of tax (see sections 602 and 618 of ITTOIA).

All of the payer's income is subject to tax, without the annuity or other annual payment being deducted (see section 348(1)(a) of ICTA) and without the charge on income consuming any part of the payer's basic rate band (as it is always to be charged at the basic rate: see section 3 of ICTA), to ensure the tax concerned is collected from the payer.

Section 348 of ICTA can only work where the payer has sufficient income. Where this is not the case, section 349 of ICTA applies. Here, deduction of income tax is mandatory and the tax is collected by assessment under section 350(1) of ICTA. There is no relief under the deduction at source regime for payments assessed under section 350 (but the payment may qualify for other relief, eg as a deduction in calculating trading profits).

At the boundary between these two regimes lie cases where the payer has only sufficient income to cover part of the charge on income. In these cases the whole payment falls within section 349(1) of ICTA (and so deduction of tax is mandatory), but it is only the tax on the excess that needs to be collected by assessment under section 350(1) of ICTA (see the reference there to "on the payment, or on so much thereof as is not made out of profits or gains brought into charge to income tax").

There are then a variety of provisions designed to maximise the extent to which payments can be handled within the scheme of section 348 of ICTA, including those reducing the extent of personal reliefs (see section 276 of ICTA), tax reducer reliefs (see eg section 256(3)(c)(ii) of ICTA), and the availability of terminal loss relief (see the first part of section 388(5) of ICTA). It is only where such measures prove insufficient that the regime of section 349(1) of ICTA comes into play.

Complex features of the present position include:

- the conceptual background of the payer's income being alienated to the payee (an approach which dates from the time when different sources of income were assessed separately without regard to total income);
- the idea of payments being (or not being) made out of profits or gains brought into charge to income tax, the boundary between sections 348 and 349(1) of ICTA, and the need for a payer to know which regime will apply; and
- the resulting multiplicity of provisions across the income tax code which require understanding of charges on income, despite the fact that the range of payments still treated in this way is now very narrow.

PROVISIONS ABOUT PATENT ROYALTIES

The source legislation takes a different approach as between annual payments and patent royalties.

The main legislation involved is section 51 of ITTOIA (which denies a trading deduction for patent royalties) and section 387 of ICTA (which, where tax is accounted for on a charge under section 350 of ICTA, enables relief to be given as a carry forward loss instead).

Section 387 of ICTA was introduced in FA 1928 in response to A-G v Metropolitan Water Board (1927), 13 TC 294 CA. That case concerned a payment of interest (interest being a charge on income at that time) which was found not to be payable out of income because the previous year basis of assessment then in force meant that it had been paid in a different year from that in which the corresponding income had arisen, and so the tax deducted was not covered. Section 387 addresses the inequity by allowing the amounts assessed under section 350(1) to count as losses to be carried forward against future profits.

Section 51 of ITTOIA (based on section 74(1)(p) of ICTA) prevents patent royalties from being deductions in computing trading profits. But it is still possible for patent royalties to give rise to a loss under section 387 of ICTA.

But annual payments are not prevented from being trade deductions, as is indicated (in an insurance context) by the case of Gresham Life Assurance Society v Styles (1892), 3 TC 185 HL. And sections 74(1)(m) and 817(1)(b) of ICTA were not rewritten for income tax purposes in ITTOIA, as they were unnecessary.

So any annual payment made wholly and exclusively for the purposes of the trade, profession or vocation (in accordance with the requirement in section 387(1) of ICTA) will already have been deducted in computing the profits of that business. So no further relief will be necessary or allowed, as section 385 of ICTA ensures that relief is only given under that section if it has not already been obtained elsewhere.

Accordingly, section 387 of ICTA only applies to patent royalties. And if it were not for section 51 of ITTOIA it would not be necessary.

UNAUTHORISED UNIT TRUSTS (UUTS)

Under section 469(3) of ICTA (and section 548(2) of ITTOIA), trustees of UUTs are treated as making annual payments equal to the amount shown by the UUTs accounts as available for distribution or investment.

The trustees are chargeable with the income arising, and the charge to tax on that income is almost exclusively at the basic rate. But for a number of reasons (eg the availability to the trustees of capital allowances) the amount of the deemed annual payment need not be equal to the amount of the trust's taxable income.

Trustees may therefore be treated (under section 348 of ICTA) as deducting and retaining income tax to the extent that the deemed annual payments do not exceed the taxable income. But it is also possible for trustees to be treated as making a payment not wholly out of taxable income, and thus to incur a liability under section 350 of ICTA. In practice such tax is collected through the UUT's self assessment return. Where there is a liability under section 350 the rules in section 469(5A) to (5D) of ICTA give relief to the extent that, in previous tax years, taxable income has exceeded the deemed annual payments.

THE REWRITTEN LEGISLATION

The approach adopted removes many of the complexities in the source legislation, by bringing the legislation substantially into line with the computational approach adopted in practice in the comprehensive tax calculation guide that accompanies self-assessment returns (which for example already treats relief for charges as a deduction from income).

GENERAL RULES

Under this change relief is given for the annual payments and patent royalties previously within section 348 of ICTA as a deduction in calculating net income (but not from "non-qualifying income"): see sections 448(4), 449(5), 1025(2)(a) and 1026. So section 3 of ICTA is not rewritten. That section required the income out of which an annual payment or patent royalty payment is made to be charged at the basic rate. The new approach makes it unnecessary.

Income tax is still deducted (at the basic rate, except in the cases covered by section 902(3)). Rather than this being optional or mandatory depending on the payer's position, it is always mandatory. So section 348(1)(c) of ICTA is not rewritten. The tax deducted from the payment will be collected directly rather than being charged on the income out of which the payment is made.

The tax deducted is then collected as part of the payer's self-assessment (see Chapter 17 of Part 15 of this Act) and the provisions that restrict personal reliefs etc are no longer needed.

The change also means that some payers who under the source legislation have to account for part or all of the deducted tax under a section 350 assessment will now account for it under Self Assessment. This will affect:

- all individuals (section 350 of ICTA will no longer apply to them, regardless of the amount of income they have in the tax year); and
- persons other than individuals whose income is only sufficient to cover part of the charge.

It should normally be less onerous for taxpayers to deal with this on their self-assessment returns than to have to deal with it separately. But a few taxpayers who do not presently require a self-assessment return will need to complete one in future.

In addition, taxpayers will no longer have to worry about which regime applies. This is relevant in relation to taxpayers for whom it is not easy to tell in advance whether their income will or will not be sufficient to cover charges on income.

The change may affect the time at which tax is paid (including payments on account) and the compliance regime applicable. But it will affect only a small number of taxpayers and the amounts involved are correspondingly small.

None of this will affect the position of corporation tax payers, exempt bodies such as local authorities, or income tax payers (other than individuals) who have no income and who would not otherwise have needed to complete a self-assessment form. All these will remain within one or other of the regimes rewritten in Chapters 15 and 16 of Part 15 of this Act.

SPECIFIC RULES ABOUT PATENT ROYALTIES

This change also more fully aligns the mechanics of the legislative approach to patent royalties with that for annual payments.

Patent royalties will in future be deductible in calculating net income where appropriate, but tax will still be deducted and accounted for in respect of such payments. This involves repealing section 387 of ICTA and section 51 of ITTOIA (and the corresponding entry in the table in section 272 of ITTOIA) and, as a consequence, the latter part of section 388(5) of ICTA (interaction of section 387 payments with terminal loss relief).

This is in principle in taxpayers’ favour, because of the removal of the restrictions in section 387(2) of ICTA, but should not change things in practice as any payment falling foul of them would be very unlikely to qualify as a trading deduction.

SPECIFIC RULES FOR UNAUTHORISED UNIT TRUSTS

In accordance with the general approach, trustees of UUTs will obtain a deduction in calculating net income of the amount of their deemed payments in a tax year (see section 505). Those deemed payments, as now, will be equal to the amount shown in the trustees’ accounts as available for distribution or investment.

They are no longer described as annual payments, because the charge on the recipient of them in Chapter 10 of Part 4 of ITTOIA is distinct from the charge on annual payments in Chapter 7 of Part 5 of that Act. But relevant rules relating to annual payments are applied to unauthorised unit trusts where necessary.

This change will make no difference to the amount of tax trustees of UUTs pay or to how it is collected, as it is in all cases collected through trustees’ self assessment returns at present.

The relief that applies if, in previous tax years, taxable income has exceeded deemed payments will also remain unchanged. But it is now expressed in terms of tax rather than as an amount by which a deemed payment is reduced: see sections 942(3) to (5) and 943.

CONSEQUENTIAL AMENDMENTS TO LONDON OLYMPIC GAMES LEGISLATION

Sections 65, 67 and 68 of FA 2006 remove from certain persons the duty to deduct sums representing income tax from annual payments. The source legislation refers only to section 349(1) of ICTA; it does not refer to section 348(1), but only because that section provides a right to deduct rather than a duty to deduct. Accordingly, consequential amendments are made by Schedule 1 to ensure that no new duty to deduct arises in such cases as a result of this Change replacing the right to deduct under section 348(1) with a duty.

CONSEQUENTIAL AMENDMENT TO PROVISION REGARDING DESIGNATED INTERNATIONAL ORGANISATIONS

Section 582A(1) and (4) of ICTA removes the requirement to deduct sums representing income tax from annual payments and patent royalties within section 349(1) of ICTA made by designated international organisations. It applies to cases where deduction of tax is mandatory. Now that mandatory deduction has been extended to such payments that previously fell within section 348 of ICTA, section 979 (which rewrites section 582A of ICTA) similarly applies to all payments within Chapter 6 of Part 15 of this Act.

RELATED CHANGES

There are a number of related Changes, which are concerned with:

- when payments are regarded as being, or not being, made out of profits or gains brought into charge to income tax, not least in the context of trusts (*Change 82*);
- the rate at which tax is to be deducted, depending on the year in which the payment is made (*Change 138*);
- the deduction of tax from patent royalties which are annual payments (*Change 139*); and
- the interplay between charges on income and various reliefs and adjustments that relate to a later year, such as loss relief claims and farmers' and creative artists' averaging (*Change 154*).

THIS CHANGE IS IN PRINCIPLE FAVOURABLE TO SOME TAXPAYERS. IT ALSO AFFECTS WHEN AND HOW TAX IS PAID AND ADMINISTRATIVE REQUIREMENTS. BUT THE NUMBERS AFFECTED ARE EXPECTED TO BE FEW (AND THE AMOUNTS INVOLVED SMALL).

Change 82: Charges on income: when payments are made "out of" profits or gains brought into charge to income tax: sections 450, 505, 1025 and 1026

This change concerns the rewrite of the phrase "out of profits or gains brought into charge to income tax", in the context of the general approach to the rules about charges on income (see *Change 81*).

The question whether a payment is made out of profits or gains brought into charge to income tax is easily answered if a payer has no income subject to income tax (such as a company, an exempt person, or an individual who happens to have no income). The difficulties arise where a payer has some income subject to income tax.

Where a payer does have some such income, a number of questions can arise in deciding whether or not the payment can be said to have been made out of that income, and there is a good deal of case law on the point. The significance of the point, under the new approach, is whether or not the payer can deduct the payment at Step 2 of the tax calculation (see section 23 of this Act).

The first issue is whether or not the income is sufficient overall. And this is the only question which now matters in the case of individuals – see CIR v Plummer (1979), 54 TC 1 HL at page 41 (Lord Wilberforce). So here it is necessary to compare the amount of the individual's "modified net income" (as given by section 1025) with the amount of the payment. For this purpose it is necessary to ignore this relief itself and any "non-qualifying income" as provided by section 1026.

In other instances the position is less straightforward and regard must be had to a number of decided cases. For persons other than individuals, additional tests can be discerned from these cases which outlaw deductions for payments which:

- are reimbursed (unless the reimbursement is taxable);
- can only lawfully be made out of capital or exempt income; or
- are treated by the payer as made out of capital or exempt income (when they need not have been) and this has a real world effect.

The following paragraphs provide more detail on cases that illustrate the three principles mentioned in the bullets above.

As to the first bullet: a number of cases (Dickson v Hampstead Borough Council (1927), 11 TC 691 KBD, Corporation of Birmingham v CIR (1930), 15 TC 172 HL, Scarborough Corporation v CIR (1947), 28 TC 147 KBD) have concerned statutory subsidies for interest payable on borrowings for capital works. (Such interest was then an annual payment.) The subsidies, which were not taxable in the recipients' hands, were for the gross amount of the interest, but in each case the corporation (which had taxed income) sought to obtain relief by retaining the tax deducted from the interest it paid. And in each case the courts held that this was inadmissible, and that the tax should be handed over.

As to the second bullet: in Sugden v Leeds Corporation (1913), 6 TC 211 HL the corporation borrowed money for two purposes: for investment into gasworks, waterworks and tramways ("municipal" undertakings), which were highly lucrative, and into sanitary works, which were not. There was in effect a statutory provision that the two funds could not be mixed. The corporation had insufficient money in the "sanitary" fund to meet the interest, so paid the balance of interest (which then was an annual payment) out of the Consolidated Fund, the income of which was untaxed (the borough rates). It was held that the corporation could not use the income from the "municipal" fund to frank the payment, and was assessable for the tax on the balance of the interest. It was not that the corporation had acted outside its powers, but that, had it made such an actual payment out of the "municipal" fund, it would have been so acting.

As to the third bullet: in Central London Railway Co v CIR (1936), 20 TC 102 HL and Chancery Lane Safe Deposit and Offices Co Ltd v CIR (1965), 43 TC 83 HL the respective companies borrowed money for capital works and charged such interest to capital in their accounts. It was held that this policy was not a matter of "domestic bookkeeping" but had a real effect on persons' rights and liabilities (absolute or contingent), because the fund of distributable profits was affected. In CIR v Ayr Town Council (1938), 22 TC 381 CS at page 403, Lord Normand said:

"Though the taxpayer is not bound by the mere form of the accounts, he is bound by the accounts so far as they have recorded a decision to debit the various funds in a particular way which has practical results apart from his right to retain Income Tax …

And in the circumstances dealt with in the first two cases mentioned above it was held to be inadmissible for the taxpayer to state that for one purpose it had made a capital payment, while for another it had made the same payment out of taxed income.

Under the approach to rewriting sections 348 and 349(1) of ICTA, the regime that applies for deducting and accounting for tax will no longer depend on whether the payment is made out of income brought into charge to income tax. Accordingly the rules on relief for payments are rewritten without direct appeal to that concept. On this approach, the restrictions on relief for persons other than individuals discerned from the cases mentioned above must be set out explicitly.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 83: Relief for payments to trade unions and police organisations: claims requirement: sections 457 and 458

This change introduces a claims requirement into the sections giving relief for life insurance related parts of payments to trade unions and police organisations (which are based on section 266(7) of ICTA).

In general, relief for life insurance premiums is given without a claim – section 266(1) of ICTA. This reflects the fact that in relation to qualifying ordinary life insurance policies relief is given at source, by the policyholder paying a reduced premium to the insurance company. But it is less satisfactory in relation to the life insurance related part of payments made gross to trade unions and police organisations for which relief is available in calculating net income, given that other such reliefs, and personal allowances, have to be claimed.

In practice, box 15.10 of the self assessment return does require a claim to this relief. The introduction of a formal claims requirement brings the law into line with this practice and provides a mechanism for resolving disputes.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 84: Limits to relief for payments to trade unions and police organisations and payments for benefit of family members: sections 457, 458 and 459

This change revises and simplifies the limits to relief for the life insurance related parts of payments to trade unions and police organisations under section 266(7) of ICTA and for payments to secure annuities etc under section 273 of ICTA.

The limits to relief are in section 274 of ICTA. They are in two parts.

Section 274(1) provides an overall limit of the greater of £1,500 and one-sixth of total income to the aggregate amount of premiums and other sums qualifying for relief under section 266. This rule did not impact on claims under section 266(7) and its linkage to other reliefs under section 266 (which are not being rewritten) is a needless complication. Accordingly, this part of the limit has been dropped. It did not apply to payments under section 273.

Section 274(2) and (3) provides a combined limit to relief under sections 266 and 273 in respect of any premiums or other sums that secure benefits other than capital sums payable on death. This is also complex, in that it combines premiums under section 266(1) with other payments under section 266(7) and section 273. Also, in expressing the limit as it applies to payments under section 266(7) in terms of tax at the basic rate, it is inconsistent with the fact that the relief operates as a deduction in calculating net income. Furthermore, relief under section 273 operates differently, as a tax reduction. It is much more natural to have independent limits applying to each provision.

The amounts of relief actually given under section 266(7) are small. While the existing limit to relief applies only to the part of any payment providing certain benefits, it is proposed to apply the limit to the whole of the qualifying payment. Although introducing a limit of £100 (corresponding to a qualifying payment of £200) is adverse in principle it is understood that no existing claims will be affected. And the fact that the relief will operate as a deduction in calculating net income rather than being limited to basic rate is taxpayer-favourable.

For relief under section 273 (ignoring the fact that other payments may have already used up some of the limit), the limit is £100 at basic rate. In strictness, the limit applies only to part of some payments under section 273, so again this aspect of the change is adverse in theory, but most or all payments under section 273 are solely to provide annuities to which the limit does apply. And in practice the limit has always been applied to all payments within that provision.

Each of the three provisions has been rewritten with an independent limit of £100. The exclusion of war insurance premiums from counting towards the limits (section 274(4)) is obsolete and has not been included.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 85: Settlements: receipts not charged at special trust rates: sections 481 and 873

This change ensures that receipts within section 686A of ICTA are not liable at the special trust rates when they arise to charitable trusts or to certain pension funds. It also ensures that the special trust rates do not apply to such receipts that are accumulated or discretionary income or would be but for being excepted by section 480(3) of this Act.

Certain amounts arising to trustees are liable at either the trust rate or the dividend trust rate regardless of whether or not the trustees would otherwise have accumulation or discretionary income.

Before FA 2006, the provisions applying the special trust rates were in the parts of the income tax code dealing with the types of amount concerned and section 686A of ICTA dealt only with distributions on the purchase by a company of its own shares. With effect from 6 April 2006, substituted section 686A brings together all the charges at the special rates.

Before 6 April 2006, section 686A(4) contained express exemptions from the charge at the special rates for charitable trusts and certain pension funds. These exemptions were not replicated in the substituted section although corresponding exemptions were retained in section 686. The exemptions are re-inserted in the re-write of section 686A (see section 481 of this Act).

The exemptions now apply to all the items within substituted section 686A, not just to distributions arising on the purchase by a company of its own shares. The exemption for charitable trusts is in section 481(1) (see section 686A(4)(c) before 6 April 2006) and that for the pension funds concerned is in section 481(5)(c) (see section 686A(4)(d) before 6 April 2006).

Prior to 6 April 2006, section 686A(4)(a) also ensured that there was no overlap between sections 686 and 686A. That has been replicated in section 481(5)(a) and (b).

What was section 686A(4)(b) prior to 6 April 2006 has not been re-written on the basis that the corresponding exemption in section 686 was repealed by FA 2006.

Trustees liable at one of the special trust rates are subject to the deduction of income tax at source provisions applying to deposit-takers and building societies in Chapter 2 of Part 15 of this Act. To ensure that section 873 also applies in the same way as its source legislation in section 481(4A) of ICTA did prior to 6 April 2006, section 873(2) also reinstates corresponding exemptions.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 86: Settlements: taxation of amounts taxable under the accrued income scheme: section 482 and Schedule 1 (section 720 of ICTA)

This change ensures that income arising to trustees under sections 628(5) and 630(2) (accrued income profits) is treated in the same way as all other receipts that are taxed at the trust rate.

Section 686A of ICTA, as substituted by FA 2006, brought together those receipts by trustees that are taxable at one of the special trust rates whether or not the trustees would otherwise have accumulation or discretionary income. But it did not include amounts taxable on trustees at the trust rate by virtue of section 720(5) of ICTA. In the interests of simplification, these amounts are included in the re-write of section 686A. See Type 2 in section 482.

The inclusion of these amounts in the list in section 482 means that the exemptions for charitable trusts and specified pension funds apply and that trustees' expenses may be set against the deemed income.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 87: Settlements: trustees' expenses set against accumulated or discretionary income when incurred: sections 484 and 485 and Schedule 2Part 10 (trustees' expenses to be set against trustees' trust rate income)

This change alters the way that trustees' expenses are taken into account in measuring the trustees' liability on income liable at the dividend trust rate or at the trust rate, so that this is done by reference to when the expenses are incurred rather than when they are paid. It also introduces explicit rules about the relief available where the expenses exceed such income.

Accumulation or discretionary income, and certain other receipts of trustees, are liable to income tax at either the trust rate or the dividend trust rate. Section 686(2AA) of ICTA provides that where this "trust rate income" is applied in defraying allowable expenses the income is charged instead at the normal rate appropriate to the income concerned. The word "defraying" is considered to require that the expense must have been paid before it is taken into account.

For settlements in which a beneficiary has an interest in possession, expenses are taken into account when they are *incurred* (see section 500(1) of this Act). This difference can give rise to practical difficulty, eg in relation to settlements that have both types of beneficiary. This change removes the difference, so that the rule in section 484 also uses the "incurred" basis.

Section 485 introduces explicit rules about the relief available where the trustees' expenses exceed the trustees' trust rate income in the tax year concerned. That section also operates by reference to when the expenses are incurred (contrary to present practice). The rule is that excess expenses are carried forward and relief is given as soon as there is sufficient income available.

In general, expenses are not paid before they are incurred. This timing effect will normally be in trustees' favour.

THIS CHANGE WILL NOT ALTER THE AMOUNT CHARGED TO TAX. THE MOST IT WILL DO IS AFFECT THE TIMING OF TAX LIABILITY. IN A SMALL MINORITY OF CASES THIS COULD MEAN A DIFFERENT RATE OF TAX BEING APPLIED. ANY OVERALL TAX EFFECT IS LIKELY TO BE NEGLIGIBLE.

Change 88: Settlements: grossing up of trustees' expenses set against accumulated or discretionary income: section 486

This change makes it clear that trustees' expenses are grossed up when set against the amount of income chargeable on the trustees at the trust rate or the dividend trust rate.

Trustees are chargeable under section 686(1) of ICTA at either the trust rate or the dividend trust rate on their accumulated or discretionary income. But section 686(2AA) of ICTA provides that where that income is applied in paying allowable expenses the income is charged instead at the normal rate appropriate to that income.

Since the expenses are regarded as being paid out of income after it has suffered tax at the normal rate, the amount of income arising to trustees which is applied in defraying expenses is an amount of income sufficient to meet both that tax and the expenses. In order to arrive at this amount of income, the expenses have to be grossed up at the appropriate rate. The grossing up of expenses is accepted practice although it is not clear from section 686 of ICTA itself.

In setting out how allowable expenses are taken into account, Steps 3 to 6 of section 486(1) require those expenses to be grossed up at the normal rate for the type of income concerned.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 89: Settlements: discretionary payments: provisions applying only to UK resident trustees: sections 493 and 497 and Schedule 2Part 10 (discretionary payments: trustees' tax pool)

This change makes it explicit that the Chapter dealing with the taxation of discretionary payments by trustees applies only to payments made and tax suffered while the trustees are UK resident.

Section 687 of ICTA contains rules regarding the liabilities of the trustees and the beneficiary when the trustees make a payment to a beneficiary in the exercise of a discretion. The rules can only operate sensibly where the payment is chargeable on the beneficiary as an annual payment under Chapter 7 of Part 5 of ITTOIA and it is well established that those provisions only apply where the payment arises in the United Kingdom.

The question can arise as to whether that test is satisfied in cases where UK resident trustees exercise discretion abroad or non-UK resident trustees exercise discretion in the United Kingdom. The approach adopted in practice is that section 687 of ICTA applies only to payments by UK resident trustees. Accordingly, section 493 contains the condition that it only applies to UK resident trustees. It follows that where a payment is made by non-UK resident trustees:

- the payment does not carry any tax credit in the hands of the beneficiary; and
- the trustees are not liable for any tax in respect of the payment.

As a corollary to the provisions of section 687 of ICTA not applying to non-UK resident trustees, tax only enters the trustees' tax pool if it is tax suffered on income arising while the trustees are UK resident – see section 497.

This change does not affect the operation of ESC B18, which enables UK resident beneficiaries who receive discretionary payments to have a credit for the tax paid by non-UK resident trustees on United Kingdom source income.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 90: Settlements: tax statements for settlors: section 495

This change allows the settlor of a trust to require a statement from the trustees where the income is regarded as that of the settlor rather than a beneficiary.

Section 352 of ICTA applies where trustees make a payment in the exercise of a discretion. It allows the recipient to require the trustees to provide a statement of the actual amount of the payment, the corresponding gross amount (grossing up at the trust rate) and the amount of tax deemed to have been deducted.

This is appropriate where the beneficiary is chargeable on the payment, but in a case where the settlor is chargeable under section 629 of ITTOIA it is that person who will need these details.

Accordingly, section 495 says that it is the person who is treated as having paid the income tax on the payment who may require a statement from the trustees.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 91: Settlements: trustees' expenses reducing beneficiary's income: sections 500, 503 and Schedule 1 (section 646A of ITTOIA)

This change makes explicit some of the rules about the way expenses incurred by trustees in connection with income to which a beneficiary is entitled reduce the amount of the beneficiary's income for tax purposes.

There are only two provisions in ICTA that concern the tax treatment of expenses in relation to income to which a beneficiary is entitled before it is distributed (where the beneficiary is regarded as having an interest in possession). These are:

- section 689A, which deals with the disregard of some expenses in the case of a non-resident beneficiary; and
- section 689B, which concerns the order in which expenses reduce the beneficiary's income.

While there are additional provisions in section 686(2AA) of ICTA that give some rules on the treatment of trustees' expenses in relation to accumulation or discretionary income, there is no corresponding provision for interest in possession trusts. The practices that have become established and which are reflected in these sections are based on the principle that the income of a beneficiary is the income arising to the trustees so far as the beneficiary is entitled to it.

There are two ways in which this principle operates.

First, if the trustees' expenses are chargeable to income under a provision of the settlement, then irrespective of whether they would be so chargeable in the absence of that provision, the expenses are to be taken into account. This is subject to the existence of any law that in a particular case (for example by way of a court order) overrides the provision in the trust deed.

This is different from the rule that operates in relation to accumulated or discretionary income where the terms of the settlement are to be ignored, and from what it appears that section 689A of ICTA provides for in this context.

If the deed is silent on whether a particular expense is chargeable to income then the expense is taken into account if it would be chargeable to income under general trust law.

These rules are reflected in section 500. They mean that an expense is allowable if it is chargeable to income under the trust deed, even if it would be chargeable to capital under general trust law. Conversely, in cases where general trust law would require an expense to be charged to income, but the trust deed charges it to capital, then the change means that the expense is not allowable.

The second area concerns how trustees' expenses are taken into account in such cases.

The expenses do not affect the amount of income on which the trustees are chargeable to tax, but operate to reduce the amount of the beneficiary's income. It is not that the beneficiary gets relief for the expenses as such; it is simply that the beneficiary is not entitled to the income used to pay the expenses. So, the beneficiary's income (as reduced by allowable expenses) is grossed up at the normal rate appropriate to that income to arrive at the gross amount which is to be treated as part of the beneficiary's total income.

This is not set out in the source legislation but, based on the decision in CIR v Lord Hamilton of Dalzell (1926), 10 TC 406 CS, it is the accepted way that expenses are taken into account. Section 503 reflects this.

This change also provides rules about cases where the trustees' expenses exceed a beneficiary's income. Section 500(1) applies in relation to the tax year in which the beneficiary's entitlement to income is reduced, whether the expense was incurred in that tax year or an earlier tax year. The reference to an earlier tax year means that the section covers cases where the trustees' expenses in an earlier tax year exceed the income in that earlier year and so the trustees are carrying forward the excess.

THIS CHANGE IS IN PRINCIPLE ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 92: Charitable trusts: exemption for adjustment income and post-cessation receipts of certain trades and property businesses: sections 524, 525, 526, 531 and 539

This change introduces an exemption from income tax, in the case of charitable trusts, for the adjustment income and post-cessation receipts of trades whose profits are exempt, or would be exempt if the trade had not ceased. It also introduces an exemption for the adjustment income and post-cessation receipts of property businesses, and of trades in cases where such income or receipts arise from land.

The general rule for calculating the profits of a trade for tax purposes is that the profits must be calculated on the basis of accounts drawn up in accordance with generally accepted accounting practice (see section 25 of ITTOIA). But an adjustment will be required if there is a change of basis in circumstances where the old basis accorded with law or practice in one period of account and the new basis accords with law and practice in the next period of account (see section 227 of ITTOIA). If the adjustment is positive, it is called adjustment income.

Adjustment income is charged to tax as trading income under section 228 of ITTOIA. There is no exemption for adjustment income in the source legislation for charitable trusts. But HMRC practice is to treat adjustment income in the same way as other trading income. That is, to treat it as exempt if it arises from a trade that benefits from the exemption in section 505(1)(e) of ICTA (rewritten as section 524), or if it arises in a small-scale trade where the income limits in section 46 of FA 2000 (rewritten as section 528) are not breached.

This change provides an exemption for adjustment income of a charitable trade or a small-scale trade. If a trade is treated as two separate trades in accordance with section 525(2) any adjustment income will be apportioned to the two parts (and this could mean completely apportioned to just one part if relating only to that part) and an exemption will then be available for the adjustment income apportioned to the charitable part.

Post-cessation receipts are taxed under Chapter 18 of Part 2 of ITTOIA. There is no exemption for post-cessation receipts in the source legislation for charitable trusts, other than the exemption in section 46 of FA 2000 (rewritten in sections 526 to 528) which applies only if the receipts are below a certain level. But HMRC practice is to treat post-cessation receipts as exempt from income tax if they arise from a trade that benefited from the exemption in section 505(1)(e) of ICTA (rewritten as section 524).

This change provides an exemption for post-cessation receipts from a charitable trade. If a trade is treated as two separate trades in accordance with section 525(2) any post-cessation receipts will be apportioned to the two parts (and this could mean completely apportioned to just one part if relating only to that part) and an exemption will then be available for the receipts apportioned to the charitable part.

The source legislation (section 505(1)(a) of ICTA, rewritten in section 531) provides an exemption from tax under Parts 2 and 3 of ITTOIA in respect of any profits or gains arising in respect of rents or other receipts from an estate, interest or right in or over any land. The exemption is available only to the extent that the profits or gains arise from land vested for charitable purposes and the profits or gains are applied for charitable purposes. HMRC practice is to treat associated adjustment income and post cessation receipts as eligible for exemption. This change provides such an exemption.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 93: Charitable trusts: mixed trades: requiring an apportionment to be just and reasonable: section 525

This change requires apportionment of expenses etc of a mixed trade, between the deemed charitable trade and the deemed other trade, to be "just" as well as "reasonable".

The source legislation in section 505(1B) of ICTA, as inserted by section 56 of FA 2006, requires such apportionments to be "reasonable". All other apportionments under this Act are required to be "just and reasonable". There is no reason why an apportionment should not be on a just and reasonable basis. And it is desirable that all apportionments should be made on the same basis.

Accordingly, section 525(4) requires a just and reasonable apportionment to be made where the source legislation requires the apportionment to be made on a reasonable basis.

The same change was made in ITTOIA, to provide a uniform expression of the basis on which apportionments are to be made.

THIS CHANGE MAKES A MINOR AMENDMENT TO THE BASIS OF APPORTIONMENT FOR MIXED TRADES, BUT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 94: Charitable trusts: limit on exemption for profits etc of small-scale trades and certain miscellaneous income: sections 526 and 528

This change rewrites the limit on the level of a charitable trust's income for the purposes of the exemption for profits etc of small-scale trades in section 526 and certain miscellaneous income in section 527 by reference to the charitable trust's incoming resources rather than in terms of its gross income. It also removes the requirement that the exemption for profits etc of a small-scale trade can apply only if the trade is carried on wholly or partly in the United Kingdom.

Section 46 of FA 2000 provides for an exemption from income tax for certain profits or other income or gains of a charitable trust which are chargeable to income tax. The exemption applies in respect of a trade carried on wholly or partly in the United Kingdom or under or by virtue of any provision to which section 1016 of this Act (based on section 836B of ICTA) applies.

Section 46(3) of FA 2000 provides that one of the requirements for the exemption to apply is that the charitable trust's "gross income" must not exceed the "requisite limit". The "requisite limit" is defined in section 46(4) of that Act and depends on the charitable trust's incoming resources for the chargeable period.

Section 528 sets out the condition about the level of the trading and miscellaneous income that has to be met if the exemptions in sections 526 or 527 are to be available.

The condition operates by reference to the incoming resources associated with the trading activity and miscellaneous transactions whose profits are not exempt under other provisions. The expression "incoming resources" is used instead of "gross income" because this accounting term is a more direct and accessible way of capturing the meaning of "gross income" as defined in the source legislation.

The source legislation aimed to bring in turnover for trading activity and gross receipts for Schedule D Case VI transactions. But these terms are not used in charity accounting. "Incoming resources" is familiar to those involved in preparing or working with charity accounts. And since charity accounting does not allow offset between income and expenditure in determining disclosure (in contrast with the disclosure in the accounts of commercial organisations), it is relatively easy to check the limits.

It is not clear in section 46 of FA 2000 whether "gross income" includes incoming resources from an activity which gives rise to a loss, in cases where a profit would be taxable. But incoming resources from an activity are included irrespective of whether there is a profit or a loss.

Charitable trusts do not in practice include balancing charges in "gross income". And balancing charges do not come within the meaning of incoming resources.

The requirement in section 46(1)(a) of FA 2000 that the trade is carried on wholly or partly in the United Kingdom reflects the pre-ITTOIA requirement that the trade be subject to tax under Schedule D Case I (rather than Case V). In practice a charitable trust established in the United Kingdom will not carry on a trade wholly outside the United Kingdom, given the oversight exercised from its head office. And HMRC practice has been to accept that the profits of a small-scale trade are exempt, without considering where the trade is carried on. So the requirement has been dropped.

This change aligns the rewritten legislation with the way it is considered section 46 of FA 2000 is operated in practice.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 95: Charitable trusts: exemption for profits from fund-raising events: sections 529 and 539

This change gives statutory effect to ESC C4 (trading activities for charitable purposes).

The concession provides an exemption for the profits of various fund-raising activities which amount to a trade, but which are only undertaken to raise money for charity. The concession does not apply in circumstances where an attempt is made to use it for tax avoidance, and to reflect this the new statutory exemption is subject to the restrictions in section 539.

The fund-raising event has to be of a kind that falls within the exemption from VAT under Group 12 of Schedule 9 to the Value Added Tax Act 1994. This Schedule provides an exemption from VAT for the supply by a charity of goods and services in connection with an event that is organised primarily to raise money for itself or other charities. The Schedule defines "event" and places certain limits on the number of events that a charity can hold in the same location in any given year.

Section 529, in line with the extra-statutory concession, is linked to the VAT legislation to provide consistency in tax treatment.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 96: Charitable trusts: exemption for income from intellectual property etc: section 536

This change provides an exemption from income tax for certain royalties and other income from intellectual property and certain income derived from a relevant telecommunication right, whether or not the income is annual in nature.

Section 505(1)(c)(ii) of ICTA provides for an exemption from tax in respect of (among other things) income chargeable under section 579 of ITTOIA and income chargeable under Chapter 4 of Part 5 of ITTOIA. But only, in each case, to the extent that the income relates to annual payments.

Section 579 of ITTOIA charges royalties etc from intellectual property and Chapter 4 of Part 5 charges certain telecommunication rights. In each case the charge to tax is on income that does not arise from the carrying on of a trade. So the income chargeable under the provisions referred to can be annual in nature, but need not be so. Prior to ITTOIA, income of this sort was chargeable under Schedule D Case III if annual in nature, and under Schedule D Case VI if not. So the exemption applied only to Case III income.

But in practice HMRC allow an exemption for income chargeable under section 579 or under Chapter 4 of Part 5 whether or not it is annual in nature. This change is in line with that practice, and reflects the unity of the charging provisions post-ITTOIA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 97: Charitable trusts: exemption for income from estates in administration: sections 537 and 539

This change provides an exemption to trustees of charitable trusts who are liable to income tax under section 659 of ITTOIA on estate income charged under section 649 of that Act, to the extent that the income is applied to the purposes of the charitable trust.

Estate income is income from property held by the personal representatives or administrators of the estate of a deceased person on behalf of the beneficiaries of the estate. The administrators are liable to income tax on the income.

Income of United Kingdom estates and United Kingdom source income of foreign estates is chargeable under section 649 of ITTOIA.

Foreign income of foreign estates (see section 651 of ITTOIA) is treated as arising from sources outside the United Kingdom (see section 658(2) of that Act) and is not chargeable under section 649 of that Act but falls to be dealt with in accordance with the rules applying to income from the particular source. And any relevant exemptions provided by Part 10 of this Act apply accordingly.

There is a long-standing HMRC practice of treating United Kingdom estate income received by charities as exempt, and of allowing repayment claims in such cases. This change puts this on an explicit statutory basis.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 98: Charitable trusts: meaning of non-charitable expenditure: sections 543, 544 and 545

This change clarifies the meaning of "non-charitable expenditure".

Section 506(1) of ICTA defines "charitable expenditure" as:

"(subject to subsections (3) to (5) below) expenditure which is exclusively for charitable purposes.

Section 506(3) to (5) treats certain payments, investments or loans as amounts of non-charitable expenditure.

Section 505(4) of ICTA restricts a charity's tax exemption by reference to non-charitable expenditure. "Non-charitable expenditure" is not defined but, by implication, it is expenditure which is not charitable expenditure.

Sections 543, 544 and 545 set out the definition of "non-charitable expenditure" in some detail, to reflect practice and HMRC guidance.

Section 543(1)(a) to (f), supported by section 544, provide in relation to trades, property businesses and miscellaneous transactions, that it is *losses* which may count as non-charitable expenditure, rather than those expenses which are required to be taken into account in calculating the profits or losses concerned.

Section 543(1)(a) to (f) also ensure that such losses do not count as non-charitable expenditure if corresponding profits would have been exempt under the provisions about small-scale trades, fund-raising events, lotteries or property income in sections 526, 529, 530 and 531. And section 543(1)(a)(i) makes it clear that losses made in a charitable trade do not count as non-charitable expenditure.

Section 545 supports section 543(1)(f), making it clear that expenditure (which is not itself defined in the source legislation) includes capital expenditure, but not the making of investments or loans or the repayment of loans made to the charitable trust. Section 543(1)(i) and (j) then make specific provision about investments or loans that are not approved charitable investments or loans, reflecting section 506(4) of ICTA.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS LINE WITH CURRENT PRACTICE.

Change 99: Charitable trusts: tax year in which certain expenditure treated as incurred: section 546

This change makes it explicit that the time when expenditure is treated as incurred depends on UK generally accepted accounting practice (UK GAAP).

Section 506(2) of ICTA provides that, for the purposes of section 505 of ICTA:

"where expenditure which is not actually incurred in a particular chargeable period properly falls to be charged against the income of that chargeable period as being referable to commitments (whether or not of a contractual nature) which the charity has entered into before or during that period, it shall be treated as incurred in that period.

Section 506(2) was first enacted in FA 1986 and advanced the time that certain expenditure is recognised, on the basis that charitable trusts may have some flexibility in this regard. As a result of subsequent developments in accounting practice, the legislation now implicitly mirrors UK GAAP.

Section 546 is based on section 506(2) of ICTA, and makes the reference to UK GAAP explicit. Section 997(2) defines UK GAAP for the Income Tax Acts.

Section 546 is drafted in terms of the position if UK GAAP had applied because there is no legal or other obligation requiring all charitable trusts to prepare their accounts in accordance with UK GAAP. In particular "Accounting and Reporting for Charities: Statement of Recommended Practice (revised 2005)", which imposes a requirement to account in accordance with UK GAAP on charitable trusts (with certain exceptions), is not mandatory in Scotland and Northern Ireland. Neither does it apply to charitable trusts which are able to prepare accounts on a "receipts and payments" basis rather than an "accruals" basis.

This approach ensures parity of treatment as between charitable trusts operating in different parts of the United Kingdom or adopting different bases of accounting.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 100: Charitable trusts: approved charitable investments: sections 558, 559, 560 and 1021

This change modernises the list of investments qualifying as approved charitable investments for the purposes of the rules restricting exemptions.

Although the list is based on Part I of Schedule 20 to ICTA (qualifying investments), it does not replicate the approach taken in that Part.

Part I of Schedule 20 defines qualifying investments by specifying certain investments itself, and also by referring to investments falling within Part I, Part II (apart from paragraph 13) or Part III of Schedule 1 to the Trustee Investment Act 1961 (TIA 1961).

For trust law purposes TIA 1961 has been largely superseded by the Trustee Act 2000 (TA 2000). TA 2000 increased significantly the range of investments trustees can invest in, and it would be a significant change in the law to allow any investment in accordance with TA 2000 to be treated as an approved charitable investment. But it would be unhelpful to continue to refer for tax purposes to a Schedule to an Act (TIA 1961) that trustees no longer need to refer to for investment purposes.

So the detail of investments covered by Schedule 1 to TIA 1961 is incorporated in sections 558 and 559 in a more succinct and updated form.

This has been done by referring to the types of investment that a charitable trust can hold on "an approved basis". So investment in, for example, fixed or variable interest securities issued by any of Her Majesty's Government, the government of any overseas territory within the Commonwealth and the government of any state within (broadly) the European Union (EU) is reduced to securities issued by the government of any state in the EU and of any other state. This is wider, and so (strictly) is a taxpayer-favourable change. And rather than list the large number of individual entities in whose securities a charitable trust can hold an approved investment, reference is made to the international entities listed in the directive on the taxation of interest payments. Again, this is a taxpayer-favourable change.

This approach tends to broaden the scope of possible investments, but in a way that is in keeping with HMRC practice in relation to claims that an individual investment should be regarded as qualifying, as set out in paragraph 9(1) of Schedule 20.

When it comes to the ability to hold an approved investment in the securities of (broadly) a non-listed company, the anti-avoidance provisions in Part IV of Schedule 1 to TIA 1961 have been largely repeated.

A more detailed analysis of where the approved investments in the source legislation appear in the rewritten sections 558 and 559 is as follows:

Schedule 20 to ICTA	*Section 558*	*Section 559*
Paragraph 2	See details below relating to investments listed in TIA 1961	
Paragraph 3	Types 2 and 4	
Paragraph 3A	Types 3 and 4	
Paragraph 4	Type 5	
Paragraph 5 (note: the Unlisted Securities Market no longer exists)	Type 1	Subsection (1)(h)
Paragraph 6	Type 8	
Paragraph 6A	Type 1	Subsection (1)(g)
Paragraph 7	Type 9	
Paragraph 7A	Type 11	
Paragraph 8	Type 11	
Paragraph 9	Type 12	
Part 1 of Schedule 1 to TIA 1961:	*Section 558*	*Section 559*
Paragraph 1: Savings Certificates	Type 6	
Paragraph 1: Other	Type 1	Subsection (1)(a)
Paragraph 2 (note: only deposits in the National Savings Bank are still relevant)	Type 10(a)	
Part 2 of Schedule 1 to TIA 1961	*Section 558*	*Section 559*
Paragraph 1: Treasury Bills and Tax Reserve Certificates	Type 6	
Paragraph 1: Northern Ireland Treasury Bills	Type 7	
Paragraph 1: Other	Type 1	Subsection (1)(a)
Paragraph 2 (but principal must be guaranteed as well as interest)	Type 1	Subsection (1)(a)

Part 2 of Schedule 1 to TIA 1961	*Section 558*	*Section 559*
Paragraph 3 (but assumes nationalised industries are not an issue in the United Kingdom and are not likely to be an issue elsewhere)	Type 1	Subsection (1)(b)
Paragraph 4 (and extended to securities issued outside the United Kingdom)	Type 1	Subsection (1)(b)
Paragraph 4A (and extended to securities issued outside the United Kingdom and drops requirement about parameters for setting the interest rate)	Type 1	Subsection (1)(b)
Paragraph 5 (and extended to securities issued outside the United Kingdom)	Type 1	Subsection (1)(c) and (d)
Paragraph 5A (and extended to securities issued outside the United Kingdom and drops requirement about parameters for setting the interest rate)	Type 1	Subsection (1)(c) and (d)
Paragraph 5B	Type 1	Subsection (1)(b) and (c)
Paragraph 6	Type 1	Subsection (1)(h)
Paragraph 7	Type 1	Subsection (1)(h)
Paragraph 9 (but some loans and deposits are not covered as this is considered unnecessary)	Type 1	Subsection (1)(b)
Paragraph 9A (but drops requirement about parameters for setting the interest rate)	Type 1	Subsection (1)(b)
Paragraph 10A	Type 8	
Paragraph 12	Type 10(b)	
Paragraph 13	Excluded by paragraph 2 of Schedule 20 to ICTA	
Paragraph 14	Type 5	
Paragraph 15	Type 6	
Paragraph 16	Type 1	Subsection (1)(b)
Paragraph 17 (but principal must be guaranteed as well as interest)	Type 1	Subsection (1)(b)
Paragraph 18 (but assumes nationalised industries are not an issue in the United Kingdom and are not likely to be an issue elsewhere)	Type 1	Subsection (1)(b)
Paragraph 19	Type 1	Subsection (1)(b)
Paragraph 20	Type 1	Subsection (1)(c) and (d)
Paragraph 21	Type 1	Subsection (1)(i)

Part 2 of Schedule 1 to TIA 1961	*Section 558*	*Section 559*
Paragraph 22 (but some loans and deposits are not covered as this is considered unnecessary)	Type 1	Subsection (1)(b)
Paragraph 23 (and extended to similar societies outside the EU)	Type 10(c)	
Paragraph 24	Excluded (by extension) by paragraph 2 of Schedule 20 to ICTA	
Part 3 of Schedule 1 to TIA 1961	*Section 558*	*Section 559*
Paragraph 1 (and extended to securities issued outside the United Kingdom)	Type 1	Subsection (1)(i)
Paragraph 2	Type 1	Subsection (1)(e)
Paragraph 2A	Type 1	Subsection (1)(g)
Paragraph 3	Type 8	
Paragraph 4 (and extended to securities issued outside the EU and to securities of non-EU incorporated companies)	Type 1	Subsection (1)(i)
Paragraph 5 (and extended to similar societies outside the EU)	Type 1	Subsection (1)(f)
Paragraph 6	Type 8	
Part 4 of Schedule 1 to TIA 1961	*Section 560*	
Paragraph 1	Not covered – this is taxpayer-favourable	
Paragraph 2	Covered by Conditions A and B	
Paragraph 2A	Covered by Conditions A and B	
Paragraph 3	Covered by Condition C	

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 101: Accrued income profits: variable rate securities: transfers after the securities' last interest period: sections 579, 617, 630, 636, 639, 640, 641, 667, 669 and 747 and Schedule 1 (section 119 of TCGA and section 161 of FA 1998)

This change relates to the clarification of when accrued income scheme profits on transfers of variable rate securities arise where the settlement day for the transfer occurs after the end of the securities' last interest period and consequential changes.

(1) Accrued income charges (and reliefs) are normally computed by reference to transfers of securities of the same kind which are settled in the same interest period (see sections 713(1) and 714(1) and (2) of ICTA). Profits are treated as received on the last day of that period (see section 714(2) of ICTA).

Normally securities pay their last interest on their redemption day. So settlement on the transfer of securities will only occur outside an interest period in exceptional circumstances. There are two particular cases where the settlement day occurs after the end of the securities' last interest period. One is where securities with a variable rate of interest ("variable rate securities") are transferred, including securities which pay their last interest some time before redemption day. (The other is securities transferred with unrealised interest.)

Section 717 of ICTA deals with variable rate securities. The provisions about their transfer are not straightforward. Since section 717(7) of ICTA provides that the securities are treated as being transferred with accrued interest if they would not otherwise be so treated, it is clear how transfers which are settled in an interest period are dealt with: they fall within the main accrued income scheme regime and so the rule in section 714(2) of ICTA will apply. But it is not so clear what happens where the settlement day occurs after the end of the securities' last interest period.

In the case of a transfer that is treated as taking place at redemption under section 717(8) of ICTA, section 712(4) of ICTA provides that the settlement day is the day of the transfer (that is, the day of the redemption). Where the last interest period ends before redemption, so that the settlement day occurs after the end of the securities' last interest period, section 717(11) of ICTA, as applied by section 717(10) of ICTA, treats a further period lasting up to the settlement (redemption) day as an interest period of the security ("the artificial interest period"). Section 713(2)(a) of ICTA then operates so that the transferor is treated as entitled to a sum in the artificial interest period in which the settlement day falls. The rule in section 714(2) of ICTA then applies by reference to the artificial interest period. This has the result that the accrued income profits on redemption are taxed in the tax year in which the settlement (redemption) day falls.

However, section 717(10) of ICTA says nothing explicit about section 717(11) of ICTA applying to ordinary transfers (as distinct from transfers that are deemed to occur on redemptions) where the settlement day occurs after the end of the last interest period but before the date of redemption. Consequently, it is not clear how they should be dealt with. But in practice, HMRC interpret section 717(11) of ICTA as applying in all cases where the settlement day in fact falls after the end of the last interest period, so as to add an artificial interest period up to the settlement day for any transfer after the final interest period of a variable rate security. Then section 713(2)(a) of ICTA can again operate by reference to the artificial interest period, with the result that the accrued income profits are taxed in the tax year in which the settlement day falls.

Section 617(3) gives effect to that interpretation by providing that profits on all transfers of variable rate securities are treated as made in the tax year in which the settlement day falls where the settlement day is after the end of the last interest period.

Section 630 deals with transfers of variable rate securities where the settlement day falls outside an interest period. It deals with all such transfers, rather than restricting its application to transfers on redemption. Section 630 (1) and (2) therefore also gives effect to that interpretation in determining whether the transferor is treated as making accrued income profits without distinguishing a transfer to which section 717(11) of ICTA applied.

((B) Under section 721(2) of ICTA, if an individual dies, and the personal representatives transfer securities to a legatee *in the interest period in which the individual died*, section 713 of ICTA does not apply to that transfer.

As explained in part (A) of this note, in the case of the redemption of variable rate securities where the settlement day for the transfer occurs after the end of the securities' last interest period, section 717(10) and (11) of ICTA create a further artificial interest period and in practice this is taken to extend to all transfers and not just redemptions.

The settlement day for the purposes of section 721 of ICTA is the day on which the securities are transferred by the personal representatives to the legatee (see section 712(4) of ICTA). This is unlikely to coincide with the redemption day, but in practice it would be treated as falling within the artificial interest period.

As a consequence of the change explained in part (A), section 636, which rewrites the exemption for transfers to legatees in section 721 of ICTA, makes special provision at subsection (3) so that transfers to legatees of variable rate securities after the end of the only or last interest period of the securities are covered by the exemption, even though they will no longer occur in the artificial interest period and so will not fall within section 636(2).

((C) Section 715(1) of ICTA provides various exclusions from section 713(2)(a) of ICTA. The exclusions in section 715(1)(b), (c) and (e) of ICTA exclude transfers by individuals, personal representatives and the trustees of a disabled person's trusts unless, on any day in the year of assessment in which the interest period of the securities ends or the previous year, the nominal value of securities held by the transferor exceeds £5,000. Therefore these exclusions depend on the settlement day being in an interest period.

As a consequence of the change explained in part (A), sections 639, 640 and 641 which rewrite these exclusions make special provision so that transfers by these kinds of transferors, where the settlement day is after the end of the only or last interest period of the securities, are covered by the exclusions, even though they will no longer occur in the artificial interest period.

So, for example, for transfers by individuals section 639(3) provides that in the case of variable rate securities an individual is an excluded transferor if the nominal value of the securities does not exceed £5,000 in the relevant tax year or the previous tax year. Section 639(4)(a) provides that, if the settlement day falls in an interest period, the relevant tax year is the tax year in which the interest period ends. Section 639(4)(b) provides that, if the settlement day does not fall in an interest period, the relevant tax year is the tax year in which the settlement day falls.

((D) Under section 720(6) of ICTA, where trustees are treated as receiving income under section 714(2) of ICTA, that income is treated for the purposes of Chapter 5 of Part 5 of ITTOIA as income arising under the settlement. Section 720(6) of ICTA applies similarly in the case of trustees, who are resident or domiciled outside the United Kingdom throughout a tax year in which an interest period (or part of it) falls, if they would have been treated under section 714(2) of ICTA at the end of that interest period as receiving income (or a greater amount of income), had they been resident or domiciled in the United Kingdom during a part of such a tax year. The amount (or greater amount) that would have been so treated under section 714(2) of ICTA is also treated as income arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA.

(Trustees who are resident or domiciled outside the United Kingdom would normally fall with section 715(1)(f) of ICTA so that section 713 of ICTA does not apply to give amounts that would be taken into account under section 714(2) of ICTA. See section 643 which makes provision equivalent to section 715(1)(f) of ICTA, so that such trustees would normally be an "excluded transferor" or "excluded transferee" for the purposes of Part 12.)

Where an amount of accrued income profits is treated as arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA, the settlor will be charged to tax on the amount of the accrued income profits and not the trustees (had they otherwise been the person liable for tax on those profits).

By virtue of section 717(7) of ICTA, transfers of variable rate securities are treated for the purposes of sections 710 to 727A of ICTA as a transfer with accrued interest. Where the transfer occurs within an interest period, section 713 of ICTA applies (subject to the modification in section 717(9) of ICTA) to provide the amount that falls within section 714(2) of ICTA. As explained in part (A) of this note, in the case of the redemption of variable rate securities if the settlement day for the transfer occurs after the end of the securities' last interest period, section 717(10) and (11) of ICTA create a further artificial interest period. So, in that case section 713 of ICTA (as modified) applies again to provide an amount falling within section 714(2) of ICTA.

Section 667 treats "qualifying accrued income profits" which trustees are treated as making (or would be treated as making but for the fact that they are resident or domiciled outside the United Kingdom) as income arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA. "Qualifying accrued income profits" include profits treated as made under section 628(5) (profits treated as made in an interest period on a transfer of securities with or without accrued interest), and profits treated as made under section 630(2) (profits treated as made where the settlement day is outside an interest period) in respect of a transfer of variable rate securities. As a consequence of the change explained in part (A), profits treated as made under section 630(2) include profits on all transfers of variable rate securities where the settlement day is outside an interest period. And all such profits are therefore included in "qualifying accrued income profits" as that term is used in section 667.

Sections 579 (manufactured interest on UK securities: allowable deductions: matching) and 747 (amounts corresponding to accrued income scheme profits and related interest) rewrite provisions that use cross reference to profits falling within section 714(2) of ICTA (respectively, paragraph 3(2A)(b) of Schedule 23A to, and section 742(4) of ICTA) similarly to the use made in section 720(6) of ICTA. Those sections therefore use the term "qualifying accrued income profits", as defined in each of those sections, to refer to profits arising under Part 12. The definitions refer to profits treated as made under section 630(2) in respect of a transfer of variable rate securities. So the change explained in part (A) applies also for the purposes of those sections.

((E) Under section 723(1) of ICTA, relief is available where a person is treated under section 713(2)(a) of ICTA as entitled *in an interest period* to a sum or sums in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom and the proceeds are unremittable.

As explained in part (A) of this note, in the case of the redemption of variable rate securities if the settlement day for the transfer occurs after the end of the securities' last interest period, section 717(10) and (11) of ICTA create a further artificial interest period and in practice this is taken to extend to all transfers and not just redemptions.

As a consequence of the change explained in part (A), this Part makes special provision in section 669 so that unremittable proceeds of transfers of variable rate securities after the end of the only or last interest period of the securities are covered by the relief, even though they will no longer occur in the artificial interest period and so will not fall within section 668(1).

((F) A number of provisions outside the accrued income scheme work by reference to section 713 or 714 of ICTA. To the extent that the special rules in section 717(10) and (11) of ICTA affect the application of those sections (as explained in part (A)), that effect carries through to the provision citing section 713 or 714 of ICTA. By virtue of the change explained in part (A), a provision which (as amended by Schedule 1 to this Act) works by reference to provisions in Part 12 of this Act that rewrite sections 713 or 714 of ICTA now incorporates that change in its effect. See, in particular, the amendments in that Schedule to section 119 of TCGA and section 161 of FA 1998. But more general references to the application of Part 12 of this Act or to Chapter 2 of Part 12 may similarly import the effect of this change.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 102: Accrued income profits: transfers of variable rate securities not treated as transfers with accrued interest: sections 626 and 630

This change alters the way that the accrued income scheme operates as respects transfers of variable rate securities by ceasing to treat them as transfers with accrued interest and applying the special rules relating to them directly.

Where securities are transferred with accrued interest, section 713(2)(a) and (b) of ICTA apply and there is an effect for both the transferor and the transferee. Under section 713(2)(a) of ICTA the transferor is treated as entitled to a sum and under section 713(2)(b) of ICTA the transferee is entitled to relief of the same amount. Section 713(4) and (6) of ICTA apply to determine the amount of the sum or relief ("the accrued amount") to be taken into account.

Under section 717(7) of ICTA, *all* transfers of variable rate securities are treated as transfers with accrued interest, even where they would otherwise be transfers without accrued interest. But then section 717(9) of ICTA makes two changes to section 713 of ICTA so that it does not apply in the way it normally does for transfers with accrued interest. First, section 713 of ICTA applies without subsection (2)(b), so that there is an effect only for the transferor and not for the transferee. (This means there can be a charge to tax under the accrued income scheme for the transferor but no corresponding relief for the transferee.) Secondly, section 713(4) to (6) of ICTA do not apply to determine the amount of the "sum" to be taken into account because section 713(3) to (6) of ICTA are replaced with a new subsection (3) that provides:

"In subsection (2) above "the accrued amount" means such amount (if any) as is just and reasonable.

So this approach applies a fiction, which is actually not very helpful because in fact the rules that are applied are not the same as those that apply to transfers with accrued income. Moreover, removing subsections (3) and (5) of section 713 of ICTA is unnecessary, since they apply only for transfers *without* accrued income.

Therefore, the fiction in section 717(7) of ICTA has not been rewritten. Instead, transfers of variable rate securities have been removed from the normal accrued income scheme regime, and then the special rules relating to them have been applied directly without first treating them as transfers with accrued interest, and without having to modify the normal rules.

Accordingly, sections 623 and 624, which set out the rules about when transfers are transfers with or without accrued interest, are disapplied for transfers of variable rate securities by section 623(5) and section 624(5). Sections 626 and 630 therefore apply without the intervention of any fiction. And section 635(2) and (3) sets out the special rules for transfers of variable rate securities that are the result of section 717(7) and (9) of ICTA in the terms of the rewritten accrued income scheme in this Part (i.e. that the transferee is not treated as making a payment on the transfer and the amount of the payment treated as made is such amount as is just and reasonable).

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT IS A CHANGE IN THE LAW THAT MAKES THE LEGISLATION CLEARER AND EASIER TO UNDERSTAND.

Change 103: Accrued income profits: relief for unremittable transfer proceeds: transfers with unrealised interest: sections 668 and 669

This change extends relief from tax on accrued income scheme profits if the proceeds of the transfer of foreign securities are unremittable to cases where securities are transferred with unrealised interest.

Section 723 of ICTA provides a relief if a person is treated under section 713(2)(a) of ICTA as entitled to a sum or sums in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom and the proceeds are unremittable. Section 723(1) of ICTA provides:

"This section applies where *in an interest period* a person is treated as entitled to a sum or sums under section 713(2)(a) in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom.

So the relief is only available if a person is treated as entitled to a sum or sums under section 713(2)(a) of ICTA and the person is so entitled in an interest period.

These conditions create problems if securities are transferred with the right to receive interest ("unrealised interest") payable on an interest payment day before the settlement day. Such transfers are dealt with under section 716 of ICTA.

If (as is normally the case) the settlement day for such a transfer falls within an interest period, section 716(2) of ICTA provides that section 714 of ICTA applies as if the transferor were entitled under section 713 of ICTA in the interest period to a sum equivalent to the unrealised interest. The effect is that section 714(2) of ICTA applies so that the person is treated as receiving profits, equal to that sum, that are chargeable to income tax.

But section 716(2) of ICTA only provides that section 714 of ICTA applies as if the transferor were entitled to a sum under section 713 of ICTA; it does not treat the transferor as being so entitled for all purposes. So the condition in section 723(1) of ICTA, that the transferor must be treated as entitled to a sum or sums under section 713(2)(a) of ICTA, is not satisfied. Moreover, if securities are transferred with unrealised interest and the settlement day falls outside an interest period, the second condition is not satisfied either.

In practice, however, relief is given under section 723 of ICTA if securities are transferred with unrealised interest and the proceeds of the transfer cannot be remitted to the United Kingdom, whether the settlement day falls inside or outside the interest period. So sections 668 and 669, which are based on section 723 of ICTA, cover all such transfers.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH PRACTICE.

Change 104: Accrued income profits: relief for unremittable transfer proceeds: conditions for granting relief: section 668

This change broadens one condition and removes another condition for claims for relief in respect of unremittable income under section 723 of ICTA.

Chapter 4 of Part 8 of ITTOIA provides for relief for taxpayers taxed on income arising outside the United Kingdom, if the income cannot be remitted to the United Kingdom and certain conditions are met. This provision is the model for the relief provided by the accrued income scheme for unremittable transfer proceeds. Section 841 of that Act refers to income which cannot be remitted to the United Kingdom because of the laws of the overseas territory, any executive action of its government or the impossibility of the person obtaining transferable currency in the overseas territory.

Sections 835 to 837 of ITTOIA apply to taxpayers with income charged on the remittance basis (see section 832 of that Act). They provide that relief from tax on "relevant foreign income" (see section 830 of that Act) may be claimed if the conditions set out in section 835(2) and (3) of that Act are met.

- Subsection (2) requires that the income arose before the tax year for which relief is claimed.
- Subsection (3) requires the taxpayer to have been unable to transfer the income to the United Kingdom.
- Subsection (3)(a) to (c) requires the inability to transfer to have been due to one of three reasons:
  - — the laws of the territory where the income arose;
  - — executive action of its government; or
  - — the impossibility of obtaining transferable currency in that territory.

Section 723 of ICTA provides a similar relief for accrued income scheme profits from transfers of securities situated outside the United Kingdom where the conditions set out in section 723(5)(a) to (c) of ICTA are met. Those conditions mirror the ones in section 835 of ITTOIA, but must be met in respect of the proceeds of the transfers.

Section 723(5)(c) of ICTA also requires that the inability to transfer is not due to any want of "reasonable endeavours" on the part of the taxpayer. (That condition was present in the source legislation for section 835 of ITTOIA, but was not reproduced in the rewritten legislation.)

(1) The condition contained in section 723(5)(b) of ICTA requires an inability to transfer "due to….the impossibility of obtaining foreign currency" in the territory where the income arose. It could be argued that there cannot be an inability to transfer due to the impossibility of obtaining foreign currency in that territory if foreign currency is in fact obtainable there (regardless of whether it may be transferred to the United Kingdom).

Section 668(5)(c) removes the possibility of that narrow interpretation being taken. It requires there to be an inability to transfer the proceeds due to the impossibility of obtaining in the territory currency "that could be transferred to the United Kingdom".

((B) The condition contained in section 723(5)(c) of ICTA has not been rewritten in this Act. It is regarded as adding little to the requirements of section 723(5)(a) and (b) of ICTA. If, by reasonable endeavours, the taxpayer could transfer the income to the United Kingdom, the test in section 723(5)(a) of ICTA of his being unable to transfer the income or remit the proceeds of transfer is not met, and there would then be no inability to transfer *due to* local law, government action or the impossibility of obtaining foreign currency as required under section 723(5)(b) of ICTA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 105: Accrued income profits: relief for unremittable transfer proceeds: time limits: sections 668 and 669

This change alters the time limit for claiming relief from tax on accrued income scheme profits if the proceeds of the transfer of foreign securities are unremittable.

Section 723 of ICTA provides a relief if a person is treated under section 713(2)(a) of ICTA as entitled to a sum or sums in respect of a transfer or transfers of securities of a particular kind which are situated outside the United Kingdom and the proceeds are unremittable. Under section 723(3) of ICTA the relief may only be given if a claim is made and section 723(6) of ICTA provides:

"No claim under this section shall be made in respect of a transfer more than six years after the end of the interest period in which the transfer occurred.

The usual time limit for making claims is set out in section 43 of TMA, which provides:

> "Subject to any provision of the Taxes Acts prescribing a longer or shorter period, no claim for relief in respect of income tax or capital gains tax may be made more than five years after the 31st January next following the year of assessment to which it relates.

Moreover, the time limit under section 279 of TCGA (which provides similar relief from capital gains tax where capital gains from the disposal of assets situated outside the United Kingdom cannot be remitted to the United Kingdom) is also five years from 31 January next following the tax year in which the gains accrue. (See section 279(5)(a) of TCGA.)

There does not appear to be any justification for a different time limit applying for claims under section 723 of ICTA. So, in rewriting that section in sections 668 and 669, the time limit for making the claim for relief has been changed to bring it into line with the period that applies under section 43 of TMA. And sections 668(7) and 669(4) provide that the claim must be made on or before the fifth anniversary of the normal self-assessment filing date for the tax year in which the profits would be chargeable were it not for the relief (that is, 31 January in the following tax year).

The new time limit may be longer or shorter than the time limit in section 723(6) of ICTA, depending on when in the tax year the interest period of the securities in which the transfer or transfers were made ends. If the interest period ends before 31 January in a tax year, the change will be beneficial. If it ends later the change will be adverse, but those adversely affected may make an election under Part 2 of Schedule 2 to this Act to disapply the change for the tax year to which the election applies.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 106: Accrued income profits: meaning of "interest period" where consolidation of strips into a gilt-edged security occurs: section 673

This change drops the reference to a day "specified" in a consolidated gilt-edged security in section 710(13B) of ICTA.

Strips of a gilt-edged security may be consolidated back into a gilt-edged security by exchanging the strips for a newly issued gilt-edged security. The disposal of the strips is dealt with under the deeply discounted securities regime in Chapter 8 of Part 4 of ITTOIA. But the acquisition of the gilt-edged security is treated as a transfer for the purposes of the accrued income scheme, with the person making the exchange treated as the transferee, but no one being treated as the transferor. (See section 722A(3) and (4) of ICTA.) Under section 711(6A) of ICTA the transfer may be either with accrued interest or without accrued interest.

Under the accrued income scheme, where securities are transferred with accrued interest the transferee is allowed tax relief for the accruing interest and the amount of the relief is equal to the "accrued amount". (See section 713(2) of ICTA.) Where securities are transferred without accrued interest the transferee is treated as entitled to a taxable sum and the amount of the sum is equal to the "rebate amount". (See section 713(3) of ICTA.)

If the gross interest accruing on a security is accounted for separately, the amount of the "accrued amount" or, as the case may be, the "rebate amount" under section 713(4)(a) or (5)(a) of ICTA is equal to the interest so accounted for. However, in any other case (except where the settlement day is an interest payment day), the amount of the "accrued amount" or, as the case may be, the "rebate amount" is ascertained under section 713(4)(b) or (5)(b) of ICTA by time apportioning the interest applicable to the security for the interest period in which the settlement day for the transfer falls. Formulae are provided in section 713(6) of ICTA.

Where strips are consolidated into a gilt-edged security, the settlement day is the day of the transfer. (See section 712(4) of ICTA.) So the interest period for which the gross interest has to be apportioned is the one in which the exchange takes place. But the consolidated security may be issued part of the way through an interest period for securities of that kind. As it is intended to be fully fungible with other securities of the same kind, the formulae in section 713(6) of ICTA need to be applied by reference to the same interest period as that of those other securities. Under the source legislation this is dealt with through section 710(13B) of ICTA which deems the interest period of the consolidated security in which the transfer is treated as taking place to have begun "on such day as shall for that purpose be specified in the security".

In practice, however, it appears that such a day is usually *not* specified in the security. So, as the consolidated security is intended to be fully fungible with other securities of the same kind, the specified day is in fact taken to be the day following the last interest payment day for such securities before the settlement day. Therefore, in defining "interest period" for Chapter 2 of Part 12, section 673 does not rewrite the special rule in section 710(13B) of ICTA. Instead, the rule in section 673(1)(b) will apply. So the interest period of the consolidated security will begin with the day following the last interest payment day of the kind of gilt-edged securities concerned before the settlement day.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT IS A CHANGE IN LAW BUT NOT IN PRACTICE.

Change 107: Accrued income profits (exemptions): interest on securities involving accrued income losses: sections 679 and 680

This change alters the way that, in cases where accrued income scheme losses have been sustained on the transfer of securities, relief is given in respect of interest on the securities.

(1) Under section 714(3) and (4) of ICTA a person is entitled to an allowance if the person is treated as entitled to relief under section 713 of ICTA on securities of a particular kind in an interest period and either the person is not treated under that section as entitled to a sum or the person's reliefs exceed the total sum to which the person is treated as entitled. Under section 714(5) of ICTA any amount to which the person is entitled by way of interest on the securities that -:

"(a) falls due on the securities at the end of the interest period, and

(b) is taken into account in computing tax charged for the chargeable period in which the interest period ends

is reduced by the amount of the allowance.

In rewriting section 714(5) of ICTA, instead of providing that that interest is reduced, section 679 simply provides for an exemption in relation to the interest.

((B) In addition, section 679 deals differently with the restriction in section 714(5)(b) of ICTA which currently restricts the availability of this relief for accrued income losses so that relief is given once only, in the tax year in which the interest period ends.

This restriction was originally included because of the way interest was then assessed. In the first tax year that a source was acquired, interest was taxed on a current year basis but in later tax years the basis shifted to a previous year basis. The purpose of the restriction in section 714(5)(b) of ICTA was therefore to stop loss relief being given against the interest in a year when the interest was taxed on a previous year basis.

In 1994 interest began to be taxed on a current year basis. So in any tax year income tax will be charged on the income arising in that year only. The restriction is now generally unnecessary.

The one exceptional case where such a restriction is necessary is that of trading partnerships with untaxed income. Under sections 854 and 855 of ITTOIA a second deemed business is treated as set up and commenced when a new partner joins the partnership. This may lead to "overlap" profits when the same interest will be taxed twice. For example:

- P joins an existing trading partnership on 1 January 2007.
- The partnership draws up annual accounts to 31 December.
- Securities are purchased by the partnership cum dividend. The interest period of the securities ends on 31 March 2007.
- P's basis period for 2006-07 is 1 January 2007 to 5 April 2007.
- P's basis period for 2007-08 is 1 January 2007 to 31 December 2007.

In this case the interest received on 31 March 2007 forms part of profits for both 2006-07 and 2007-08, but the allowance under section 715(4) of ICTA should only be available in 2006-07, as that is the tax year in which the interest period ends.

But for existing partners of such a partnership, the restriction could result in partners not being entitled to the allowance on the acquisition of a security if the interest period ends after the end of an accounting period. In practice, HMRC allow the relief to be given in these circumstances.

In rewriting section 714(5) of ICTA, rather than including the existing restriction, which is unnecessary in the majority of cases, and then excluding such existing partners from the restriction in appropriate circumstances, section 679(3) prevents any person from being entitled to the exemption for interest in more than one tax year. And it restricts the year when the exemption is given to the tax year in which the interest period ends.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 108: Transactions in securities, transfer of assets abroad: power to obtain information: minimum time to respond: sections 703 and 748

This change provides that the recipient of a notice to provide information relevant to the legislation on transactions in securities or transfers of assets abroad must have at least 30 days to reply, rather than at least 28 days.

Sections 708 and 745 of ICTA enable HMRC to serve notices requiring the recipient to provide information relevant to the legislation on, respectively, transactions in securities and transfers of assets abroad.

Section 708 and 745 require that the recipient must be given at least 28 days in which to reply. In other similar provisions, such as section 778 of ICTA, which is rewritten in sections 771 and 788, the statutory minimum is 30 days.

Sections 703 and 748 rewrite sections 708 and 745 respectively. They harmonise the time limits by setting the statutory minimum at 30 days.

THIS CHANGE HAS NO EFFECT FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 109: Transactions in securities: statement of case by tribunal for opinion of court: section 707 and Schedule 2Part 14 (transactions in securities: statement of case by tribunal for opinion of High Court or Court of Session)

This change affects the procedure on income tax appeals concerning transactions in securities by removing the requirement for the dissatisfied party to "declare his or their dissatisfaction" before requiring the tribunal to state a case for the opinion of the court.

Chapter 1 of Part 17 of ICTA (transactions in securities) has its own appeals procedure. This includes the option for the dissatisfied party to require an appeal which has been heard by the Special Commissioners to be re-heard by the special tribunal constituted under section 706 of ICTA.

Section 705A(1) and (2) of ICTA provide:

"(1) Immediately after the determination by the tribunal of an appeal re-heard by them under section 705 of this Act, the appellant or the Board, if dissatisfied with the determination as being erroneous in point of law, may declare his or their dissatisfaction to the tribunal.

(2) The appellant or the Board, as the case may be, having declared his or their dissatisfaction, may, within thirty days after the determination, by notice in writing require the tribunal to state and sign a case for the opinion of the High Court.

Under sections 705A(12) and 705B(1) of ICTA, in Scottish and Northern Irish appeals the case is stated for the opinion of the Court of Session sitting as the Court of Exchequer in Scotland and the Court of Appeal in Northern Ireland, respectively.

Section 705A thus obliges the dissatisfied party to declare his or their dissatisfaction before requiring the tribunal to state a case.

This obligation is considered to be superfluous.

Section 56 of TMA also deals with tax appeals to the courts by way of case stated. Section 56 of TMA (statement of case for opinion of High Court) was amended by SI 1994/1813, which (among other things) confined section 56 to appeals from the General Commissioners and substituted section 56A of TMA (appeals from the Special Commissioners). SI 1994/1813 repealed section 56(1) and (2) of TMA, the wording of which was identical in all material respects to section 705A(1) and (2). It is considered a historical accident that the obligation to declare dissatisfaction has been retained in section 705A of ICTA when it has been omitted from section 56 of TMA.

Section 707, which is based on section 705A of ICTA, therefore omits the requirement for the dissatisfied party to declare dissatisfaction before requiring the tribunal to state a case.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 110: Transfer of assets abroad: meaning of "associated operation": section 719

This change clarifies the meaning of "associated operation" for the purposes of the transfer of assets abroad legislation.

Section 742(1) of ICTA defines "an associated operation" in relation to a transfer as:

"an operation of any kind effected by any person in relation to any of the assets transferred or any assets representing, whether directly or indirectly, any of the assets transferred, or to the income arising from any such assets, or to any assets representing, whether directly or indirectly, the accumulations of income arising from any such assets.

This definition is ambiguous. It is unclear whether the references to "any such assets" are references only to the assets actually transferred, or to those assets plus any assets representing them.

The punctuation indicates that the latter is the better view, and section 719 of this Act reflects it.

This is a minor change in the law in that it will prevent the taxpayer arguing for the contrary view.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 111: Transfer of assets abroad: cessation of entitlement to receive capital sum: section 729

This change makes it clear that there is no liability under section 739(3) of ICTA (transfer of assets abroad: charge where capital sum receivable or received) if the taxpayer's entitlement to receive a capital sum has ceased.

Section 739 of ICTA prevents individuals who are ordinarily resident in the United Kingdom from avoiding liability to income tax by means of transfers of assets as a result of which income becomes payable to persons who are non-UK resident or non-UK domiciled. Section 739(3) deems income to become the taxable income of the individual if the individual receives or is entitled to receive a capital sum.

Broadly speaking, any sum paid or payable by way of loan or repayment of a loan is a "capital sum" for this purpose, as is any other sum paid or payable otherwise than as income, if it is not paid or payable for full consideration in money or money's worth. Section 739(3) does not deem the capital sum to be income; instead, it takes income which has become payable to persons abroad as a result of the transfer and deems that income to be the transferor's.

But the wording of section 739(3) of ICTA leaves the timing of the charge rather unclear. It reads:

"Where, whether before or after any such transfer, such an individual receives or is entitled to receive any capital sum …

Section 739(6) provides that income is not deemed to be the individual's under section 739(3) for any tax year "by reason only of his having received a sum by way of loan if that sum has been wholly repaid before the beginning of that year". Therefore income may be deemed to be the individual's in other cases where there has been an actual receipt of a capital sum in a previous tax year. But section 739 makes no provision about whether section 739(3) imposes a charge if the individual was merely entitled to receive a capital sum in a previous tax year.

In practice, where entitlement to a capital sum has ceased HMRC do not pursue further liability under section 739(3).

Section 729 gives effect to this practice by providing that the individual must either receive or be entitled to receive a capital sum in the tax year or have received a capital sum in an earlier tax year.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 112: Transfer of assets abroad: transferors not subject to charge where benefit received: section 732

This change clarifies the exclusion from liability to income tax under section 740 of ICTA (transfer of assets abroad: charge where benefit received) for those who are liable to income tax under section 739 of ICTA (transfer of assets abroad: charge where power to enjoy income or where capital sum received) on deemed income in respect of the same transfer. The change makes it clear that this exclusion extends to those who would be liable under section 739 apart from falling within the exception in section 743(3) for non-domiciled individuals taxed on the remittance basis.

Section 739 of ICTA prevents individuals who are ordinarily resident in the United Kingdom from avoiding liability to income tax by means of transfers of assets as a result of which income becomes payable to persons who are non-UK resident or non-UK domiciled. Section 739 deems the income of the person abroad to be the taxable income of the individual if the individual has power to enjoy the income of the person abroad or receives a capital sum.

Under sections 831 and 832 of ITTOIA 2005, persons who are domiciled outside the United Kingdom can make a claim only to be subject to income tax in the United Kingdom on the relevant foreign income which is received in the United Kingdom (and not on their worldwide relevant foreign income).

Section 743(3) of ICTA makes a corresponding exception from section 739 of that Act for individuals who are domiciled outside the United Kingdom. An individual is not chargeable on deemed income under section 739 if that individual would not have been chargeable in respect of the actual income because of the individual's domicile.

Section 740 of ICTA deems individuals to receive taxable income if they receive benefits provided out of assets available as a result of transfers of the kind envisaged in section 739 and are not "liable to tax under section 739 by reference to the transfer". This raises the question whether, by preventing a non-UK domiciled individual transferor from being chargeable under section 739, section 743(3) of ICTA exposes that individual to potential liability under section 740.

It is HMRC's practice not to assess under section 740 a non-UK domiciled individual who transfers assets but is outside the charge to tax under section 739 by virtue of the provisions of section 743(3). But it is arguable that the wording of section 740 would permit a charge under section 740 on a non-UK domiciled transferor in these circumstances. Section 732 of this Act gives the current practice a clear statutory basis.

Where a non-UK domiciled individual transfers assets but is not chargeable to tax under section 739 owing to section 743(3), there is no bar in HMRC's view on the application of section 740 to others who did not themselves make the transfer but were beneficiaries of it. HMRC interpret section 732 in the same way.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 113: Transfer of assets abroad: calculation of liability of non-transferors receiving benefit: section 733

This change clarifies how liability for income tax of non-transferors who receive a benefit is calculated, in particular where the benefit is less than the "relevant income" in relation to the individual receiving the benefit.

Section 740 of ICTA deems individuals to receive taxable income if (broadly speaking) they receive benefits as a result of transfers of assets as a result of which income becomes payable to persons resident or domiciled outside the United Kingdom and are not liable under section 739 of ICTA (liability of transferors) in respect of the transfers.

The general effect of section 740(1) to (3) of ICTA is:

- to tax non-transferors on the amount or value of any such benefit received by them;
- only to tax such a benefit where, on or after 10 March 1981 (see section 740(7) of ICTA), income has arisen by the use of which the benefit could be provided ("relevant income"); and
- to tax the benefit whether it is conferred before or after the relevant income is actually available.

Relevant income is defined in relation to an individual in section 740(3) of ICTA. Briefly, it is any income arising to a person abroad which, as a result of the transfer of assets, "can directly or indirectly be used for providing a benefit for the individual".

Under section 740(2)(a) of ICTA the amount to be charged in the tax year in which the benefit is received is found by comparing the amount or value of the benefit with "the relevant income of years of assessment up to and including the year of assessment in which the benefit is received". Under section 740(2)(b) if the benefit exceeds the relevant income, then an amount equal to the relevant income is chargeable to income tax in the individual's hands and the excess benefit is carried forward, compared with relevant income in the next and subsequent tax years and charged so far as it does not exceed that relevant income, until none is left to be carried forward.

Section 740 of ICTA leaves several questions unanswered.

It provides that if the relevant income exceeds the benefit, the amount or value of the benefit is chargeable to income tax in the individual's hands, but does not make provision about the treatment of the excess of the relevant income over that amount.

Taken literally and in isolation, section 740(2)(a) suggests that whenever a benefit is received the amount or value of the benefit must be compared with all the relevant income that has arisen on or after 10 March 1981, regardless of whether the receipt of previous benefits has involved charges by reference to that income before. But relevant income is defined as income that can directly or indirectly be used to provide a benefit in the tax year, and section 744(1) and (2)(b) of ICTA prevent the same relevant income being taken into account more than once.

It is therefore considered that the surplus relevant income (if it continues to be available) has not been taken into account and so must be carried forward year by year until extinguished by a benefit or benefits. Section 733 of this Act gives effect to this view by providing for surplus relevant income to be carried forward.

This change has consequential effects on the way that section 740(6) of ICTA is rewritten in section 734 of this Act. That section provides for a reduction in the amount carried forward in respect of a benefit to a tax year after the year of receipt where the whole or part of the benefit is a capital payment that causes a capital gains tax charge to arise.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 114: Transfer of assets abroad, transactions in land and sales of occupation income: power to obtain information: "reasonably require": sections 748, 771 and 788

This change expressly restricts the particulars that an officer of Revenue and Customs may require to be provided under section 745(1) or section 778(1) of ICTA to those particulars which the officer may reasonably require.

Section 745(1) of ICTA enables the Board to require a person to give them such particulars "as they think necessary" for the purposes of Chapter 3 of Part 17 of ICTA. Section 778(1) of ICTA similarly enables the Board or an inspector to require a person to give them such particulars "as the Board or the inspector think necessary" for the purposes of sections 775 and 776.

The opportunity has been taken in sections 748, 771 and 788 of this Act to modernise this language and expressly impose the criterion of reasonableness. This is consistent with the way in which HMRC exercise the power in practice.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 115: Transactions in land and sales of income from occupation: application to non-UK residents: sections 756, 759 and 778

This change is about the omission of provisions which might suggest that the normal rule that non-UK residents are not liable for income tax when the source of the income is outside the United Kingdom does not apply in the case of the charges under sections 775 and 776 of ICTA.

Section 775(9) of ICTA (sales of income from occupation: territorial scope) provides:

"This section shall apply to all persons, whether resident in the United Kingdom or not, if the occupation of the individual is carried on wholly or partly in the United Kingdom.

Section 776(14) of ICTA (transactions in land: territorial scope) similarly reads:

"This section shall apply to all persons, whether resident in the United Kingdom or not, if all or any part of the land in question is situated in the United Kingdom.

These provisions derive from paragraph 7(1) and (2) respectively of Schedule 16 to FA 1969.

It is unclear to what extent section 776 of ICTA applies to a non-UK resident who disposes of several areas of land, some within the United Kingdom and some outside the United Kingdom, under a single transaction if the statutory conditions for liability under section 776 are met. Similarly, it is unclear to what extent section 775 of ICTA applies to a non-UK resident who carries on an occupation partly within and partly outside the United Kingdom and enters into a transaction within section 775.

Section 827A(3) of ICTA provides that an amount arising to a non-UK resident is chargeable to income tax only if it is from a source in the United Kingdom. This would mean that the non-UK resident would only be chargeable on the gain attributable to the land situated, or on the capital amount attributable to the occupation carried on, in the United Kingdom.

But section 827A(5) of ICTA provides that section 827A is subject to any express or implied provision to the contrary in any provision of the Income Tax Acts. It could be argued that sections 775(9) and 776(14) of ICTA each show a contrary intention to the general rule in section 827A(3) and that therefore in such a case the whole of the gain would be chargeable.

In practice, HMRC do not regard any such contrary intention as being shown. Sections 759 and 776 of this Act follow that interpretation and so do not rewrite the part of sections 775(9) and 776(14) about residence. This omission is considered to be a change in the law, as it will prevent HMRC from arguing for the other interpretation.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 116: Transactions in land: person liable: provider of opportunity to realise a gain: section 759

This change omits words from section 776(8) of ICTA indicating that where a gain on a transaction in land that is charged under that section is derived from an opportunity of realising a gain provided by another person and as a result that person is liable for the tax, it does not matter whether or not the opportunity was put at the disposal of the person to whom the gain actually accrues.

Section 776 of ICTA charges gains of a capital nature relating to the land to income tax where the gains are made by persons connected with land or the development of land and the statutory conditions are met.

In certain circumstances, people who are liable to pay income tax in the United Kingdom may enter into transactions in land as a result of which value, or an opportunity of realising a gain, is provided to another person (who may not be so liable). In such cases, section 776(8) of ICTA lays down that the provider of the value or, as the case may be, the opportunity is the person liable to income tax under section 776.

Section 776(8), so far as relevant, reads:

"If all or any part of the gain accruing to any person is derived from value, or an opportunity of realising a gain, provided directly or indirectly by some other person, whether or not put at the disposal of the first-mentioned person …

In Yuill v Wilson (1980), 52 TC 674[19] at page 706, Goff LJ criticised the drafting of what is now section 776(8):

"I find it very difficult to appreciate what [the words "whether or not put at the disposal of the first-mentioned person" in what is now section 776(8)] were intended to cover. In the case of *value* I can well see that a gain may be derived by one person from value provided by another, whether directly or indirectly, without that value being put at the disposal of the first-mentioned person; for example, if A pays money to B as consideration for the grant of an option to C. As at present advised, however, I find it very difficult to see how one can gain from an *opportunity* provided by another without that opportunity being put at the disposal of the first-mentioned person. (emphasis added)

As it is considered that no sensible meaning can be given to the words "whether or not put at the disposal of the first-mentioned person" so far as they relate to the earlier words "an opportunity of realising a gain", in rewriting the passage under review section 759(5) (transactions in land: person liable) refers only to the value provided by another person and not the opportunity of realising a gain.

If this view were incorrect, then the restriction of the scope of section 759(5) might in some circumstances exclude taxpayers from liability under the "transactions in land" Chapter.

19 [1980] STC 460.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 117: Transactions in land and sales of occupation income: income treated as the highest part of the taxpayer's income: sections 768 and 786

This change introduces a rule for determining in a case where a person has income chargeable under section 775 of ICTA (sales of occupation income) and income chargeable under section 776 of ICTA (transactions in land) how much of each of those kinds of income is treated as the highest part of the person's income.

Section 777 of ICTA supplements both section 775 and section 776 of ICTA.

Under both section 775 and section 776, a person (A) may be assessed to tax in respect of consideration receivable by another person (B). Under section 777(8)(a), in both cases A is entitled to recover from B the tax assessed and paid. To this end, section 777(8) entitles A to obtain from HMRC a certificate specifying the amount of income in respect of which tax has been paid.

The last sentence of section 777(8) provides:

"For the purposes of this subsection any income which a person is treated as having by virtue of sections 775 and 776 shall, subject to section 833(3), be treated as the highest part of his income.

Although the expression "the highest part of [the taxpayer's] income" in section 777(8) is not expressly defined, it is clear from the context that the expression means the part of the taxpayer's income which is subject to the taxpayer's highest marginal rate or rates of income tax.

But, if there is more than one amount of deemed income under section 775 or section 776 or both, and section 775 or section 776 or both take the taxpayer into the next tax bracket (e.g. over the higher rate threshold), section 777(8) does not specify the priority of the charges.

Such a case is unlikely to arise in practice, because section 777(8) certificates are rarely if ever requested. But, if it did, HMRC would resolve the problem by a just and reasonable apportionment under section 777(6)(a).

Sections 768 and 786 rewrite section 777(8). Splitting the last sentence of section 777(8) in this way has highlighted the absence of a tie-breaker in the source legislation. The sections therefore include one: they provide that if the individual is treated as having income under both Chapters, only a just and reasonable proportion of the land income, and only a just and reasonable proportion of the occupation income, is to be treated as the highest part of the individual's income.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 118: Transactions in land: clearance procedure: section 770

This change gives the Commissioners for Her Majesty's Revenue and Customs responsibility for granting or denying clearance concerning transactions in land.

Section 776 of ICTA is an anti-avoidance provision concerning transactions in land. Section 776(11) lays down a statutory clearance procedure. It provides that the taxpayer is to provide particulars of the transaction to "the inspector to whom he makes his return of income".

This could cause theoretical difficulties if the taxpayer:

- is not legally obliged to file a self-assessment return;
- does not file a self-assessment return; and

- wishes to obtain clearance under section 776(11) of ICTA.

In practice, if the taxpayer makes a clearance application to the HMRC office dealing with that taxpayer's affairs, that HMRC office will process the application.

Section 770, which is based on section 776(11) of ICTA, gives the responsibility for clearances concerning transactions in land to the Commissioners for Her Majesty's Revenue and Customs, rather than the officer to whom the taxpayer makes a return of income. This is consistent with section 707 of ICTA (transactions in securities: clearance procedure), which is rewritten in sections 701 and 702.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 119: Sales of occupation income: restriction on exemption for sales as going concerns: meaning of "income or receipts": section 785

This change clarifies the meaning of "income and receipts" for the purposes of the restriction under section 775(5) of ICTA on the exemption for sales of going concerns from the charge under section 775 of ICTA. The restriction on the exemption applies where the value of the going concern is attributable to a material extent to prospective income or profits for which full consideration will not be received.

Section 775 of ICTA (sale by individual of income derived from his personal activities) is directed against arrangements whereby individuals seek to sell their earnings in return for capital sums which escape income tax. If it applies, section 775 taxes the capital sum received for the sale as income.

Section 775(4) of ICTA gives an exemption for sales of going concerns. For example, it is common for existing partners in a professional firm to be paid a capital sum by a new partner in return for a share in the partnership. Section 775(4) provides that section 775 does not apply so far as the value of what is disposed of is attributable to its value as a going concern. So it ensures that section 775 does not catch normal commercial arrangements such as this.

Section 775(5) of ICTA is directed against attempts to abuse this exemption. If (for example) the taxpayer transfers into an existing business the copyright of a book which he or she has written, and obtains a capital sum for the disposal of the business as a going concern, the exemption is restricted. To the extent that the value of the business is attributable to the going concern, it falls within section 775(4). But to the extent that the value of the business is attributable to the copyright, section 775(5) takes the capital sum out of section 775(4) and taxes it as income.

Section 775(5) of ICTA reads:

"If the value of the profession, vocation or business as a going concern is derived to a material extent from prospective income or receipts derived directly or indirectly from the individual's activities in the occupation, and for which, when all capital amounts are disregarded, the individual will not have received full consideration, whether as a partner in a partnership or as an employee or otherwise, subsection (4) above shall not exempt the part of a capital amount so derived.

Section 775(3)(b) of ICTA provides that the expression "income or receipts" includes "payments for any description of copyright or licence or franchise or other right deriving its value from the activities, including the past activities, of the individual."

But the scope of this inclusion section is uncertain. On the one hand, section 775(3) of ICTA begins "In this section …", implying that it extends to section 775(5). On the other, section 775(3)(b) begins "references in subsection (1) above", implying that it does not. It is unclear which takes priority.

It is considered that, as a matter of normal usage, the expression "income or receipts derived directly or indirectly from the individual's activities in the occupation" in section 775(5) of

ICTA is apt to include “payments for any description of copyright or licence or franchise or other right deriving its value from the activities, including the past activities, of the individual.” Therefore in so far as section 775(3)(b) applies to section 775(5) it is merely declaratory.

Section 785 rewrites section 775(5) of ICTA on the basis that section 775(3)(b) applies to it.

This is a change in the law, in that it will prevent taxpayers from maintaining the contrary view.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 120: Limit on liability to income tax of non-UK resident companies: omission of disregard of any relief to which a company is entitled by virtue of arrangements having effect under section 788 of ICTA: section 815

This change omits section 151(1)(a)(ii) of FA 2003.

Section 151(1) of FA 2003 provides that:

“The income tax chargeable for a year of assessment on the total income of a company that is not resident in the United Kingdom is limited to the sum of the following amounts—

(a) the amount of tax that, apart from this section, would be chargeable on that total income if—

(i) the amount of that income were reduced by the amount of any income to which this section applies, and

(ii) there were disregarded any relief to which that company is entitled by virtue of arrangements having effect under section 788 of the Taxes Act 1988 (double taxation relief), and

(b) the amount of tax deducted from so much of any income to which this section applies as is income the tax on which is deducted at source.

Section 151 of FA 2003 replaced section 129 of FA 1995. There was no disregard in section 129 of FA 1995 similar to that in section 151(1)(a)(ii) of FA 2003. The replacement of section 129 of FA 1995 by section 151 of FA 2003 was not intended to make any change in the law except so far as a change was necessary following the change from “branch or agency” to “permanent establishment” introduced by section 148 of FA 2003.

It appears that section 151(1)(a)(ii) of FA 2003 was included by analogy with section 128(1)(a)(ii) of FA 1995. That sub-paragraph, however, only disregards reliefs under Chapter 1 of Part 7 of ICTA to which an individual is entitled, including any such reliefs to which an individual is entitled under that Chapter by virtue of a double taxation arrangement. The principal reliefs under that Chapter are personal allowance, blind person’s allowance and married couple’s allowance. The only other reliefs under that Chapter are life assurance premium relief and relief for payments securing annuities.

For an individual, only the personal and other reliefs mentioned above are disregarded in calculating the limit, not all reliefs to which the individual is entitled as a result of a double taxation arrangement.

For companies, the position should be the same. This means that there are no reliefs which should be disregarded, because a company is not entitled to any of those personal and other reliefs. If the reliefs to which the company was entitled as a result of a double taxation arrangement were disregarded, the limit on liability to income tax for the company could be higher, which could be to the company’s disadvantage.

The provisions of sub-paragraph (ii) have, therefore, been omitted from the rewrite of section 151(1)(a) of FA 2003 in section 815(4), on the basis that they are inappropriate.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 121: Limit on liability to income tax of non-UK resident companies: substitution of references to income for references to chargeable profits in paragraph 4(3) and (5) of Schedule 26 to FA 2003: sections 821 and 823

This change substitutes references to a non-UK resident company's income in sections 821(3) and 823(2)(b) for the references to its chargeable profits in paragraph 4(3) and (5) of Schedule 26 to FA 2003. Paragraph 4 sets out the 20% rule applicable to investment managers.

The term "chargeable profits" is not defined for the purposes of Schedule 26 to FA 2003. Section 11(2) of ICTA defines the chargeable profits of a non-UK resident company as being the profits attributable to the company's permanent establishment in the United Kingdom and provides that such profits are chargeable to corporation tax. That definition, therefore, has no application in relation to the liability of a non-UK resident company to income tax in respect of income deriving from transactions carried out on behalf of the company by an investment manager who meets the independent investment manager conditions.

The basis on which the legislation in FA 2003 was prepared was that it was not to affect the law under FA 1995, except so far as required to adopt the concept of permanent establishment in place of branch or agency in relation to non-UK resident companies.

It is clear from the reference in the definition of "relevant excluded income" in section 127(5) of FA 1995 to "such of the profits and gains of the non-resident…as…for the purposes of section 128 below would fall (apart from the requirements of subsection (4) above) to be treated as excluded income" that the defined term in that Act is limited to income and does not include gains. This has been reflected in sections 821(2) and 823(2)(a).

The references to "the aggregate of such of the chargeable profits of the company" in paragraph 4(3) of Schedule 26 to FA 2003 and to "so much of the chargeable profits of the non-resident company" in paragraph 4(5) of that Schedule are, therefore, in practice read as referring to income only.

Accordingly, section 821(3) refers to "the total of the non-UK resident company's income for the accounting periods" which derives from the relevant investment transactions, and section 823(2)(b) refers to "so much of the income of the non-UK resident company" deriving from the transaction.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 122: Limit on liability to income tax of non-UK residents: inclusion of stock dividends from UK resident companies as an additional category of disregarded savings and investment income: section 825

This change adds stock dividends chargeable to income tax under Chapter 5 of Part 4 of ITTOIA to the list of savings and investment income which is disregarded income under section 813 or disregarded company income under section 816.

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

This established practice has been recognised in the rewrite of section 1B of ICTA. Section 13(2) of this Act applies the dividend upper rate instead of the higher rate to "dividend income".

This term is defined in section 19 to include income under Chapter 5 of Part 4 of ITTOIA. Accordingly, stock dividends from UK resident companies will be taxed at the same rates as apply to ordinary dividends.

In the light of this change, it is not appropriate that any distinction should continue to be made between the status as disregarded income or disregarded company income of dividends from UK resident companies chargeable under Chapter 3 of Part 4 of ITTOIA and stock dividends from such companies chargeable under Chapter 5 of that Part. Such stock dividends have, accordingly, been added in section 825(1)(a).

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 123: Occasional residence abroad: omission of limitation to Commonwealth citizens and citizens of the Republic of Ireland: section 829

This change extends the application of section 829 to all individuals who are UK resident and ordinarily UK resident and leave the United Kingdom for the purpose only of occasional residence abroad.

Section 829 is based on section 334 of ICTA, which applies only to Commonwealth citizens and citizens of the Republic of Ireland who are ordinarily UK resident.

The origin of the provisions in section 334 can be traced back to section X of the Statute of 1799 (39 George III c.13):

> "And be it further enacted that any subject of His Majesty whose ordinary residence shall have been in Great Britain and who shall have departed from Great Britain and gone into any parts beyond the seas for the purpose only of occasional residence at the time of the execution of this Act, shall be deemed, notwithstanding such temporary absence, a person chargeable in respect of his or her income as a person actually residing in Great Britain and shall be assessed and charged accordingly (in the manner hereinafter directed) upon the whole amount of his or her income whether the same shall arise from property in Great Britain or elsewhere, or from any profession, office, pension, stipend, employment, trade or vocation, in Great Britain or elsewhere

through section 39 of the Income Tax Act 1842:

> "And be it enacted that any subject of Her Majesty whose ordinary residence shall have been in Great Britain, and who shall have departed from Great Britain and gone into any Parts beyond the Seas, for the Purpose only of occasional Residence, at the Time of the Execution of this Act, shall be deemed, notwithstanding such temporary Absence, a Person chargeable to the Duties granted by this Act as a Person actually residing in Great Britain, and shall be assessed and charged accordingly (in manner hereinafter directed) upon the whole Amount of his Profits or Gains, whether the same shall arise from property in Great Britain or elsewhere, or from any allowance, annuity, or stipend, (save as herein is excepted,) or from any profession, employment, trade or vocation, in Great Britain or elsewhere

to its re-enactment, with no pre-consolidation amendments, in the first income tax consolidation Act, the Income Tax Act 1918, as rule 3 of the general rules applicable to Schedules A to E:

> "Every British subject whose ordinary residence has been in the United Kingdom shall be assessed and charged to tax, notwithstanding that at the time the assessment or charge is made he may have left the United Kingdom, if he has so left the United Kingdom for the purpose only of occasional residence abroad, and shall be charged as a person actually residing in the United Kingdom upon the whole amount of his profits or gains, whether they arise from property in the United Kingdom or elsewhere, or from any allowance, annuity, or stipend (save as herein is excepted), or from any trade, profession, employment, or vocation in the United Kingdom or elsewhere.

The reference to British subject has subsequently been amended to reflect the establishment of the Republic of Ireland as an independent Sovereign State and the creation of the Commonwealth. But, otherwise, the language of the provision has not changed in any material respect.

In his judgment in Reed (HM Inspector of Taxes) v Clark, (1985), 58 TC 528 Ch D[20], Nicholls J reviews the history of this provision (then section 49 of ICTA 1970) and the cases in which it is considered. He observes (at page 550 B):

"Despite the long history of the statutory provision now reproduced as s 49, the researches of very experienced Counsel have not revealed any reported decision in which a claim to tax has succeeded only by virtue of that provision. But in several cases the provision has been commented upon…

Nicholls J refers to the judgments in Levene v CIR (1927), 13 TC 486 HL at all its stages. The judgment of Viscount Cave LC in that case in the House of Lords contains the following passage (at page 505):

"My Lords, the word "reside" is a familiar English word and is defined in the Oxford English Dictionary as meaning "to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place". No doubt this definition must for present purposes be taken subject to any modification which may result from the terms of the Income Tax Act and Schedules; but, subject to that observation, it may be accepted as an accurate indication of the meaning of the word "reside". In most cases there is no difficulty in determining where a man has his settled or usual abode, and if that is ascertained he is not the less resident there because from time to time he leaves it for the purpose of business or pleasure.

The cases also make clear that residence in this context denotes, to paraphrase the words of Rowlatt J at first instance in Levene (at page 492), a quality attributable to the individual which makes the individual describable as resident with reference to a place.

In Reed v Clark the issue in relation to section 49 of ICTA 1970 was whether, it having been found by the Commissioners that Mr Clark was resident in the USA for the tax year 1978-79, his residence was only occasional. The decision of the Commissioners that it was not and that Mr Clark was both resident and ordinarily resident in the USA for that year was upheld by Nicholls J.

Although historically the provisions in section 334 of ICTA have been limited to British subjects and their current manifestations, Commonwealth citizens and citizens of the Republic of Ireland, the observations of Viscount Cave LC in Levene quoted above are applicable to any individual who has his or her settled or usual abode in the United Kingdom. Such a settled or usual abode will in virtually every case lead to the result that an individual is ordinarily UK resident for income tax purposes.

In accordance with the judgment of Viscount Cave LC, occasional residence abroad by such an individual who is not a Commonwealth citizen or a citizen of the Republic of Ireland equally will not displace the quality of the individual's residence as being in the United Kingdom. In practice, the same tests are applied in determining whether any individual, whether or not a Commonwealth citizen or a citizen of the republic of Ireland, has ceased to be UK resident upon leaving the United Kingdom. This change makes this explicit.

In rewriting this provision, it has also been made explicit that it only applies if the individual is UK resident, as well as ordinarily UK resident, at the time the individual leaves the United Kingdom. There has never been any doubt that the provision only applies if the individual is both UK resident and ordinarily UK resident at that time.

20 [1985] STC 323

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 124: Individuals in the United Kingdom for temporary purpose: substitution of 183 days for six months: sections 831 and 832

This change replaces references to six months with references to 183 days in sections 831(1) and 832(1) which deal with the residence status of individuals who are in the United Kingdom for some temporary purpose only.

Section 831(1) is based on section 336(1) of ICTA which provides that:

"A person shall not be charged to income tax under a charge to which subsection (1A) applies as a person residing in the United Kingdom, in respect of profits or gains received in respect of possessions or securities out of the United Kingdom, if—

(a) he is in the United Kingdom for some temporary purpose only and not with any view or intent of establishing his residence there, and

(b) he has not actually resided in the United Kingdom at one time or several times for a period equal in the whole to six months in any year of assessment, but if any such person resides in the United Kingdom for such a period he shall be so chargeable for that year.

Section 832(1) is based on section 336(2) of ICTA, which provides that:

"For the purposes of determining taxable earnings from an employment under Chapters 4 and 5 of Part 2 of the Income Tax (Earnings and Pensions) Act 2003 (employment income: charge to tax), a person who is in the United Kingdom for some temporary purpose only and not with the intention of establishing his residence there shall not be treated as resident in the United Kingdom if he has not in the aggregate spent at least six months in the United Kingdom in the year of assessment, but shall be treated as resident there if he has.

Section 336(1) and (2) of ICTA both depend upon the question whether the period or periods during which the person has been actually residing in the United Kingdom, or which the person has spent there, amount in total to six months. But the number of days in a consecutive period of six months may vary between 181 and 184. In the majority of cases, the period is of 183 days or less.

Accordingly, to ensure fairness between all persons affected by these provisions and to cater for broken periods, references to six months in these provisions are in practice treated as references to 183 days. This practice is published in HMRC booklet IR20: Residents and non-residents: Liability to tax in the UK.

Sections 831(1) and 832(1), therefore, refer to 183 days in place of six months.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 125: Jointly held property and earned income: section 836 and Schedule 1 (section 189 of FA 2004)

This change concerns the earned income exception from the rule which allocates income arising on property held jointly by a married couple, or members of a civil partnership, who live together, equally between the individuals concerned.

The change is that the joint property rule is rewritten in direct terms without reference to earned income, and the earned income exception is replaced with one for all partnership income, which has broadly the same effect. It also makes a related change to the definition of "relevant UK earnings" in section 189 of FA 2004.

Section 282A(1) of ICTA provides a rule that income arising to married couples and civil partners from jointly held property is allocated equally (the 50:50 rule). The rule is subject to a number of exceptions, including section 282A(4)(a). That subsection excludes all earned income from the rule. Earned income is defined by section 833(4) to (6) of ICTA.

This joint property rule is the only place in the Income Tax Acts where the concept of earned income is used directly. This note considers each type of earned income in turn and sets out whether it can arise on jointly held property.

The first case dealt with in section 833(4) of ICTA is employment, pension and social security income and property income attached to an employment. Such income cannot arise jointly.

The second case in section 833(4) is income arising from a trade, profession or vocation. Clearly, such income can arise jointly, ie where the business is carried on in partnership. Such income is specifically excluded from the 50:50 rule by direct reference to partnerships – see *Exception C*. Because all income subject to the partnership rules in Part 9 of ITTOIA is excluded it is not necessary to reproduce the special rule in section 282A(4)(b) to ensure that the income of sleeping partners is also excluded.

Section 833(5) to (5E) of ICTA contains complex rules to determine whether income arising from patents and know-how is earned or unearned. Such income can arise jointly. The section does not reproduce any of these rules and all such income (unless it is partnership income) will as a result fall within the 50:50 rule.

So where income was previously classified as earned the 50:50 rule will apply in cases where it did not apply before. But, couples will have the option of electing for allocation to follow beneficial entitlement (provided their shares in the asset match their shares in the income), which gives couples an alternative basis on which to allocate income that may work to their advantage.

The other types of income to be considered are those that are treated as earned under specific provisions:

- Adjustment income within section 232 of ITTOIA. This income can arise jointly where it is partnership income. It is now excluded from the 50:50 rule through the exclusion for partnership income.
- Post-cessation receipts within section 256 of ITTOIA. The source of such receipts is considered to be the trade, profession or vocation, and that no longer exists. It follows that the income does not arise from jointly held property and so is not within section 282A of ICTA.
- Furnished holiday lettings businesses within Chapter 6 of Part 3 of ITTOIA. This is specifically excluded by *Exception D*.
- Sale of income derived from personal activities within section 775 of ICTA. This cannot arise jointly.
- Profits from a Lloyd’s underwriting business. Section 171 FA 1993 provides that all income arising to a member from a Lloyd’s underwriting business is treated as arising from a trade. This might include income from jointly held property, such as that held in an ancillary trust fund. Such income is treated as earned under section 180 FA 1993. In order to ensure that the 50:50 rule does not apply, section 180(1)(b) is amended by Schedule 1 to specifically disapply section 836.

In summary, the exclusion for income subject to the partnership rules corresponds closely to the exclusion in the source legislation for earned income. The only type of income that will become subject to the 50:50 rule is income from patents and know-how that was previously classified as earned under the rules in section 833(5) to (5E) of ICTA. And this should generally work to the taxpayers’ advantage.

The repeal of section 833(5) to (5E) of ICTA also requires a change to the definition of “relevant UK earnings” in section 189(2)(c) of FA 2004. In essence, patent income arising to an individual who devised an invention counts as relevant UK earnings, but this is subject to exceptions in section 833(5C) and (5E) of ICTA. The amendment made to section 189 by Schedule 1 to this Act does not incorporate those exceptions, so that a wider range of patent income now qualifies as "relevant UK earnings". This works to the taxpayer's advantage.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 126: Deduction of tax: deposit-takers and building societies: enactment of regulations: sections 852, 853, 871, 872, 946, 947, Schedule 1 (section 17 of TMA and Schedule 2 to FA 2005) and Schedule 2Part 15 (deduction by deposit-takers: discretionary or accumulation settlements)

INTRODUCTION

This change enacts some provisions of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) and certain provisions in other regulations and orders. The main purpose of the change is to secure a common basis for the split between the primary and secondary legislation about the deduction of sums representing income tax by deposit-takers and by building societies.

POSITION UNDER THE SOURCE LEGISLATION

The main source provisions for the deposit-taker regime, such as the main definitions, details of the categories of payment from which a sum representing income tax is or is not to be deducted and provisions about declarations of non-UK residence, are set out in sections 480A to 482 of ICTA. These sections are supported by the Income Tax (Deposit-takers) (Interest Payments) Regulations 1990 (SI 1990/2232). This split between primary and secondary legislation is in keeping with the approach to the divide between primary and secondary legislation generally.

But, for historical reasons, not least in relation to the creation and later abolition of composite rate tax, all of the provisions for building societies are regulations - in particular the building society regulations made under section 477A of ICTA.

The following regulations and orders also apply in relation to the deduction regimes:

- The Income Tax (Building Societies) (Audit Powers) Regulations 1992 (SI 1992/10) and the Income Tax (Deposit-takers) (Audit Powers) Regulations 1992 (SI 1992/12) about audit powers for the two regimes;
- The Income Tax (Deposit-takers) (Non-residents) Regulations 1992 (SI 1992/14) about declarations and certificates for non-UK residents;
- The Income Tax (Interest Payments) (Information Powers) Regulations 1992 (SI 1992/15) about the provision of information by building societies and deposit-takers;
- The Income Tax (Prescribed Deposit-takers) Order 1992 (SI 1992/3234) which treats firms with EEA passport rights as deposit-takers;
- The Deposit-takers (Interest Payments) (Discretionary or Accumulation Trusts) Regulations 1995 (SI 1995/1370); and
- The Income Tax (Prescribed Deposit-takers) Order 2002 (SI 2002/1968), which treats certain dealers in financial instruments as deposit-takers.

REVISED APPROACH

The enactment of the following regulations ensures that the provisions relating to building societies will be divided between primary and secondary legislation in the same way as for deposit-takers. To achieve this:

- parts of regulations 2, 3, 4 and 11 of the building society regulations are included in Chapter 2 of Part 15 of this Act;
- regulation 10 of the building society regulations is included in Chapter 15 of Part 15 of this Act; and
- regulation 12(1) of the building society regulations is incorporated into section 17 of TMA (see Schedule 1 to this Act).

As a number of the building society regulations are enacted, the wide powers provided in section 477A(1) of ICTA are replaced with specific regulation and order making powers in line with the deposit-taker regime.

This makes it explicit that the two regimes run in parallel (differing only where necessary to reflect the particular status of building societies). It also facilitates the making of any future changes, because any such changes to those building society rules now in primary legislation will be made in a Finance Act (rather than by regulation) alongside parallel changes made to the rules for deposit-takers. Equally, it will no longer be possible to amend those rules by regulations.

This approach is also a prerequisite for *Change 127*, under which the main provisions of the two regimes are aligned and combined.

In addition the following provisions in regulations are also included in the Act:

- (in section 853) provisions about EEA firms (SI 1992/3234) and dealers in financial instruments (SI 2002/1968);
- (in section 849(4) and Schedule 1 Part 2 (new paragraph 11 of Schedule 2 to FA 2005)) the provisions about "relevant arrangements" in regulation 2(4) and (5) of the building society regulations (SI 1990/2231); and
- (in Schedule 2 Part 15 (deduction by deposit-takers: discretionary or accumulation settlements)) the provisions about deposits made by the trustees of discretionary or accumulation settlements before 6 April 1995 (SI 1995/1370).

IMPLICATIONS FOR MATERIAL REMAINING IN REGULATIONS

This Act contains powers to enable regulations to be made in relation to the matters for which regulations can presently be made (excluding those matters now included within the sections of this Act). These powers support the existing regulations, which will remain in force under the continuity of the law provisions in this Act (see Part 1 of Schedule 1 to this Act), and enable changes to them to be made in future.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 127: Deduction of tax: deposit-takers and building societies: definition of relevant investment: sections 851, 856, 858, 859 and 872

Introduction

This change builds on *Change 126* (enactment of regulations). It aligns the gross payment category rules for building societies with those for deposit-takers, resulting in a common basis for identifying the payments which are to be subject to deduction of sums representing income tax. This change enables the two regimes to be combined.

Under the source legislation, there is a significant difference in the way the deposit-taker rules and the building society rules identify the payments from which sums representing income tax are potentially to be deducted (subject to the various exceptions). The deposit-taker rules in section 481(4) of ICTA identify four categories (individuals, Scottish partnerships, personal representatives and trustees). But regulation 3 of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) imposes an obligation to deduct sums representing income tax in all cases unless the payment falls within the scope of a gross payment category set out in regulation 4 (or the payment is referred to in section 477A(1A) of ICTA).

The reasons for this are historical. The difference of approach no longer achieves anything of substance and makes the essential identity of the two regimes very difficult to discern. The regimes are aligned to the deposit-taker approach (already in primary legislation), this being the simpler of the two.

HISTORY

The history of these provisions starts in 1894, when extra-statutory arrangements were first introduced under which building societies accounted annually for income tax at a composite rate. These arrangements became statutory in 1951 and regulations included various exceptions (eg for pension funds).

In FA 1984 a similar composite rate tax (CRT) scheme with quarterly accounting was introduced for retail bank deposits. This triggered changes to the building society rules in 1985, to bring them onto a similar quarterly scheme and to widen the range of exceptions. But, whereas bank interest was either paid gross or net of CRT, any building society payments which were not within CRT, or specifically allowed to be paid gross, had to be paid net of basic rate tax.

From April 1991, CRT was abolished in favour of deduction of sums representing basic rate income tax. So far as the building society provisions were concerned, this was achieved simply by requiring deduction of sums representing basic rate tax from payments other than those which could be paid gross. The possibility of re-engineering the provisions more fundamentally, along the lines now proposed, was considered but did not prove possible at the time.

Since then, a number of further additions have been made to the categories of payment that can be made gross, in particular going beyond exempt bodies to embrace companies (in 1992). Differences of scope between the regimes are now very small.

EFFECTS OF ALIGNMENT

There are a number of circumstances in which payments by building societies made after deduction under the source legislation will no longer need to have sums representing income tax deducted.

This is a taxpayer-favourable change in cash flow terms, but does not affect final liability to tax. It could also, in some circumstances, mean the taxpayer has to complete a self-assessment return. But these effects could arise under the source legislation if a taxpayer used a deposit-taker rather than a building society.

In tandem with this, the basis on which building societies may treat investments as relevant is aligned to that for deposit-takers. This:

- reduces the range of cases in which building societies will need to obtain declarations specifically for tax purposes; and
- means that many of the provisions in regulation 4(1) of the building society regulations, which identify specific gross payment categories, will no longer be needed (in particular, regulations 4(1)(d), (f), (g), (k), (p), (q) and (r)).

As a result of the alignment, the following remaining differences of scope between the two regimes are removed:

- The gross payment categories for non-UK residents are defined by reference to the beneficial owner. For building societies, this means that the payment will not need to be made directly to the non-UK resident beneficiary in order for it to be made gross.

- Payments made to non-UK resident individuals (or Scottish partnerships) under regulation 4(1)(a) of the building society regulations will only be made gross where *all* the persons (or, in the case of a Scottish partnership, the partners) entitled to the payment are not UK resident, in line with HMRC practice.

- Payments to overseas non-corporate bodies (eg a Delaware Limited Liability Partnership) not within regulation 4(1)(a) or 4(1)(g) of the building society regulations will be made gross if all of the partners are not ordinarily UK resident.

- Payments made by building societies to partnerships (including limited liability partnerships) which are either partnerships of companies or partnerships between individuals and companies are in practice subject to deduction of sums representing income tax. This is because there is no specific gross payment category for payments made to partnerships involving companies (although it is possible that regulation 4(1)(g) of the building society regulations might allow payments made to partners which are companies to be made gross). Following alignment to the deposit-taker regime (section 481(4) of ICTA), such payments will no longer be subject to deduction of sums representing income tax.

- Payments made by building societies to Scottish partnerships where one or more of the partners are companies will be made gross under the rewritten legislation. Under the source legislation, such payments are made after deduction of a sum representing income tax as there is no gross payment category in the building society regulations to allow for the payment to be made gross (and regulation 4(1)(g) of the building society regulations will not apply as the payment cannot be described as being made *to* the company).

- Payments made by building societies to unapproved pension schemes (including funded unapproved retirement benefit schemes), are technically subject to deduction of sums representing tax simply because they are not listed in regulation 4. But HMRC practice is to allow such payments to be made gross, and the alignment will bring the legislation into line with this.

- Payments made by building societies to joint accounts where the holders are not all from one of the four categories of person to whom the deposit-taker regime applies will no longer be subject to deduction of sums representing income tax. (Such a case is theoretical as it is understood that building societies do not in practice permit joint accounts of such a kind.)

- Payments made by building societies to non-UK resident trustees of a discretionary or accumulation settlement will be made gross. Regulation 4(1)(bb) of the building society regulations refers to trustees of a discretionary or accumulation trust. This change in terminology brings the building society regime into line with the deposit-taker regime, which was amended by Schedule 13 to FA 2006.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL. IT ALSO AFFECTS ADMINISTRATIVE REQUIREMENTS, IN PARTICULAR IN RELATION TO BUILDING SOCIETIES.

Change 128: Deduction of tax: deposit-takers and building societies: deduction by reference to beneficiary of payments: section 856

This change aligns the way the deposit-taker and building society regimes take account of the identity of the beneficiaries of the payments concerned. It ensures that payments made by building societies will be subject to deduction at source only if the person *beneficially* entitled to the payment is an individual or a Scottish partnership (where all the partners are individuals) or the person is a personal representative or a trustee of a discretionary or accumulation settlement.

This means that payments made through third parties will be subject to deduction of sums representing income tax where the beneficiary falls into one of those categories.

The source legislation for building societies requires deduction from *all* payments (without focusing on the beneficial owner), unless the recipient falls into a gross payment category set out in regulation 4 of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) (or the payment is referred to in section 477A(1A) of ICTA).

But, as part of the alignment of the gross payment category rules for building societies with deposit-takers (see *Change 127*), deduction will apply only to payments falling within the four categories of payee identified by section 481(4) of ICTA. In this context, regulation 4(1)(b) of the building society regulations (gross payments made to trustees where the beneficiary is an individual or Scottish partnership) has not been rewritten, as it makes no difference whether a payment is made to a trustee where the income of the trustee is payable to an individual or a Scottish partnership, or the payment is itself one to which an individual or Scottish partnership is beneficially entitled.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 129: Deduction of tax: deposit-takers and building societies: investments to be treated as being or as not being relevant investments: section 857

This change is about the administrative effect of *Changes 126* (enactment of regulations) and *127* (definition of relevant investment) on how deposit-takers and building societies decide whether or not to treat investments as relevant investments.

As part of the alignment of the building society regime and deposit-takers regime, it is necessary to have one common basis for determining when an investment should be treated as being a relevant investment. This involves changes to the rules regarding the way that building societies check whether a particular payment should be made gross.

For example, regulations 11(1), (2), (2A) and (4) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) state that a building society cannot treat a payment as being within one of the gross payment categories found in regulation 4(1)(a) to (g), (k) or (r) unless it has a declaration to that effect. But once it has that declaration, it can continue to treat such payments as gross until it has information that regulation 4(1) of the building society regulations may not apply.

For deposit-takers, declarations are only required for persons falling in the equivalent of regulations 4(1)(a) to (c). As deposit-takers do not have to obtain declarations in respect of regulation 4(1)(d) to (g), (k) or (r), once the two regimes are aligned, building societies will no longer have to obtain declarations for payments previously caught under regulations 4(1)(d) to (g), (k) and (r). Building societies will have to check only that the payment is not caught in one of the four categories and, if it is not, no further checks or declarations will be required.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 130: Deduction of tax: deposit-takers and building societies: declarations of non-UK residence: sections 858, 859, 860 and 861

This change aligns the rules about declarations as between the deposit-taker and building society regimes, in line with practice, so that in all cases a declaration of non-UK residence in the prescribed or authorised format (which may or may not be in writing) will be required in order for a gross payment to be made.

Section 481(5)(k) of ICTA requires deposit-takers to have received a written declaration from an “appropriate person” confirming that the individual, deceased person or trustees are (or, in the case of a deceased person, was) non-UK resident before a gross payment can be made.

The declaration needs:

- to be in a prescribed or authorised format and contain an undertaking to notify the deposit-taker if circumstances change (see section 482(2) of ICTA); and
- to contain the names and addresses of the individuals or partners to whom the declaration applies (see section 482(2A) of ICTA).

These latter conditions are not prerequisites for the payment to be made gross. But a penalty can arise if they are not met (see section 98 of TMA).

But current practice is that the payment will only be made gross where a declaration is made in the prescribed or authorised format which contains all the above mentioned information.

For building societies the position is slightly different. Under the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) building societies cannot make gross payments unless they have received a non-UK resident declaration (which need not be in writing) from an "appropriate person" which must contain an undertaking to notify the building society if there is a change in circumstances (regulation 11(1) to (2AB)).

But it is not a prerequisite for gross payment that the declaration contains the names and addresses of the individuals or partners concerned (regulation 11(2AC) of the building society regulations). Nor is it necessary for the declaration to be in a prescribed or authorised format (regulation 11(3)). But a penalty can arise if these conditions are not met (see section 98 of TMA).

Again, current practice is that the payment will only be made gross where a non-UK resident declaration is made in the prescribed or authorised format and it contains all the above mentioned information.

In order to align both the deposit-taker and building society regimes with current practice a number of steps have been taken.

Firstly, the sections require in all cases a declaration of non-UK residence in the prescribed or authorised format (which may or may not be in writing) in order for a gross payment to be made.

The requirement that the declaration for deposit-takers be *in writing* (section 481(5)(k) of ICTA) has, therefore, not been reproduced, as it is unnecessary if the declaration is in a prescribed or authorised format. Further, the requirement, in section 482(2) of ICTA, that the declaration must contain such *information* as the Commissioners for Her Majesty's Revenue and Customs may *reasonably require* is in line with the deposit-taker rules, but goes beyond the explicit terms of regulation 11(3) of the building society regulations.

Second, declarations will need to include an undertaking (except in relation to deceased persons), and, in the case of the "individual interest condition" in section 856(3) or the "Scottish partnership condition" in section 856(4), it will require the names and addresses of the individuals concerned.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 131: Deduction of tax: deposit-takers and building societies: declarations of non-UK residence: Scottish partnerships: sections 859 and 861

This change clarifies the operation of provisions about Scottish partnerships.

Under Scottish law, a Scottish partnership is a separate legal entity and thus capable of being the beneficial owner of a deposit. Section 481(4)(b) of ICTA states that where a deposit is owned by a Scottish partnership, and all the partners are individuals, it will be treated as a relevant investment.

But under section 481(5)(k)(i) of ICTA, the deposit will not be treated as a relevant investment where, "the person who is beneficially entitled to the interest is not … ordinarily resident in the United Kingdom".

As the Scottish partnership is the person beneficially entitled to the deposit, this does not sit comfortably with the fact that it is the partners who each have a residence status, rather than the partnership itself. Further, existing practice (although declarations in favour of Scottish partnerships are rare) is to apply this provision by reference to whether all the partners are not ordinarily resident in the United Kingdom (rather than whether the Scottish partnership is not ordinarily resident).

Section 481(5)(k)(i) of ICTA and regulation 4(1)(a) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) have therefore been rewritten in section 859 in such a way as to ensure that a deposit will not be a relevant investment where a declaration has been made by the Scottish partnership that *all the partners* of the Scottish partnership are not ordinarily resident in the United Kingdom.

In the same way, section 481(5)(k)(iii) of ICTA treats a deposit as not being a relevant investment where the trustees are not UK resident and believe that no beneficiary is an individual ordinarily resident in the UK or a UK resident company. On a strict reading of section 481(5)(k)(iii) this means that a declaration may be made where the trustees are non-UK residents and a Scottish partnership, consisting in whole or part of UK resident partners, is a beneficiary. In order to rewrite section 481(5)(k)(iii) of ICTA in a way that is consistent with the rewrite of section 481(5)(k)(i) of ICTA, it is necessary to refer to the *partners* of the Scottish partnership rather than the *Scottish partnership* in section 861.

This aspect of section 861 follows the approach currently taken by regulation 4(1)(bb) of the building society regulations which allows a payment to be made gross where the trustees are not UK resident and the beneficiaries are non-UK resident or, in the case of a Scottish partnership, the partners are non-UK resident individuals. But regulation 11(2AA)(b) of the building society regulations requires the building society to obtain a declaration stating that the trustee does not have reasonable grounds for believing that the *beneficiaries* are UK resident. In order to rewrite regulation 11(2AA)(b) in a way that is consistent with regulation 4(1)(bb)(ii), it is necessary for the rewritten legislation to refer to the *partners* of the Scottish partnership rather than the *Scottish partnership*.

Section 861, therefore, provides that, where the beneficiary is a Scottish partnership, the declaration must confirm that all the partners are not ordinarily UK resident.

Further, section 482(2)(a) of ICTA and regulation 11(2AB)(b) of the building society regulations require an undertaking to be included in the declaration that, if the beneficiary becomes resident, a notification will be sent to the deposit-taker or building society. In order to rewrite these provisions in a way that is consistent with the rewrite of section 481(5)(k)(i) and (iii) of ICTA and regulation 4(1)(a) and (bb) of the building society regulations, reference is made, in sections 859(3) and 861(3), to the *partners* of the Scottish partnership rather than the beneficiary.

Finally, for building societies, section 861(3)(b)(iii) departs from regulation 4(1)(bb)(ii) of the building society regulations, which in effect requires the declaration to state that no beneficiary of the trust is a Scottish partnership with a UK resident partner *or* a company partner *(whether UK resident or non-UK resident)*. It appears more appropriate for regulation 4(1)(bb)(ii) of the building society regulations to be consistent with the general approach taken in regulation 4(1)(bb)(iii) dealing with trusts. Consequently, section 861(3)(b)(iii) only refers to *UK resident company partners*.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 132: Deduction of tax: deposit-takers and building societies: inspection of declarations: section 862

This change aligns the rules about inspection of declarations as between deposit-takers and building societies.

Section 482(3) of ICTA allows an officer of Revenue and Customs to issue a notice to inspect "all" declarations made to deposit-takers. This section has been rewritten so the notice may allow the officer to inspect "any" declarations made. This change makes the position more flexible and brings the deposit-taker legislation into line with the building society legislation (regulation 11(5) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231)).

This change may, in some circumstances, make compliance more onerous for a deposit-taker. For example, where a notice specifies particular declarations and the deposit-taker has to select the appropriate declarations.

But it is likely, in general, that this change will reduce both the compliance burden for deposit-takers and administrative costs for HMRC as it will be possible for the notice only to require specific declarations.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 133: Deduction of tax: deposit-takers and building societies: qualifying deposit rights: sections 864 and 889

This change omits the provisions about deposit rights in sections 349(3A), 349(4), 477A(1A) and (10) and 481(5A) of ICTA, as these are obsolete.

These provisions were inserted by Schedule 8 to F(No 2)A 1992, alongside the insertion of section 56A of ICTA in order to pave the way for the introduction of dematerialised transactions.

Section 56A supplemented section 56 of ICTA, to ensure that the charge to tax on income from the disposal of deposits would embrace income from the disposal of such deposit rights. And the provisions inserted into sections 349, 477A and 481 extended the exceptions from the duty to deduct which applied to qualifying certificates of deposit to deposit rights satisfying the relevant qualifying conditions.

The legislation in F(No 2)A 1992 was timed to coincide with the intended introduction of TAURUS (Transfer and Automated Registration of Uncertificated Stock). But in 1993 TAURUS was abandoned and so this legislation was never used.

Instead a new electronic settlement system (CREST) was proposed and began operation in 1996, under the terms of the Uncertificated Securities Regulations 1995 (SI 1995/3272) (now replaced by the Uncertificated Securities Regulations 2001 (SI 2001/3755)). In 2003, specific regulations were made to cater for electronic settlement of dematerialised rights in deposits (the Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations (SI 2003/1633)).

The references to uncertificated eligible debt security units in SI 2003/1633 were incorporated directly into the relevant provisions of ICTA by ITTOIA. These references have been rewritten in this Act as "qualifying uncertificated eligible debt security units" (see sections 864, 889(3)(b) and 986).

The references to deposit rights in sections 349(3A), 349(4), 477A(1A) and (10) and section 481(5A) of ICTA are therefore obsolete and have been omitted. And, accordingly, regulation 4(1)(j) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) is not rewritten.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 134: Deduction of tax: interest paid by building societies: sections 874 and 875

This change removes a drafting defect in section 349(2) of ICTA, to make it clear that Chapter 3 of Part 15 of this Act (deduction from certain payments of yearly interest) does not apply to any interest paid by building societies. All duties to deduct sums representing income tax from payments made by building societies are dealt with in Chapters 2 and 4 of Part 15 of this Act (based on sections 349(3A) and (3B) and regulations made under 477A(1) of ICTA).

Subject to certain exceptions that are not relevant here, section 349(2) of ICTA imposes a duty to deduct sums representing income tax from yearly interest paid (whether by or through the payer):

"(a) otherwise than in a fiduciary or representative capacity, by a company (other than a building society) or local authority; or

(b) by or on behalf of a partnership of which a company is a member; or

(c) by any person to another person whose usual place of abode is outside the United Kingdom.

Under the source legislation, payments by building societies of interest on shares in, deposits with or loans to them are dealt with by regulations under section 477A(1) of ICTA. The scope of this provision is wide. But yearly interest on freely transferable securities issued by building societies are excluded from those regulations by section 477A(1A) of ICTA, being dealt with separately in section 349(3A) and (3B) of ICTA.

A building society is a body corporate, within the definition of a company in section 832(1) of ICTA, so section 349(2)(b) of ICTA could be read as catching any payments of yearly interest by a partnership of which a building society is a member. Also, section 349(2)(c) of ICTA, with its reference to payments "by any person", could be read as imposing a duty on a building society to deduct from payments of yearly interest it makes to persons abroad. But both these possibilities would duplicate duties imposed by regulations made under sections 349(3A) and 477A(1) of ICTA.

This was not always so. As originally enacted, section 476(5)(a) of ICTA excluded from sections 348 to 350 of ICTA any dividends or interest to which regulations applied, unless those regulations specifically provided for sections 348 to 350 to apply. (The current regulations make no such provision.) At that time building societies could not issue freely transferable securities.

On the abolition of the composite rate provisions by FA 1990, section 349(3) of ICTA, which provides for exceptions to the duty to deduct under section 349(2), was amended by inserting subsection (3)(e) to exclude from that duty:

"any dividend or interest paid or credited in a relevant year of assessment in respect of shares in, or deposits with or loans to, a building society.

But in FA 1991 amendments were made to ICTA by locating the duty to deduct from dividends and interest on freely transferable securities in new sections 349(3A) and (3B). To pave the way for this, section 477A(1A) was inserted, ensuring that such dividends and interest were outside the scope of the regulations under section 477A. Further, the words inserted as section 349(3)(e) of ICTA by FA 1990 were repealed and the words "(other than a building society)" inserted into section 349(2)(a) of ICTA, but with no adjustment to section 349(2)(b) or (c). This inadvertently opened up the possibility that parts, but not all, of section 349(2) could apply to payments of interest by a building society.

This change restores the position of building society interest payments by excluding them from Chapter 3 of Part 15 of this Act (the rewritten equivalent of sections 349(2) and (3) of ICTA). So all payments of dividends and interest now fall under either Chapter 2 or Chapter 4 of Part 15 of this Act.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 135: Enactment of the European Investment Bank (Designated International Organisation) Order 1996 (SI 1996/1179): sections 879, 991 and Schedule 1 (section 840A of ICTA)

This change enacts the provisions of the European Investment Bank (Designated International Organisation) Order 1996 (SI 1996/1179) (the Order).

Under section 840A(1)(d) of ICTA the Treasury has powers to designate a "relevant international organisation" as a bank. That provision is rewritten for income tax in section 991(4) of this Act.

To date the power has only been used in relation to the European Investment Bank (the EIB). The operative provisions of the Order are in Articles 3 and 4. Article 3 of the Order designates the EIB as a bank. This is enacted by this Act, so that:

- for income tax purposes, the EIB is now specifically included in the definition of "bank" in section 991(2)(d); and
- for corporation tax purposes, the definition of "bank" in section 840A of ICTA includes the EIB (see new subsection (1)(ca) of that section).

Article 4 modifies the normal rules about the deduction of a sum representing income tax from interest in the case of interest paid to the EIB.

Under section 874(1), certain persons paying yearly interest must deduct from the payment a sum representing income tax. Section 879(1) provides an exception to that duty if the person beneficially entitled to the interest is within the charge to corporation tax. Article 4 of the Order withdraws, in the case of the EIB, the condition that the person must be within the charge to corporation tax. This allows interest on advances from the EIB to be paid gross.

This is enacted in section 879(3). As a result of this Change, the Order is revoked by this Act.

The Treasury powers to designate further international organisations will remain as before, both for income tax and corporation tax purposes.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 136: Deduction of tax: statutory interest: section 888

This change makes specific provision that payments of "statutory interest" are not subject to deduction of tax under section 874.

The Late Payment of Commercial Debts (Interest) Act 1998 requires payment of "statutory interest" in certain circumstances. Tax Bulletin 42 (August 1999, interpretations) indicated that where such interest is paid, it would not be regarded as yearly and would not, therefore, be subject to deduction of tax under section 349(2) of ICTA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 137: Deduction of tax: payments of UK public revenue dividends: application for deduction of tax: section 895

This change extends the definition of "registered" to include securities which are "recorded" in the books of the Registrar of Government Stock, in order to provide legislative support for deduction at source applications under section 895 in respect of UK public revenue dividends on securities held in CREST.

Section 50(2) of ICTA provides that holders of any *registered* securities may apply to have income tax deducted at source. Section 50(7) of ICTA defines "registered" as meaning entered in the register of the Registrar of Government Stock in accordance with the regulations under section 47(1)(b) of FA 1942 (see regulation 3 of the Government Stock Regulations 2004 (SI 2004/1611)).

Securities which are held in CREST are not entered in the register of the Registrar of Government Stock. The Registrar of Government Stock only maintains a *record* of entries made in CREST's register. This means that, strictly, UK public revenue dividends on securities held in CREST cannot be the subject of an application for deduction at source as the securities are not "*registered*" (ie they are not entered on the register of the Registrar of Government Stock).

But current practice is that UK public revenue dividends on securities held in CREST are paid net of tax on application. In order to legislate for this, the definition of "registered" has been extended to include securities entered in a register maintained in accordance with regulations made under section 207 of the Companies Act 1989. Regulation 21 of the Uncertificated Securities Regulations 2001 (SI 2001/3755) (as amended), introduced under that section, requires the Registrar of Government Stock to maintain a record of entries made in CREST's register.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 138: Charges on income: year in which payments taken into account: rates for deduction of tax: sections 900, 901, 902 and 903

This change requires a sum representing income tax to be deducted from certain annual payments and patent royalties at the basic rate (or, in some cases, the savings rate) in force in the tax year they are *made*. It also ensures the payments will always be taken into account in the payer's tax calculation for the tax year in which they are made.

Section 4 of ICTA requires any deduction made to be at the basic or savings rate in force for the relevant tax year. That year is defined in section 4(2) of ICTA and depends on whether the payment is paid wholly out of income brought into charge to income tax. If it is, the relevant year is the tax year in which the payment is due to be paid. If not, the relevant year is the tax year in which the payment is made.

In either case, the relevant year is also the year against the income of which the payment is treated as a charge by virtue of the rule in section 835(6)(b) of ICTA which links into section 4 of ICTA.

These rules give rise to two awkward points.

The first is that the payer may not know the level of his income for the tax year at the time of payment and so there may be uncertainty about whether it will be treated as being paid wholly out of income brought into charge to income tax. Not knowing which tax year is relevant at the time of payment means that the payer may not know the rate for deduction at that time. (This uncertainty is also referred to in connection with *Change 81*).

The second concerns the case where the payer has insufficient income in the year the payment was due but has ample income in the following year and (whether or not for that reason) makes the payment in that following year. Here, a sum representing income tax will be deductible at the rate for the year in which the payment was due. And section 835(6)(b) provides that the payment is treated as a charge against the payer's income of that year. That is potentially disadvantageous to a payer who has insufficient income in that year to cover the charge.

Under this change, the provisions of section 4 of ICTA are not rewritten so far as they address these issues, but instead the rule is that deduction is made at the applicable rate in force for the year of payment. And the sections providing for the collection of the tax (in later Chapters of Part 15) and for relief for the payments themselves in calculating net income (Chapter 4 of Part 8) follow suit. The self-assessment return and guidance material already effectively adopt this approach, by simply asking for details of payments without considering whether a payment is late.

Moving to a deduction at the rate in force for the year of payment may benefit the taxpayer in the second case cited above. But the taxpayer is not disadvantaged in the reverse scenario, where a payment is made late and the payer had ample income in the year the payment was due, but has less total income than the amount of the payment in the year of payment. That is because the payer's income would not have been enough to cover the charge (before the change) and (after the change) it is only possible for some of the payment to be deducted in calculating net income.

Nothing in this new rule affects the year in which a payment subject to deduction of tax at source is assessable on the recipient. That is fixed by provisions such as sections 580(1) and 684(1) of ITTOIA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. IT ALSO AFFECTS WHEN TAX IS PAID. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 139: Charges on income: no deduction of tax from certain patent royalty payments: section 903

This change removes any requirement to deduct sums representing income tax from patent royalty payments that are exempt under section 347A of ICTA or section 727 of ITTOIA.

Those sections exempt certain annual payments (defined as "qualifying annual payments" by section 899) if they are paid by an individual other than in connection with that individual's trade. Because of those exemptions, the deduction at source provisions in section 348(1) and 349(1)(a) of ICTA do not apply to the annual payments covered by section 347A of ICTA and section 727 of ITTOIA.

Deduction at source might arguably still apply under sections 348(2) and 349(1)(b) of ICTA on the grounds that the payment is in respect of a patent, in the absence of a parallel proviso to that in sections 348(1A)(a) and 349(1A)(a) of ICTA. But it is not sensible for deduction at source to apply to a payment that is exempt regardless of who receives it. Moreover, sections 348(2) and 349(1) of ICTA require deduction of "a sum representing the amount of income tax" on the payment. It is doubtful whether this requirement could have any application in the case of payments that cannot be taxable income of the payee.

Accordingly, section 903, which is based on sections 348(2) and 349(1)(b) of ICTA, requires sums representing income tax to be deducted only from patent royalty payments that are not qualifying annual payments. If a qualifying annual payment (whether in respect of a patent or not) is paid by an individual in connection with the individual's trade, deduction is made under section 900. If paid by a person other than an individual, deduction is made under section 901. But none of the rewritten deduction at source provisions applies to a patent royalty payment that is an exempt annual payment.

This change will affect very few cases. Most patent royalty payments by individuals will be made in the course of the individual's trade. Furthermore, the exemption only applies to patent royalties that are also annual payments. Most patent royalties will not be pure income in the recipient's hands, but will instead be taxable trading receipts.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 140: Deduction of tax: scope of duty to deduct from certain royalties: sections 903 and 906

This change enacts a principle of case law that determines the scope of the duty to deduct in certain cases involving payments in respect of royalties, patents, copyrights, design rights and public lending rights.

Where such payments are annual payments, the scope of the duty to deduct from annual payments can be seen from Earl Howe v CIR, (1919) 7 TC 289, CA. In that case Scrutton LJ said:

"The result of these Sections [corresponding to section 348 of ICTA] seems to be that the "annuities, interest, and other annual payments" which can be deducted to obtain exemption are those from which the claimant can deduct tax on behalf of the recipient; being in effect the profits of the recipient who bears the tax they are not also to be treated as profits of the person paying them. If no tax can be deducted on behalf of the recipient, they cannot be treated as profits of the recipient, and must be treated as paid out of profits of the person paying, who is therefore to be taxed on them.

This principle was confirmed in the case of Bingham v CIR, (1955) 36 TC 254, ChD. In that case, a man resident in the United Kingdom made maintenance payments to his former wife who was resident in the Netherlands. The payments had been ordered by a Dutch court and so were not UK source income. He claimed to deduct those payments (which at that time were annual payments) from his income for surtax purposes. It was held that, since his former wife was not liable to UK taxation on the maintenance payments, sums representing income tax could not be deducted from the payments under what is now section 348 of ICTA, and they were not allowable as a deduction.

In the case of copyrights, design rights and public lending rights, sections 536, 537 and 537B of ICTA apply section 349(1) of ICTA as if the payments were annual payments. (The duty to deduct in such cases is rewritten in section 906.) So it follows that if the person whose income it is has no liability to UK income tax on the payments, the duty to deduct under section 349(1) of ICTA cannot apply.

There is nothing specific to apply the same principle to payments in respect of a patent (section 903). But Scrutton LJ's discussion of the principle is wide enough to encompass patent payments. And there would be no logic in a policy that demanded deduction at source if a patent payment was also an annual payment, but not otherwise.

This change enacts the relevant case law in both sections 903 and 906 and aligns the statute with practice.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 141: Deduction of tax: manufactured overseas dividends: periods for accounting for tax: section 925

This change brings the law into line with practice in relation to the periods by reference to which overseas dividend manufacturers may set off amounts of overseas tax against their United Kingdom tax liabilities.

Paragraph 4(7) of Schedule 23A to ICTA provides:

"Dividend manufacturing regulations may make provision for a person who, in any chargeable period, is an overseas dividend manufacturer to be entitled in prescribed circumstances to set off in accordance with the regulations and to the prescribed extent, amounts falling within paragraph (a) of sub-paragraph (7AA) below against the sums falling within paragraph (b) of that sub-paragraph, and to account to the Board for, or as the case may be, claim credit in respect of, the balance.

Section 832(1) of ICTA defines "chargeable period" as an accounting period of a company or a year of assessment. It defines "year of assessment", with reference to income tax, as a year for which such tax is granted by any Act granting income tax.

Section 925 rewrites paragraph 4(7) of Schedule 23A to ICTA in terms of a "prescribed period" rather than a "chargeable period". This will enable the Treasury to make regulations about set-off in relation to a period other than a tax year if that is thought desirable. This flexibility is potentially beneficial to taxpayers, as it enables regulations to prescribe periods (such as periods of account) which will be to their administrative convenience.

THE CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT, OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 142: Deduction of tax: collection: deposit-takers, building societies and certain companies: building society return periods: section 947

This change removes any doubt about whether paragraph 2(2)(b) of Schedule 16 to ICTA and regulation 10(3)(d)(b) of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations) have the same meaning.

Under the source legislation regulation 10(3)(d) of the building society regulations modifies paragraph 2(2)(a) to (c) of Schedule 16 to ICTA in respect of building societies, so that complete payment quarters and any *part* of an accounting period will be treated as a return period. But where a *complete* accounting period is wholly contained within a return period, there is no return period. This means, for example, that a complete accounting period running from say 1 January to 31 January will not be caught by regulation 10.

So, in keeping with the alignment of the rules on deduction of tax at source for deposit-takers and building societies (see *Changes 126* and *127*), *subsections (2)* and *(3)* of section 947 have been drafted so that they also apply to building societies.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 143: Deduction of tax: collection: deposit-takers, building societies and certain companies: returns: sections 949, 952, 953, 957 and 958

This change makes it clear that a return need be submitted only where a section 946 payment was made in that particular return period. It also clarifies related points.

Paragraph 2 of Schedule 16 to ICTA leaves it unclear whether a return need be made only for a return period in which a section 946 payment has been made or whether returns need to be made for each return period in any accounting period in which at least one section 946 payment has been made. Section 949 makes the position clear, in line with current practice.

The related points which follow from this change affect sections 952, 953, 957 and 958.

Sections 952(2) and 953(4) (set-off) clarify that a payer may make a set-off claim even where no section 946 payment has been made in the return period concerned. Under the source legislation this point is unclear because paragraph 5 of Schedule 16 to ICTA requires the claim to be included in a paragraph 2 return. (As mentioned above, it is unclear when such a return needs to be submitted.)

Section 957 (assessment in other cases) clarifies that an assessment can be made in respect of *any* return (including a return made only in order to make a set-off claim). Under the source legislation, this point is unclear as paragraph 4(2) of Schedule 16 to ICTA refers to returns made under paragraph 2. (As mentioned above, it is unclear when such a return needs to be submitted.)

Section 958 (payer's duty to deliver amended return) clarifies that the payer is under a duty to correct not only returns which include a section 946 payment, but also returns where a claim for set-off has been made. Under the source legislation, this point is unclear as paragraph 7A of Schedule 16 to ICTA refers to returns made under paragraph 2. (As mentioned above, it is unclear when such a return needs to be submitted.)

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 144: Deduction of tax: collection: deposit-takers, building societies and certain companies: payments made otherwise than in an accounting period: section 950

This change brings into line the information which is required to be included on a return if a payment is made otherwise than in an accounting period with the information which is required if a payment is made in an accounting period.

Paragraph 9 of Schedule 16 to ICTA does not have a specific information requirement. But all payments must be accounted for on returns which, according to section 113(1) of TMA, "… shall be in such form as the Board prescribe…".

As the form prescribed already requires the information set out in section 950 this change will have no effect in practice.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 145: Deduction of tax: collection: deposit-takers, building societies and certain companies: payer's duty to deliver amended return: section 958

This change extends the taxpayer's duty to submit corrected returns to payments made otherwise than in an accounting period.

Under paragraph 4(2) of Schedule 16 to ICTA, where an incorrect return is submitted in respect of payments made in an accounting period (see section 949), there is a duty on the taxpayer to deliver an amended return.

But the source legislation does not provide for such a duty in respect of returns in respect of payments made otherwise than in an accounting period (see section 950).

Section 958 imposes a duty to submit a corrected return regardless of whether the return is for a payment made in an accounting period or otherwise.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 146: Deduction of tax: collection: deposit-takers, building societies and certain companies: power to make regulations modifying this Chapter: section 962

This change confirms that the powers to modify the provisions dealing with collection of income tax deducted at source by regulations apply to deposit-takers and building societies.

Section 350(4) of ICTA allows the Commissioners for Her Majesty's Revenue and Customs to make regulations which modify Schedule 16 to ICTA in its application to payments covered by section 349 of ICTA. These powers do not specifically mention the making of regulations which modify Schedule 16 in its application to payments made by building societies (covered by regulations under section 477A of ICTA), or payments by deposit-takers (covered by section 480A of ICTA).

But regulations made under the powers in section 350(4) of ICTA are capable of modifying Schedule 16 as it applies to deposit-taker and building society payments.

The aim of regulation 10 of the building society regulations (SI 1990/2231) and section 480A of ICTA is that, subject to some specific modifications, the collection regime applying to section 349 payments should apply to deposit-taker and building society payments. So regulation 10 and section 480A should be read as applying Schedule 16 to ICTA as modified from time to time by regulations made under section 350(4) of that Act.

It also possible to read the power in section 350(4) as a power to modify Schedule 16 as applied by regulations under section 477A and by section 480A. And, in the case of building societies, section 477A allows regulations to be made in respect of building society payments. And regulation 10 incorporates the provisions of Schedule 16 with modifications. So section 962 of this Act reflects the regulation making power in section 477A by permitting regulations to modify Chapter 15 of Part 15 of this Act in its application to building society payments.

Section 962 allows regulations to be made modifying that Chapter in relation to any kind of section 946 payment. This reflects the general way in which the various provisions about deduction of income tax at source are brought together and rationalised in this Act.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 147: Deduction of tax: removal of charge to tax: sections 939, 946, 963, 964 and 971

This change removes the charging provision in sections 42A(1), 350(1) and 582 of ICTA, to bring this legislation into line with the approach taken in other legislation about collection of income tax deducted at source. So a person will not be chargeable in relation to tax to be accounted for under Part 15 of this Act.

Section 42A(1) of ICTA allows the Commissioners for Her Majesty's Revenue and Customs to make regulations for the "charging, assessment, collection and recovery" of prescribed amounts which may become chargeable under Schedule A or as the profits of a UK property business.

Section 350(1) of ICTA provides that the person by or through whom certain payments are made (from which sums representing income tax are required to be deducted) shall be "assessable and chargeable" with income tax on the payment. And the idea of the payer being chargeable flows through into Schedule 16 to ICTA, as applied by section 350(4) of ICTA for certain payments caught by section 349 of that Act.

Section 582 of ICTA applies the section 350(1) charge to the special case of funding bonds, where instead of making a deduction the issuer of the bonds retains enough bonds to cover the sum representing income tax.

Other legislation concerned with deduction at source does not involve the payer being chargeable. Examples include PAYE legislation, and the rules for deposit-takers and building societies (sections 477A and 480A of ICTA) which apply Schedule 16 to ICTA directly rather than through section 350 of that Act.

This change aligns the sections rewriting sections 42A, 350(1) and 582 of ICTA with those rewriting other legislation which does not involve the idea of the payer being chargeable, rather than retaining that idea.

This, in particular, gives greater clarity to the distinction between:

- income tax charged on persons in their own right (on their own income); and
- income tax paid under deduction of tax at source provisions (where income tax is ultimately borne by the persons for whom the payments constitute income).

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 148: Deduction of tax: manufactured interest on UK securities: tax statements: section 975

This change brings the rules for tax statements about manufactured interest on UK securities into line with the rules for tax statements about actual interest on UK securities.

Paragraph 3(8) and (9) of Schedule 23A to ICTA deal with statements about manufactured interest on UK securities paid under deduction of tax. Section 352 of ICTA deals with statements about actual interest on UK securities paid under deduction of tax.

Paragraph 3(8) and (9) of Schedule 23A to ICTA and section 352 of ICTA are very similar. They differ in two respects.

First, under section 352, the statement is to be provided "if the recipient so requests in writing". By contrast, under paragraph 3(8), "the interest manufacturer shall, on paying the manufactured interest, provide" the statement. But since in both cases the recipient can enforce the duty to provide the statement, this does not appear to make any practical difference.

Second, paragraph 3(8)(d) requires the statement to include the date of the payment by the interest manufacturer, but section 352 imposes no such requirement. Neither does the rule about tax statements relating to manufactured overseas dividends in regulation 15 of the Income Tax (Manufactured Overseas Dividends) Regulations 1993 (SI 1993/2004).

These differences are believed to be due to historical accident. This Act therefore conforms the rewritten paragraph 3(8) and (9) to section 352.

Accordingly, section 975 of this Act, which is based on section 352 of ICTA, applies without modification to manufactured interest on UK securities paid under deduction of tax.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 149: Deduction of tax: meaning of "qualifying certificate of deposit" and "qualifying uncertificated eligible debt security unit": sections 985 and 986

This change aligns the terms of the repayment condition in the definitions of "qualifying certificate of deposit" and "qualifying uncertificated eligible debt security unit" with the terms of the repayment condition in the definition of "qualifying time deposit".

Under the source legislation (sections 349(4) and 482(6) of ICTA), the issuer of any of these two instruments must pay an amount of not less than £50,000 (or equivalent if in a foreign currency) "after a period of not more than five years beginning with the date on which the deposit is made".

The source legislation is not clear about whether this means that the amount must be repaid in one tranche at a specified time. But in practice, whenever these instruments are issued, they are issued on the basis that the amount is payable in one tranche at a specified time within five years of the date of the deposit being made, in line with the position for qualifying time deposits.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE BUT NOT IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 150: Interpretation: definition of "personal representatives" for the purposes of the Income Tax Acts: section 989

This change applies the new defined term, "personal representatives" for the purposes of the Income Tax Acts. It completes the process started by ITEPA as a result of which definitions to the same effect were applied:

- by section 721(1) of ITEPA for the purposes of that Act;
- by section 279(1) of FA 2004 for the purposes of Part 4 of that Act (Pension schemes etc); and
- by section 878(1) of ITTOIA for the purposes of that Act.

The application of the defined term to ITEPA and ITTOIA is described in Change 159 in Annex 1 to the Explanatory Notes to ITEPA and in Change 151 in Annex 1 to the Explanatory Notes to ITTOIA. This note draws heavily on the contents of those notes.

With the exception of sections 111 and 151 of FA 1989, wherever the term "personal representatives" is used in the Income Tax Acts, other than ITEPA, Part 4 of FA 2004 and ITTOIA, the term is undefined.

Places where it is so used include the following provisions on which this Act is based:

- section 360A(2) of ICTA (meaning of "material interest" in section 360 of that Act (loan to buy interest in close company)) (see section 395(1)(d));
- section 364(1) of ICTA (loan to pay inheritance tax) (see section 403(1) and (2));
- section 417(3) of ICTA (meaning of "associate" for the purposes of Part 11 of that Act (Close companies)) (see section 253(1)(c)(i));
- sections 481(4)(c) and 482(6) of ICTA (meaning of "relevant deposit" for the purposes of section 480A of that Act (relevant deposits: deduction of tax from interest payments)) (see sections 856(5) and 860(4));
- section 686(6) of ICTA (accumulation and discretionary trusts: special rates of tax) (see section 483(1));
- section 703(11) of ICTA (cancellation of tax advantage) (see section 712(2));
- section 715 of ICTA (exceptions from sections 713 and 714 of that Act (accrued income scheme: deemed sums and reliefs)) (see section 640);
- section 721 of ICTA (accrued income scheme: death) (see section 636);

- section 777(7) of ICTA (provisions supplementary to sections 775 and 776 of that Act (sale by individual of income derived from his personal activities and transactions in land: taxation of capital gains)) (see sections 763(4) and 782(4)); and
- paragraph 50(1) of Schedule 16 to FA 2002 (meaning of “associate” for the purposes of that Schedule) (see section 381(1)(c)(i)).

Section 111 of FA 1989 (residence of personal representatives) has its own definition of “personal representatives”. Section 111(1) and (2) of FA 1989 have been rewritten in section 834.

The definition in section 111(3) of FA 1989, which is also applied for the purposes of section 151 (assessment of trustees etc) of that Act by subsection (3) of that section, provides that:

“In this section “personal representatives” means#

(a) in relation to England and Wales, the deceased person’s personal representatives as defined by section 55 of the Administration of Estates Act 1925;

(b) in relation to Scotland, his executor or the judicial factor on his estate;

(c) in relation to Northern Ireland, his personal representatives as defined by section 45(1) of the Administration of Estates Act (Northern Ireland) 1955; and

(d) in relation to another country or territory, the persons having in relation to him under its law any functions corresponding to the functions for administration purposes of personal representatives under the law of England and Wales.

Section 55(1)(xi) of the Administration of Estates Act 1925 provides that:

> ““personal representative” means the executor, original or by representation, or administrator for the time being of a deceased person, and as regards any liability for the payment of death duties includes any person who takes possession of or intermeddles with the property of a deceased person without the authority of the personal representatives or the court, and “executor” includes a person deemed to be appointed executor as respects settled land.

Section 45(1) of the Administration of Estates Act (Northern Ireland) 1955 provides that:

> ““personal representatives” means the executors or executor, original or by representation, or the administrators or administrator for the time being of a deceased person.

The definitions in section 55 of the Administration of Estates Act 1925 and section 45(1) of the Administration of Estates Act (Northern Ireland) 1955 refer to executors as well as administrators.

Under English law, executors are generally appointed by the will. Administrators are appointed by the court where no one is appointed as executor by the will or where the deceased dies without leaving a valid will.

English law recognises three other categories of executor. The first is executor according to the tenor, who on the terms of the will is appointed to perform the essential duties of an executor where the deceased person has failed to nominate a person to be his executor. Secondly there is executor de son tort, who is a person who takes upon himself the position of executor or intermeddles with the goods of the deceased person without having been appointed executor or administrator. Thirdly there is special executor, the term given to a person who is a trustee of settled land at the time of the death. The position is similar for Northern Ireland.

For the purposes of Scottish law, an executor is appointed either expressly or impliedly by the deceased, in which case the executor is known as an executor nominate, or by the court, in which case the executor is known as an executor dative. So the term “executor” under Scottish law is broadly equivalent to an “executor or administrator” under English law. Scottish law also recognises judicial factors and executor-creditors who may be appointed by the court to administer the deceased’s estate or part of it. Although a judicial factor could not be described as an executor, such a factor might be regarded as an “administrator”.

So, in relation to any part of the United Kingdom, a deceased person's personal representatives within the meaning of section 111(3) of FA 1989 are the persons responsible for administering the person's estate.

Accordingly, the first limb of the definition in section 989, that personal representatives are:

"in the United Kingdom, persons responsible for administering the estate of the deceased,

catches the same persons as does section 111(3) of FA 1989 in relation to each part of the United Kingdom, but does so more directly and succinctly.

It follows from what is said above, that the application of the first limb of the definition in section 989 in relation to the provisions in the Income Tax Acts which use the expression "personal representatives" without definition, including those rewritten in this Act, reflects the ordinary common sense meaning of those terms in each part of the United Kingdom.

The second limb of the definition in section 989 is in similar terms to section 111(3)(d) of FA 1989. It provides that personal representatives are:

"in a territory outside the United Kingdom, those persons having functions under its law equivalent to those of administering the estate of the deceased.

Section 111(3) of FA 1989 has, accordingly, not been rewritten and the definition in section 989 applies for the purposes of section 834 of this Act and section 151 of FA 1989.

That leaves the question of whether there is any change involved in applying the second limb to provisions in the Income Tax Acts which use the expressions "personal representatives" without definition, as those provisions apply to countries and territories outside the United Kingdom.

The terms "executor" and "administrator" are not terms of art in relation to countries and territories outside the United Kingdom. But it seems likely that a court would hold that references to "personal representatives" in tax legislation would, in the absence of a definition, cover the people that most closely resemble executors or administrators in the United Kingdom. In view of what is said above, that means the people who have functions corresponding to those of personal representatives in the United Kingdom ie functions equivalent to those of administering the estate of the deceased.

References to "personal representatives" without definition in the Income Tax Acts, including in those provisions on which this Act is based, can be read as references to anyone with responsibility for administering a deceased person's estate, including those with equivalent responsibilities in other jurisdictions. These provisions can be divided into two categories.

In the first category are provisions which confirm that, on an individual's death, rights and liabilities which are or would otherwise have been conferred on the individual are conferred on the individual's personal representatives.

In this context it is clear that the references to "personal representatives" are to whoever in fact has the role of administering the property of the deceased person. These provisions are intended to confirm that such persons have the same ability and responsibility to deal with the deceased individual's tax affairs as the individual would have had if the individual were still alive, and are subject to the same tax liabilities.

Provisions in this category rewritten in this Act include sections 703(11) and 777(7) of ICTA. Such provisions which are not being rewritten include section 97(1) of TMA which provides that, if it comes to the notice of the personal representatives that the deceased made an incorrect return etc, they are under a duty to remedy the error without unreasonable delay.

The second category covers those provisions which apply only because a person has died, so that his or her property is being administered by his or her personal representatives.

In this category of cases, the fact that someone has died creates a gap in the law (or at least a doubt as to what the law is) or requires some special arrangement to be made. The provisions in question fill the gap or satisfy the requirement. So it is consistent with the aim of these provisions for them to be interpreted as applying in all cases in which a person has died and his property is being administered by others.

Provisions in this category rewritten in this Act include:

- section 364(1) of ICTA which extends tax relief to personal representatives in respect of interest paid on a loan to pay inheritance tax; and
- the meaning of "associate" given by section 360A(2) of ICTA and paragraph 50(1) of Schedule 16 to FA 2002 and by section 417(3) of ICTA as applied by section 312(1) of that Act, which provide that a person who has an interest in shares or obligations forming part of a deceased's estate is an associate of the personal representatives of the deceased.

Provisions in this category which are not being rewritten include section 179A(3) of FA 1993 which provides that the carrying on of the underwriting business of a deceased member of Lloyd's by the deceased member's personal representatives is not to be treated as a change in the persons engaged in carrying on that business.

As a consequence of the inclusion of this definition in section 989, the definitions to the same effect in section 721(1) of ITEPA, section 279(1) of FA 2004 and section 878(1) of ITTOIA are no longer necessary and are repealed by Schedule 3. Sections 111(3) and 151(3) of FA 1989 are also repealed.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX PAID, WHO PAYS IT OR WHEN.

Change 151: Interpretation: adopted children: section 989 and Schedule 1 (section 832 of ICTA)

This change omits section 832(5) of ICTA, so that the general law will apply, with the result that adopted children will be treated as if they were born as the children of their adopters.

The general law is set out in the Adoption and Children Act 2002 (as regards England and Wales), the Adoption (Scotland) Act 1978 (as regards Scotland) and the Adoption (Northern Ireland) Order 1987 (as regards Northern Ireland).

Section 67 of the Adoption and Children Act 2002 provides that "an adopted person is to be treated in law as if born as the child of the adopters or adopter" and that this applies for the interpretation of enactments passed before or since the adoption, subject to any contrary indication. Similar provision is made in the Scottish and Northern Irish legislation referred to above.

It is possible that this change might very slightly alter the scope of those adoptions which are covered. For example, under the general law some overseas adoptions are only covered if they are covered by an order made by the Secretary of State. (See sections 66(1)(d) and 87(1) of the Adoption and Children Act 2002). Depending on the tax provision in question, this could in principle be either taxpayer-adverse or taxpayer-favourable. But it will make no difference in practice.

The reference in section 832(5) of ICTA to paragraph 10 of Schedule 30 to ICTA 1988 is now otiose as that paragraph has been repealed.

Given the nature of the case, the change is extended to corporation tax, by repealing section 832(5) of ICTA.

THIS CHANGE IS IN PRINCIPLE ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 152: Interpretation: references to Scottish and Northern Ireland legislation: sections 66, 114, 532, 536, 558, 802, 990 and 1018

This change is about the extent to which references to “Act” are to be interpreted as including references to Scottish and Northern Irish primary legislation.

Section 990(1) defines “Act” to include Northern Ireland legislation for the purposes of the Income Tax Acts (unless the context otherwise requires: see section 988(1)). “Northern Ireland legislation” is defined in section 24(5) of the Interpretation Act 1978 (the 1978 Act) and applies by virtue of Schedule 1 to the 1978 Act. It is the term commonly used in legislation when referring to Northern Irish primary legislation. The definition of “Northern Ireland legislation” has seven limbs, (a) to (g).

Section 832(1) of ICTA defines “Act” to include Acts of the Parliament of Northern Ireland and a Measure of the Northern Ireland Assembly. So it expressly covers limbs (b) and (d) of the definition of “Northern Ireland legislation” in the 1978 Act. And, as a consequence of various deeming provisions contained in Schedule 12 to the Northern Ireland Act 1998, it also covers limbs (c), (e) and (f) of the definition of “Northern Ireland legislation”. Only limbs (a) and (g) of the definition of “Northern Ireland legislation” are not covered.

To simplify the definition of “Act” the current wording in section 832(1) of ICTA is replaced with a simple reference to “Northern Ireland legislation”. The change in law is that limbs (a) and (g) of the definition of “Northern Ireland legislation” will now be covered. This will not have any practical consequences.

Section 1018(1) provides that in certain sections of this Act “Act” is to include Acts of the Scottish Parliament. “Act” on its own does not include Acts of the Scottish Parliament (see the definition of “Act” in Schedule 1 to the 1978 Act) and the definition of “Act” in section 990 does not extend its meaning to include Acts of the Scottish Parliament.

But it is appropriate that references to “Act” in sections 66, 532, 536 and 558 should include references to Acts of the Scottish Parliament. In each of these cases the extension of the meaning of “Act” can only be advantageous to taxpayers. A similar provision is contained in section 879 of ITTOIA.

Section 1018(2) overrides the definition of “Act” in section 990 for the purposes of this Act. This is to make it easier to identify the sections where Northern Ireland legislation is relevant and where it is not, and follows the approach taken in section 880 of ITTOIA. The references to sections 66, 114, 532, 536, 558 and 802 either reflect the current law or, if they change the current law, can only be advantageous to taxpayers.

Examples of where “Act” does not include Northern Ireland legislation are to be found in sections 4(1), 459(1) and 849(2).

THIS CHANGE IS IN TAXPAYERS’ FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 153: Tax calculation: highest part of income: priority between items specified in section 833(3) of ICTA: section 1012

This change introduces an order of priority between employment termination payments and gains from life assurance contracts in treating such amounts as the highest part of income.

There are a number of provisions in the Income Tax Acts which specify that items are to be treated as the highest part of income. They are subject to the rule in section 833(3) of ICTA which says that employment termination payments within Chapter 3 of Part 6 of ITEPA and gains from life assurance contracts within section 465 of ITTOIA outrank income under all other such provisions and form the topmost slice of income. But section 833(3) of ICTA gives no order of priority between those two types of income.

In practice, because life assurance gains carry a notional tax credit that might otherwise be lost, it will always be to the taxpayer's advantage to treat such gains as the highest slice. Accordingly, in rewriting section 833(3) of ICTA in section 1012 it has been made clear that, that life assurance gains outrank termination payments. See also new section 404A of ITEPA and new section 465A of ITTOIA inserted by Schedule 1 to this Act.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 154: Charges on income etc: calculation of modified net income: section 1025

This change specifies that certain adjustments are to be made to the amount of a person's net income in measuring income for particular purposes. The amount after these adjustments is the person's "modified net income".

The concept applies mainly to the deduction allowed for annual payments and patent royalties under Chapter 4 of Part 8 (see sections 448(4) and 449(5)).

But it also applies to:

- the similar rules that determine the deductibility or otherwise of the deemed payments to unit holders made by an unauthorised unit trust under Chapter 9 of Part 9 (see section 505(7)); and
- the rules that apply in respect of gift aid to certain non-resident donors and to donors who elect for a gift to be treated as made in the preceding tax year (see section 427(2)).

The link between the purposes concerned is that the issue in each case is whether there is sufficient income for a payment to be regarded (under the source legislation) as having been paid "out of" the income of the year.

In determining the amount of a person's net income for a tax year under section 23 (which rewrites the relevant parts of section 835 of ICTA), it is necessary to:

- take into account all claims and adjustments which affect the measure of income; and
- make a deduction for all reliefs that are deducted from or set against income.

But it is not appropriate for all claims that have their origins in a different year to be taken into account in measuring income of the year concerned. That is because the source legislation is concerned with establishing whether, in fact, the taxpayer had sufficient taxable income "out of" which the payment could have been made.

In these cases, this change provides that certain adjustments that have their origins in a different year are disregarded in calculating the income of the year concerned.

The change does not apply to reliefs that are carried forward from an earlier year – it is well established that these do reduce the pot of income "out of" which payments can be regarded as having being made. But the position in relation to a claim or adjustment that has its origin in a later year is not explicit.

The new rule in the calculation of charged income for the purposes of relief for charges and gift aid is to disregard all adjustments (whether an increase or a decrease) that have their origins in a later year and to which Schedule 1B to TMA applies.

These adjustments are:

- carry-back of losses under sections 64(2), 72(2), 89(2) and 132(1) (based on sections 380, 381, 388 and 574 of ICTA): see paragraph 2 of Schedule 1B to TMA;
- relief for fluctuating profits of farming etc and of creative artists under Chapter 16 of Part 2 of ITTOIA: see paragraph 3 of Schedule 1B to TMA;
- carry-back of post cessation receipts under section 257 of ITTOIA: see paragraph 5 of Schedule 1B to TMA; and
- any adjustment that would have been out of time but for the extension of the deadline for claiming other reliefs as a result of a claim for fluctuating profits of farmers or creative artists: see paragraph 4 of Schedule 1B to TMA.

THIS CHANGE IS IN PRINCIPLE AND IN PRACTICE ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 155: Double relief for interest payments: repeal of section 368 of ICTA in relation to relief remaining under section 353 of ICTA: Schedule 1 (section 368 of ICTA)

This change relates to the repeal of section 368 of ICTA which prevents interest qualifying for relief twice.

Section 368 of ICTA prevents relief being given for the same amount of interest more than once, for example under section 353 of ICTA and as a trading deduction. The rule in section 368 has been rewritten in section 387. But that provision only applies to relief under Chapter 1 of Part 8 of this Act and will not apply to relief under section 353 of ICTA by virtue of section 365 of ICTA. As that relief is obsolescent, it has been left in ICTA, rather than being rewritten in the Act. It relates to interest on loans taken out to purchase a life annuity and is given as a tax reduction.

As the rule in section 368 of ICTA is repealed without being rewritten in relation to section 365, there is the theoretical possibility for relief on the same interest under section 353 (life annuity loans) of ICTA and either under section 383 of this Act or as a trading deduction.

In practice, however, it is extremely unlikely that the circumstances which might allow double relief will exist. The loan would have to be taken out before 9 March 1999 by an individual aged over 65 with at least 90% of the loan proceeds being applied to purchase the annuity and the remaining portion applied on another qualifying purpose. It is then possible for interest on that remaining portion (a maximum of 10% of the loan) to give rise to both a tax reduction and an allowable deduction.

In view of the fact that this possibility is so remote, no special rule to prevent double relief has been introduced on the repeal of section 368 of ICTA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE AND MAY BENEFIT SOME IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 156: Deduction of tax: visiting performers: Schedule 1 (section 556 of ICTA and section 13 of ITTOIA)

This change makes it explicit that, when a payment or transfer of the type referred to in section 555 of ICTA is made, section 556 of ICTA and section 13 of ITTOIA will apply regardless of whether there is a duty to deduct tax at source under section 555. This gives statutory effect to the majority decision of the House of Lords in Agassi v Robinson [2006 UKHL 23] [21].

21 [2006] STC 1056

In that case, the House of Lords held that a visiting performer is liable to income tax on payments made in respect of a UK performance regardless of whether the payment is made directly to the performer or to a person connected with the performer. They held that the liability to income tax on a visiting performer under section 18(1)(a)(iii) of ICTA is not determined by whether there is a duty to deduct income tax from the payment. So the operation of section 556 of ICTA does not depend on the payer having an obligation to deduct tax at source under section 555 of ICTA.

As Lord Scott said at paragraph 17(2) of the judgment:

"In order to know whether for section 556(5) purposes the payment is one to which section 555(2) applies, two, and in my opinion only two, questions need to be asked. First, has a payment been made (to whatever person), not being a payment "of such a kind as [has been] prescribed" (section 555(6))? If the answer is "yes", then, second, has the payment "a connection of a prescribed kind with the relevant activity"? If the answer to this question, too, is "yes" then, in my opinion, for section 556(5) purposes, the payment is one to which section 555(2) applies. The identity of the payer is, in my opinion, as a matter of construction of section 555(2), irrelevant to the question.

The amendments to section 556 of ICTA make it explicit that, when a payment or transfer of the type referred to in section 555 of ICTA is made, no liability to corporation tax will arise. This is regardless of whether there is a duty to deduct under section 966 of this Act.

The amendments to section 13 of ITTOIA make it explicit that when a payment or transfer of the type referred to in section 555 of ICTA is made, it is not necessary for there to be a duty to deduct under section 966 of this Act in order for the performer to be liable to income tax on the payment or transfer under Chapter 2 of Part 2 of ITTOIA (income taxed as trade profits).

As part of this amendment, section 555(5) of ICTA has been incorporated into section 13 of ITTOIA to make clear that there is no link between the primary liability to income tax under Chapter 2 of Part 2 of ITTOIA (income taxed as trade profits) and the duty to deduct tax under section 966 of this Act.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 157: Old double taxation relief arrangements: references to surtax: Schedule 1 (section 789 of ICTA)

This change amends how provisions for exemption from surtax in old double taxation relief arrangements are to be interpreted in relation to dividend income.

Section 789(2)(a) of ICTA provides that any provision in double taxation arrangements made before 30 March 1971 for income to be exempt from surtax is to be applied on the basis that:

- in relation to income to which section 1A of ICTA applies, the lower rate is applied instead of the higher rate; and
- for all other income, the basic rate is applied instead of the higher rate.

That provision was not amended in 1997 when the dividend ordinary rate was introduced (with effect from April 1999). Since dividend income is income to which section 1A applies it follows that, in strictness, dividend income subject to these old double taxation arrangements is to be charged at the lower rate (instead of at the dividend upper rate). That is not the intention. The amendment ensures that the rate at which this income is charged in place of the dividend upper rate will be the dividend ordinary rate (instead of the dividend upper rate).

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 158: Tax calculation: recovery of excess double taxation relief: Schedule 1 (section 804 of ICTA and paragraph 11 of Schedule 20 to FA 1994)

This change alters the way that excess double taxation relief is clawed back under section 804(5B) of ICTA and paragraph 11(3) of Schedule 20 to FA 1994.

As a result of the rules for allowing credit for overseas tax against an overlap profit, section 804(5B) of ICTA provides that in certain circumstances an excess amount of credit relief has to be identified. The taxpayer is then "treated as having received in that year a payment chargeable to income tax of an amount such that income tax on it at the basic rate is equal to the excess". So having identified an amount of tax, it is then converted to an amount of income. Section 804(6) of ICTA provides that the amount of income is not treated as income for any other purpose.

This provision is about the recovery of excess tax credit relief. It would work much more naturally if it simply provided for an amount of income tax to be charged. And it would then be no longer necessary to have the special rule in section 804(6). Accordingly, section 804(5B) of ICTA is amended to provide for an amount of income tax to be brought into charge and section 804(6) is omitted.

Paragraph 11 of Schedule 20 to FA 1994 provides corresponding rules for businesses affected by the transitional provisions for facilitating self-assessment. Paragraph 11(3) is amended in the same way and paragraph 11(7) is omitted.

THIS CHANGE HAS NO IMPLICATIONS FOR THE AMOUNT OF TAX DUE, WHO PAYS IT OR WHEN. IT AFFECTS (IN PRINCIPLE AND IN PRACTICE) ONLY ADMINISTRATIVE MATTERS.

Change 159: Inclusion of civil partners in section 37A of TMA: Schedule 1 (section 37A of TMA)

This change extends to civil partners the treatment given to spouses in certain cases where personal reliefs have been transferred and the transferor's income tax liability is subsequently increased. It corrects an omission in the changes made by the Tax and Civil Partnership Regulations 2005 (SI 2005/3229).

Under section 257BB of ICTA (as amended by those Regulations) the unused part of a married couple's tax reduction may be transferred to the claimant's spouse or civil partner. The same applies to unused blind person's allowance under section 265 of ICTA. Where there has been such a transfer and the transferor's income tax liability is subsequently increased due to an assessment to make good a loss of tax wholly or partly attributable to fraudulent or negligent conduct, section 37A of TMA provides that a transfer to a spouse is unaffected. Section 37A was not amended by the Regulations to apply in cases where the transfer of relief was to a civil partner.

In making consequential amendments to section 37A to update the references to the personal relief provisions, the opportunity has been taken to provide that civil partners are treated in the same way as spouses.

THIS CHANGE IS ADVERSE TO SOME TAXPAYERS AND FAVOURABLE TO OTHERS IN PRINCIPLE AND IN PRACTICE. BUT THE NUMBERS AFFECTED AND THE AMOUNTS INVOLVED ARE LIKELY TO BE SMALL.

Change 160: Loss relief: claims for set-off of trading losses, employment losses and post-cessation expenditure against capital gains: Schedule 1 (sections 261B to 261E of TCGA)

This change removes the requirement that a claim to set trading or other losses against other income must be made before it is possible for a claim to be made to set trading or other losses etc against capital gains, thus ensuring that such claims can be made in cases where there is no other income against which they could be set.

Section 72 of FA 1991 requires a person to make a loss relief claim under section 380 of ICTA before it is possible for the person to make a claim for capital gains tax relief in respect any unutilised part of that loss. And section 90 of FA 1995 requires a person to make a claim for loss relief under section 109A of ICTA before allowing the person to make a claim for capital gains tax relief in respect any unutilised part of that loss.

It is possible that the person will have no income, and so will simply make a claim under section 72 or section 90 as appropriate.

In practice, HMRC accept such claims under either or both of those sections, even though no income tax claim has been made. This change puts this practice on a statutory footing.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 161: Deduction of tax: visiting performers: Schedule 1 (section 48 of ITEPA)

This change makes it explicit that a "transfer" which is subject to deduction under the rules about visiting performers in Chapter 18 of Part 15 of this Act is not subject to the rules about the provision of services through intermediaries in Chapter 8 of Part 2 of ITEPA.

Section 48(2)(b) of ITEPA provides that "payments" which are subject to deduction under section 555 of ICTA are not also subject to the operation of Chapter 8 of Part 2 of ITEPA. But it says nothing about "transfers".

In practice "transfers" are also regarded as excluded from the operation of Chapter 8. The insertion of a reference to "transfer" into section 48(2)(b) of ITEPA makes it explicit that transfers caught by Chapter 18 of Part 15 of this Act are not also subject to the rules set out in Chapter 8 of Part 2 of ITEPA.

THIS CHANGE IS IN TAXPAYERS' FAVOUR IN PRINCIPLE. BUT IT IS EXPECTED TO HAVE NO PRACTICAL EFFECT AS IT IS IN LINE WITH CURRENT PRACTICE.

Change 162: Estate income: treatment of payments to beneficiaries: Schedule 1 (section 680A of ITTOIA)

This change clarifies for income tax purposes the nature of sums paid out of income by personal representatives to beneficiaries.

The aim of section 698A of ICTA is to preserve the underlying character of income received by personal representatives when that income is paid out to beneficiaries for the purpose of determining what rate of tax is to be applied to the income.

The income tax charge on estate income in the hands of the beneficiary is contained in Chapter 6 of Part 5 of ITTOIA. The rules in that Chapter gross up the amount of the actual payment to the beneficiary by reference to the tax charged on the personal representatives on the income concerned. That income may have the character of dividend income, savings income or other income and will have been charged respectively at the dividend ordinary rate, the lower rate or the basic rate.

Section 698A(2) of ICTA is clear in providing that where Chapter 6 of Part 5 of ITTOIA has grossed up a payment at the dividend ordinary rate then the payment to the beneficiary is deemed to be a dividend. The beneficiary is then potentially liable at the dividend ordinary rate or the dividend upper rate on that income.

Section 698A(1) of ICTA is less clear in achieving its objective in relation to a payment that has been grossed up at the lower rate. It treats such a payment as income to which section 1A of ICTA applies otherwise than by virtue of the income being income chargeable under Chapter 3 of Part 4 of ITTOIA (dividends). But it does not necessarily follow that it is treating the payment as income to which the lower rate applies. This is because not all the "non-Chapter 3 of Part 4 of ITTOIA" income to which section 1A of ICTA applies is income chargeable at the lower rate. Some of that income is chargeable at the dividend ordinary rate.

The same point arises in relation to income paid through a trustee where section 698A(3)(b) of ICTA applies.

Section 698A of ICTA is rewritten by new section 680A in ITTOIA. By deeming income which has been treated as bearing tax at the savings rate as savings income, any doubt about the rates of tax that apply is removed.

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

ANNEX 2:: EXTRA-STATUTORY CONCESSIONS, CASE LAW, AND LIST OF REDUNDANT MATERIAL NOT REWRITTEN

This Annex is in three parts:

- Table 1: a list of ESCs (and one Statement of Practice) that are rewritten in this Act;
- Table 2: a list of Changes which involve enacting case law principles; and
- Table 3: a list of provisions that are redundant in whole or in part and are omitted by this Act.

TABLE 1

The following ESCs and Statement of Practice are rewritten in this Act.

ESC etc	*Description*	*See Annex 1*
A43	Interest relief: partnership changes	Change 75
A86	Blind person's allowance	Change 6
C4	Fund raising events for charitable purposes	Change 95
Sp A33	Loan to invest in partnership	Change 70

TABLE 2

The following table sets out those changes in the law which involve giving statutory effect to principles derived, wholly or mainly, from case law.

Topic	*Change number*	*Section*
Charges - "out of profits or gains"	82	450
Interest in possession trusts: trustees' expenses	91	500
Individuals temporarily abroad	123	829
Visiting performers	156	**Schedule 1 (section 556 of ICTA and section 13 of ITTOIA)**

TABLE 3

The omission of provisions which are redundant in whole or in part is an integral part of the rewrite process.

But, for ease of reference, those omissions worthy of specific explanation are listed in the table below. The table also sets out where those explanations can be found.

Redundant provision	*Topic*	*See commentary on section etc*
TMA s.55(1)(c)	Deduction of tax	Schedule 1
ICTA s.2(1)	Rates of tax	4
ICTA s.266(6) and (6A)	Relief for certain life insurance payments	Chapter 6 of Part 8
ICTA s.277	Jointly owned property	Chapter 3 of Part 14
ICTA s.292	EIS	Overview to Part 5
ICTA s.294	EIS	Overview to Part 5
ICTA s.295	EIS	Overview to Part 5

Redundant provision	***Topic***	***See commentary on section etc***
ICTA s.296	EIS	Overview to Part 5
ICTA s.299(3)	EIS	209
ICTA s.305	EIS	Overview to Part 5
ICTA s.306(9) and s.307(6)(a), (aa), (7) and (8)	EIS	239
ICTA s.310(3)	EIS	241
ICTA s.350(2)	Charges on income etc	963
ICTA s.350A(2)(b)	UK public revenue dividends	897
ICTA s.360A(3)	Relief for interest paid	395
ICTA s.368(2)	Relief for interest paid	387
ICTA s.382(4)	Losses: double counting	63
ICTA s.459 to 466	Friendly societies	Schedule 1
ICTA s.467	Trade unions	Schedule 1
ICTA s.481(5A)	Qualifying deposit rights	864
ICTA s.482(11)(ab)	Deduction at source: trusts	Schedule 2
ICTA s.515	Inmarsat	Schedule 1
ICTA s.575(1)(a)	Share loss relief	131
ICTA s.691(4)	Maintenance trusts: elections	508
ICTA s.704 A(f)	Transactions in securities	686
ICTA s.742(9)(c)	Transfer of assets abroad	Schedule 1
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