EXPLANATORY MEMORANDUM TO

THE INCOME TAX (TRADING AND OTHER INCOME) ACT 2005 (CONSEQUENTIAL AMENDMENTS) ORDER 2006

2006 No. 959

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

2. Description

2.1 The Order makes amendments to:

- the Income and Corporation Taxes Act 1988;
- the Taxation of Chargeable Gains Tax Act 1992;
- the Finance (No.2) Act 1992; and
- the Finance Act 2002.

2.2 The amendments have effect for the income tax year 2006-07 onwards and for corporation tax accounting periods ending after 5 April 2006. They are deemed to have had effect also for the income tax year 2005-06 and for corporation tax accounting periods ending after 5 April 2005.

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

3.1 The Order makes consequential amendments that were inadvertently omitted from the Income Tax (Trading and Other Income) Act 2005 (ITTOIA). The Order is made under section 882 of ITTOIA. An order under section 882 must not change the law as it was immediately before ITTOIA came into effect.

4. Legislative Background

4.1 ITTOIA commenced the substantial and complex task of separating the income tax and corporation tax codes. A regulatory power was included in section 882 of ITTOIA to enable missed consequential amendments to other legislation to be made quickly and easily.

4.2 At the hearing of the Joint Committee on Tax Law Rewrite Bills on 1 February 2005 the then Economic Secretary to the Treasury, John Healey, gave an assurance that the power would not be used without the agreement of the Tax Law Rewrite Consultative and Steering Committees. That agreement has been obtained.

4.3 This is the first use of the power.

4.4 The continuity of the law provisions in ITTOIA preserve the law as it was before ITTOIA. The consequential amendments made by this Order simply make the position clear on the face of the affected legislation. So they have effect for those periods to which ITTOIA applies.

5. Extent

5.1 This Order applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Paymaster General has made the following statement regarding Human Rights:

In my view the provisions of the Income Tax (Trading And Other Income) Act 2005 (Consequential Amendments) Order 2006 are compatible with the Convention rights.

7. Policy background

7.1 The Tax Law Rewrite project was established in 1996. ITTOIA was the project's third Act and the second relating to income tax. The Tax Law Rewrite 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).

7.2 Part of the rewrite process involves separating the rules for income tax from other tax rules. This means that the law that is not rewritten has to be amended so that it continues to have effect for corporation tax and capital gains tax.

7.3 The amendments made by these regulations concern four areas:

- *Insolvent banks* If a deposit-taker ceases to trade it may not get loss relief against interest received. The rule in Schedule 12 to the Finance (No.2)Act 1992 allows the relief. The amendment ensures that the rule continues to apply for income tax.
- *Futures and options* Non-trading profits from dealing in certain futures and options are exempt from any tax charge on income. Instead, they are taxed as chargeable gains. The amendment to section 143 of the Taxation of Chargeable Gains Tax Act 1992 inserts a cross-reference to the rewritten income tax rule in ITTOIA.
- *Trading stock* If a taxpayer transfers an asset to trading stock, the usual rule is that it is treated as disposed of at market value for the purpose of calculating a capital gain. But the taxpayer may elect to have the asset treated as disposed of at a value that produces neither a gain nor a loss. The amendment to section 161 of the Taxation of Chargeable Gains Tax Act 1992 inserts a cross-reference to the rewritten income tax rule in ITTOIA.
- *Research and development (R&D)* Enhanced tax relief is given for expenditure on R&D, subject to certain conditions. If the R&D is subcontracted, one of the conditions concerns whether the subcontractor is carrying on a trade. The amendments to Schedule 12 to the Finance Act 2002 insert cross-references to the charge on trading profits in ITTOIA.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no adverse impact on business, charities or voluntary bodies

8.2 There is no impact on the public sector.

9. Contact

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