

**EXPLANATORY MEMORANDUM TO
THE CORPORATION TAX ACT 2009 (AMENDMENT) ORDER 2009
2009 No. 2860**

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

- 2.1 This instrument makes amendments to the Finance Act 1973 ("FA 1973"), the Income and Corporation Taxes Act 1988 ("ICTA"), the Taxation of Chargeable Gains Act 1992 ("TCGA 1992"), the Income Tax Act 2007 ("ITA 2007") and the Corporation Tax Act 2009 ("CTA 2009").
- 2.2 The instrument makes consequential amendments to paragraph 4(1) of Schedule 15 to FA 1973, sections 785ZB and 830 of ICTA and section 276(2) of ITA 2007 that were inadvertently omitted from CTA 2009. It also corrects minor errors concerning seven provisions of CTA 2009 and two of other Acts. The errors respectively concern section 397(8)(c) of ICTA, section 151F(3) of TCGA 1992 and sections 383(8), 514(4), 518(2), 549(4) and 695(9) of, and paragraph 71(1)(f) of Schedule 2 (and Part 2 of Schedule 3) and paragraphs 73 to 75 of Schedule 2 to, CTA 2009.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

With the exception of the amendments to paragraph 71(1)(f) of Schedule 2 to CTA 2009 and the related amendment to Part 2 of Schedule 3 to that Act, the amendments that are contained in the instrument take effect retrospectively from the date on which CTA 2009 came into force. The authority for this is contained in sections 1323(4) and 1324(4) of CTA 2009.

4. **Legislative Context**

- 4.1 The Tax Law Rewrite project was established in 1996. CTA 2009 was the project's fifth Act and the first relating to corporation tax.
- 4.2 The project's aim is to rewrite the United Kingdom's primary direct tax legislation to make it clearer and easier to use, without changing the law (apart from minor identified changes).
- 4.3 The amendments made by the instrument concern the following.

Paragraph 4(1) of Schedule 15 to FA 1973

- 4.4 Paragraph 4(1) of Schedule 15 to FA 1973 allows the Commissioners for Her Majesty's Revenue and Customs to serve a notice on the holder of a licence granted under Part 1 of the Petroleum Act 1988 requiring the licence-holder to pay a sum of tax if that tax is unpaid 30 days after it has become due. The tax in question includes tax assessed in respect of petroleum exploration or exploitation activities by virtue of section 830 of ICTA and section 874 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005").
- 4.5 Before CTA 2009 was enacted, section 830(2) to (4) of ICTA provided that profits or gains from exploration or exploitation activities should be treated for the purposes of corporation tax as profits of a trade from activities or property in the United Kingdom. These subsections were rewritten in section 1313 of CTA 2009. The making of a consequential amendment to paragraph 4 of Schedule 15 to FA 1973 to refer to cases where tax is assessed by virtue of section 1313 of CTA 2009, i.e. profits or gains from activities or property in the United Kingdom or profits of a trade carried on through a branch or agency, was overlooked. Article 2 of the instrument makes the appropriate consequential amendment to paragraph 4(1) of Schedule 15 to FA 1973.

Section 397(8)(c) of ICTA

- 4.6 Section 397 of ICTA restricts loss relief if a company carries on a trade of farming or market gardening. Broadly, a loss is restricted if the trade has incurred a loss in all of the preceding five years. Section 397(8) prevents restriction of relief if the trade was set up and commenced within the preceding five years and is intended to cover cases where old trades are discontinued and new trades are commenced. Before CTA 2009, that subsection provided that a trade was to be treated as discontinued, and a new trade set up, in any event which under any of the provisions of the Corporation Tax Acts was to be treated as equivalent to the permanent discontinuance or setting up of a trade and that a trade was to be treated as discontinued, and a new trade set up, at any time when there was a change in the persons carrying on the trade which involved all of the persons carrying it on before the change permanently ceasing to carry it on. Two sections of the Corporation Tax Acts dealt with the reference in section 397(8)(a) of ICTA to "any event" as "equivalent to the permanent discontinuance or setting up of a trade", namely sections 114 and 337(1)(a) of ICTA. Section 114(1)(c) applied to company partners and, combined with section 337 of ICTA, which treated trades as ceasing if a company ceased to carry them on, meant that changes to partners in a company partnership could result in the permanent discontinuance or setting up of a trade.
- 4.7 Section 114 of ICTA was rewritten by CTA 2009 and the consequential amendments to section 397(8) of ICTA sought to reflect the circumstances in which deemed cessations following partnership changes arose by providing that a trade shall be treated as

discontinued, and a new trade set up in the event of any of the following—

- (a) a company starting or ceasing to be within the charge to corporation tax in respect of a trade;
- (b) a change in the persons carrying on a trade, which involves all of the persons carrying it on before the change permanently ceasing to carry it on; or
- (c) a change in the persons carrying on a trade not falling within paragraph (b) if—
 - (i) immediately before the change the trade is carried on by companies in partnership and by no other person, and
 - (ii) after the change none of those companies continues to carry on the trade in partnership.

4.8 These amendments have proved to be incomplete and do not cover every change in a company partnership which results in a (deemed) cessation of the trade which was covered by the unamended legislation. There are two instances of changes to partnerships resulting in deemed cessation which are not within section 397(8) of ICTA as amended by CTA 2009. First, by introducing “and by no other person” in paragraph (c)(i), a change from a company and an individual in partnership to the same company alone is not treated as a cessation. But section 114(1) of ICTA required that the trade was treated as carried on by a company so long as the trade was carried on in partnership. So when the partnership was dissolved the company must have ceased to carry on the trade. Second, a change from a company alone to the same company and an individual in partnership does not satisfy paragraph (c) and the trade is not treated as ceasing, although before CTA 2009 it was by virtue of section 114(1) of ICTA. Article 3(2) amends section 397(8)(c) of ICTA so that section 378(8) covers all changes covered by that subsection as in force before CTA 2009.

Section 785ZB of ICTA

4.9 Section 785ZB of ICTA is the definition section for section 785ZA which restricts losses for company partnerships leasing plant or machinery. Section 785ZA applies by reference to a loss incurred in the “notional business” of the company partner. This is defined in section 785ZB(4) as the business from which the company’s share in the profits or losses of the leasing business is treated under section 114(2) of ICTA as deriving for the purposes of the charge to corporation tax and which is treated under that provision as carried on alone by the company for those purposes. Section 114(2) of ICTA provides the rules for computing and charging a company partner’s share of the profits and losses of the partnership. This section is rewritten in section 1262 of CTA 2009. The making of a consequential amendment of the reference in section 785ZB to section 114(2) of ICTA was overlooked. Article 3(3) of the instrument makes the appropriate amendment to section 785ZB(4) of ICTA.

Section 830 of ICTA

- 4.10 Section 830(2) to (4) of ICTA are rewritten in section 1313 of CTA 2009 (activities in UK sector of continental shelf) and omitted by Schedule 1 to that Act. Section 830 consequently consists of a single subsection only, dealing with the territorial sea of the United Kingdom. This renders otiose words in section 830(1) referring to the following provisions of the section, together with the reference to designated areas in the heading to the section. Article 3(4) of the instrument makes the appropriate consequential amendments to section 830 of ICTA.

Section 151F(3) of TCGA 1992

- 4.11 CTA 2009 inserted section 151F into TCGA 1992. This section of TCGA 1992, which like section 514(4) of CTA 2009 is based on section 53 of FA 2005, excludes alternative finance return from consideration for the sale of assets for the purposes of TCGA 1992, so that there is no double taxation of the same sum as income and a capital gain. Section 151F(3) of TCGA 1992 provides that the section is not to affect the operation of “any provision of this Act which provides that the consideration for a sale or purchase is taken for any purpose to be an amount other than the actual consideration”. But section 53(2) of FA 2005 reads “Subsection (1) does not affect the operation of any provision of the Tax Acts or TCGA 1992 which provides that the consideration for a sale or purchase is to be taken for any purpose to be an amount other than the actual consideration”. Article 4 of the instrument re-instates the reference to “the Tax Acts” which was incorrectly omitted when rewriting section 53(2) of FA 2005 for the purposes of TCGA 1992.

Section 276(2) of ITA 2007

- 4.12 Section 276 of ITA 2007 deals with certain conditions which a venture capital trust must meet in relation to its income in order to obtain approval from HMRC. Subsection (2) of that section deals with amounts brought into account under Chapter 2 of Part 4 of FA 1996, the loan relationships provisions. These provisions have been rewritten in Part 5 of CTA 2009 and Chapter 2 of Part 4 of FA 1996 has been repealed. Article 5 of the instrument makes the consequential amendment of the reference to Chapter 2 of Part 4 of FA 1996 in section 276(2) of ITA 2007 which was overlooked in CTA 2009.

Section 383(8) of CTA 2009

- 4.13 Section 383 of CTA 2009 provides the rules for determining whether a company partner controls a partnership in circumstances where a money debt exists between the partnership and a company partner. If there is such a money debt the rule in section 349 of CTA 2009 applies, under which debits and credits on a loan relationship are determined under the amortised cost basis. Section 383 of CTA 2009 is based on paragraph 19(7) to (9) and (14) of Schedule 9 to FA 1996. Paragraph 19(14) defined “control” for the purposes of the paragraph as having, in relation to a company, the same meaning as in section 87

of FA 1996 (see section 87A of that Act) and, in relation to a partnership, the meaning given by section 840 of ICTA.

- 4.14 The term “control” was used twice in paragraph 19 of Schedule 9 to FA 1996. Sub-paragraph (7) referred to a time at which a company partner, whether alone or taken together with one or more other company partners connected with it, controls a partnership. Sub-paragraph (9) provided that, for the purposes of sub-paragraph (7), one company partner was connected with another at any time in an accounting period if at that or any other time in the accounting period one controlled the other or both were under the control of the same person. Since sub-paragraph (7) used “control” in relation to a partnership, namely whether the company partner controlled the partnership, it follows that in that sub-paragraph the definition of “control” to be applied was that given by section 840 of ICTA (by virtue of paragraph 19(14)(b)). Since sub-paragraph (9) concerns the control of a company partner, it follows that in that sub-paragraph the definition given by section 87A of FA 1996 was to be applied.
- 4.15 Paragraph 19(7), (9) and (14) of Schedule 9 to FA 1996 are all rewritten in section 383 of CTA 2009. Section 383(8) (based on paragraph 19(14) of Schedule 9 to FA 1996) provides that section 472 of CTA 2009 (meaning of “control”) applies for the purposes of section 383. But section 472 of CTA 2009 rewrites the control provision in section 87A of FA 1996 and should only apply to “control” in section 383(7) of CTA 2009, which rewrites paragraph 19(7) of Schedule 9 to FA 1996. “Control” in section 383(3) of CTA 2009 should have the meaning in section 840 of ICTA. (Although the term “control” is used in section 383(5) of CTA 2009 the term there is clearly taken to have the meaning of “control” in section 466(2) of CTA 2009, which is the meaning given by section 472 of that Act – see section 466(6).) Article 6(2) of the instrument makes the necessary correction in section 383(8) of CTA 2009 and article 6(9) makes amendments in Schedule 4 (index of defined expressions) consequential on the amendment of section 383(8).

Section 514(4) of CTA 2009

- 4.16 Section 514 of CTA 2009 excludes alternative finance return from consideration for the sale of assets, so that there is no double taxation of the same sum as income and, most likely, a capital gain. Section 514(4) provides that the section is not to affect the operation of “any provision of the Corporation Tax Acts which provides that the consideration for a sale or purchase is taken for any purpose to be an amount other than the actual consideration”. For example, where goods are not sold at an open market value, section 18 of TCGA 1992 requires an open market value to be substituted for the purposes of computing the capital gain.
- 4.17 Section 514(4) of CTA 2009 is based on section 53(2) of FA 2005, which refers to “any provision of the Tax Acts or TCGA 1992”. This includes income tax and capital gains tax. As “The Tax Acts” is defined in section 831(2) of ICTA to include the provisions of the

Income Tax Acts, section 514(4) incorrectly rewrites the legislation on which it is based. Article 6(3) substitutes for the incorrect reference in section 514(4) of CTA 2009 to “Corporation Tax Acts” a reference to “Tax Acts or TCGA 1992”.

Section 518(2) of CTA 2009

- 4.18 Section 518 of CTA 2009 treats investment bond arrangements as securities for the purposes of the Corporation Tax Acts. It is based on section 48B(3) of FA 2005. Section 518(2) of CTA 2009 rewrites paragraphs (a) and (b) of section 48B(3) of FA 2005 but inadvertently does not rewrite paragraph (c) which for the purposes of section 84 of that Act treats a bond issuer as being party as debtor to a capital market arrangement. Article 6(4) of the instrument re-instates the omitted provision.

Section 549(4) of CTA 2009

- 4.19 Section 549 of CTA 2009 gives the meaning of a “debtor quasi-repo” for Chapter 10 of Part 6 of that Act. Section 549(4) sets out one of the conditions that must apply for a borrower to have a “debtor quasi-repo”. The condition is stated in that subsection to be that, under an arrangement whereby the borrower receives money or another asset or under any other arrangement, the borrower sells any securities at any time. Section 549(4) of CTA 2009 is based on paragraph 3(4) of Schedule 13 to FA 2007, which refers to the borrower “or any other person” selling any securities at any time. Article 6(5) of the instrument re-instates the words “or any other person” which were inadvertently omitted in section 549(4) of CTA 2009.

Section 695(9) of CTA 2009

- 4.20 Section 695 of CTA 2009 is part of the derivative contracts regime and treats as a credit the amount paid by a company for the grant of an option by a company connected with it if the option is allowed to expire to the benefit of the connected company. This section is based on paragraph 26 of Schedule 26 to FA 2002.
- 4.21 Section 695(8) to (10) of CTA 2009 explain when two companies are connected for the purposes of the section. Paragraph 26(6) of Schedule 26 to FA 2002 provides that sections 87(3) and (4) and 87A of FA 1996 (the control provisions for the purposes of loan relationships) apply also for that paragraph. The control provisions in section 87(3) and (4) of FA 1996 are rewritten for derivative contracts in section 695(8) to (10) of CTA 2009. Section 695(8) provides that two companies are connected if both are controlled by the same person. But section 695(9) provides that two companies are not connected if the person controlling both is one of a listed number of bodies. Subsection (9) inadvertently omits “the Crown” from the list, which should be the same list as in section 466(3) of CTA 2009, which rewrites section 87(4) of FA 1996 for loan relationships. Article 6(6) of the instrument re-instates the reference to the Crown in section 695(9) of CTA 2009.

Paragraph 71(1)(f) of Schedule 2 and Part 2 of Schedule 3 to CTA 2009

- 4.22 Section 84A(1) of FA 1996 provides for exchange gains and losses on loan relationships to be brought into account under section 84 of that Act for the purposes of Chapter 2 of Part 4 of that Act (loan relationships). The general rule in subsection (1) of section 84A is subject to the exceptions in subsections (3) and (3A). Section 84A(8) gives the Treasury powers to make regulations to make provision in connection with bringing into account amounts to which subsection (1) does not apply as a result of subsections (3) and (3A). Section 84A(9) provides that “bringing into account” in section 84A(8) includes bringing amounts into account for the purposes of TCGA 1992. Sections 328 and 329 of CTA 2009 rewrite section 84A of FA 1996 save where it affects TCGA 1992. The chargeable gains aspects of section 84A(8) to (10) are rewritten in new section 151E of TCGA 1992.
- 4.23 Under paragraph 9(1)(a) of Schedule 6 (accounting practice and related matters) to F(No. 2)A 2005 and Part 2(6) of Schedule 11 (repeals) to that Act, section 84A of FA 1996 ceases to have effect and is repealed from a day to be appointed by Treasury order. This means that a Treasury order may now be made to repeal new section 151E of TCGA 1992 from an appointed day. Paragraph 9(1)(a) of Schedule 6 to F(No. 2)A 2005 is rewritten in paragraph 71 of Schedule 2 to CTA 2009 and the repeal in Schedule 11 to F(No. 2)A 2005 is rewritten in Part 2 of Schedule 3 to CTA 2009 (prospective repeals). Section 1329(3) of CTA 2009 ensures that the coming into force of CTA 2009 does not affect these delayed repeals. No relevant Treasury order has been made or is likely to be made in the foreseeable future.
- 4.24 Both paragraph 71(1)(f) of Schedule 2 and Part 2 of Schedule 3 to CTA 2009 inadvertently refer to the prospective repeal of section 151F of TCGA 1992 rather than section 151E. Article 6(7)(a) and (8) of the instrument substitute corrected references to section 151E of TCGA 1992.

Paragraphs 73 to 75 of Schedule 2 to CTA 2009

- 4.25 Paragraphs 73 to 75 of Schedule 2 to CTA 2009 are transitional provisions relating to alternative finance arrangements as far as they concern corporation tax. They bring within CTA 2009 the commencement provisions for alternative finance arrangements in FA 2005, FA 2006 and FA 2007.
- 4.26 Alternative finance arrangements take the form of purchase and resale arrangements, diminishing shared ownership arrangements, investment bond arrangements, deposit arrangements, and profit share agency arrangements. These arrangements differ in their commencement provisions. The legislation takes effect either in respect of arrangements entered into after the commencement date or, in the case of deposits and investment bonds, for profits payable after the commencement date. Since many of these arrangements will have been

in effect since before FA 2005, FA 2006 and FA 2007, the commencement provisions still affect how the arrangements are to be treated for periods of account ending on or after 1 April 2009. The relevant commencement provisions are section 56 of FA 2005, sections 95(11) and 96(8) of FA 2006 and section 53(13) of FA 2007. Section 95(11) of FA 2006 and section 53(13) of FA 2007 simply apply the provisions in section 56 of FA 2005 with a change of dates.

- 4.27 A number of errors have occurred in rewriting these provisions. Paragraph 73(1) of Schedule 2 to CTA 2009 is in error in being expressed to apply to all alternative finance arrangements. It should have been limited to purchase and resale arrangements and deposit arrangements. The application of this sub-paragraph to all alternative finance arrangements produces the wrong result in relation to diminishing share ownership arrangements and profit share agency arrangements (introduced by FA 2006) and investment bond arrangements (introduced by FA 2007). In the case of diminishing shared ownership arrangements, the problem is that there is nothing in paragraphs 73 to 75 of that Schedule to exclude the application of Chapter 6 of Part 6 of CTA 2009 in relation to arrangements of that kind entered into on or after 6 April 2005 and before 1 April 2006 (compare section 96(8)(a) of FA 2006). In the case of profit share agency arrangements, the problem is that paragraph 73(1) of that Schedule prevents Chapter 6 of Part 6 of CTA 2009 applying in relation to arrangements of that kind entered into before 6 April 2005. The effect required is that, so long as alternative finance return is payable under the arrangements on or after 1 April 2006, it does not matter when the arrangements were entered into. In other words, they should be subject to the same rule as deposit arrangements, but substituting 1 April 2006 for 6 April 2005 (that being the effect of section 95(11) of FA 2006). The corresponding point arises in relation to investment bond arrangements, substituting 1 April 2007 for 1 April 2006 (that being the effect of section 53(13) of FA 2007).
- 4.28 Article 6(7) of the instrument corrects these errors. In particular, article 6(7)(c) reformulates paragraph 73(1) of Schedule 2 to CTA 2009 to restrict its application and to provide separate rules about profit share arrangements and about deposit arrangements and article 6(7)(e) amends paragraph 74(1) of that Schedule to add the appropriate rule about diminishing shared ownership arrangements (excluding the application of Chapter 6 of Part 6 of CTA 2009 in relation to arrangements of that kind entered into before 1 April 2006). No change is required to paragraph 75(1) of that Schedule, which works correctly once paragraph 73(1) is amended so as not to apply to investment bond arrangements.

5. Territorial Extent and Application

The instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to The Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Corporation Tax Act 2009 (Amendment) Order 2009 are compatible with the Convention rights.

7. Policy background

7.1 CTA 2009 is the first Act prepared by the Tax Law Rewrite project in relation to the rewrite of corporation tax. The powers in sections 1323 and 1324 were included to ensure that amendments could be made quickly and easily and without recourse to a Finance Bill.

7.2 With the exception of the amendments to paragraph 71(1)(f) of Schedule 2 to CTA 2009 and the related amendment to Part 2 of Schedule 3 to that Act, the amendments that are contained in the instrument take effect retrospectively from the date on which CTA 2009 came into force. The consequential amendments to paragraph 4(1) of Schedule 15 to FA 1973, sections 785ZB and 830 of ICTA and section 276(2) of ITA 2007 are purely clarificatory. The correction of the errors restores the generally understood meaning of the provisions. Making the instrument retrospective ensures that there will be no period of time during which the law is unclear.

8. Consultation outcome

8.1 In the Second Reading Committee on 15 January 2009 the Financial Secretary to the Treasury gave an assurance that the powers in sections 1323 and 1324 of CTA 2009 would not be used without the agreement of the Tax Law Rewrite Consultative and Steering Committees.

8.2 Papers explaining the reasons for the amendments made by this instrument have been considered by those Committees and their agreement has been obtained to the exercise of these powers.

9. Guidance

A copy of the instrument and this explanatory memorandum will be placed on the Tax Law Rewrite section of the HMRC website.

10. Impact

10.1 No impact on the private or voluntary sectors is foreseen.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

- 11.1 The legislation applies to small business.
- 11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is to introduce these amendments with retrospective effect, so that there is no uncertainty at any time about the effect of the rewritten legislation. This fulfils the aim of the TLR project which is to make the legislation clearer and easier to use, without changing the law (apart from minor, identified changes).
- 11.3 The basis for the final decision on what action to take to assist small business is the consultation with the Tax Law Rewrite Consultative Committee. The membership of this committee includes representatives of a number of organisations and professional bodies which represent, or whose members' clients include, small businesses.

12. Monitoring & review

No monitoring or review is required as a result of this instrument.

13. Contact

Richard Hayes at HM Revenue and Customs Tel: 020 7438 7833 or e-mail: richard.hayes@hmrc.gsi.gov.uk can answer any queries regarding the instrument.