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

INCOME TAX (TRADING AND OTHER INCOME) ACT

EXPLANATORY NOTES — VOLUME THREE (SCHEDULES)

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Schedule 1: Consequential Amendments
Part 1: Income and Corporation Taxes Act 1988

Paragraph 3: section 1A of ICTA

1. Section 1A of ICTA is an income tax only provision. As this section is primarily concerned with rates of tax it is not rewritten.

2. The repeal of Schedule F and Schedule D Cases III, IV, V and VI (for income tax purposes) means that it is now possible to restructure section 1A of ICTA to identify more clearly the types of income within the scope of the section. So, for example, instead of bringing in *all* income chargeable under Schedule D Case III, and then excluding certain items, it is now possible to focus directly on the income within section 1A of ICTA.

3. As a result of the revised approach, section 1A(4)(b) of ICTA – dealing with estate income chargeable under section 695(4)(b) or 696(6) of ICTA – can be repealed. Similarly, it is not necessary to retain section 1A(7) of ICTA which effectively brings purchased life annuities within the scope of section 1A of ICTA – such purchased life annuities are now brought in by the consequential amendment to section 1A(2)(a) of ICTA.

Paragraph 7: section 9 of ICTA

4. This Act deals in substance with income tax only. As a result the income tax and corporation tax codes will be separated to a much greater extent than in the source legislation.

5. Corporation tax law, in statute, is made up of a combination of express corporation tax provisions and applied income tax principles, law and practice.

6. The income tax principles, law and practice are applied by section 9 of ICTA .

7. Section 9 of ICTA, so far as it operates on statutory provisions, operates in the source legislation on both income tax provisions that are rewritten in this Act and income tax provisions that are not rewritten in this Act (for example, parts of ITEPA). It also extends to case law and practice.

8. The amendments to section 9 of ICTA maintain this approach in the context of the greater separation of the two codes. But section 9 of ICTA does not operate on the provisions in this Act to convert them into provisions of the Corporation Tax Acts, see section 881.

Paragraph 9: section 18 of ICTA

9. Paragraph 9 amends section 18 of ICTA so that subsections (1) to (4) apply only for corporation tax purposes. The income tax aspects of this provision are rewritten as follows:

Cases I and II

The income charged under Schedule D Case I or II in the source legislation is rewritten for income tax purposes in Chapter 2 of Part 2 of this Act.

Case III

10. The income charged under Schedule D Case III in the source legislation is rewritten for income tax purposes in the following places in this Act:

- Part 4 - Chapter 2 (interest), Chapter 7 (purchased life annuity payments), Chapter 8 (deeply discounted securities), Chapter 10 (distributions from unauthorised unit trusts); and

- Part 5 - Chapter 2 (receipts from intellectual property) - but royalties only, Chapter 4 (certain telecommunication rights: non-trading income) and Chapter 7 (annual payments not otherwise charged).

11. The corporation tax version of Schedule D Case III in section 18(3A) of ICTA will continue to work for corporation tax.

Cases IV and V

12. Except in respect of foreign dividends, the charge on foreign income under these Cases in the source legislation has been integrated with the charge on equivalent types of UK income in this Act for income tax purposes. The charge under Case V in the source legislation on foreign dividends is rewritten for income tax purposes in Chapter 4 of Part 4 of this Act. The Cases continue to operate as amended by section 18(3A) to (3E) of ICTA for corporation tax purposes.

Case VI

13. The provisions which are rewritten in this Act for income tax purposes, and which charge income to income tax under Schedule D Case VI in the source legislation, have been replaced by charges on each type of income. See the following Parts of this Act:

- Part 2 – Chapter 2 (income taxed as trade profits, including wayleaves), Chapter 17 (adjustment income: trades, professions and vocations) and Chapter 18 (post-cessation receipts: trades, professions and vocations);
- Part 3 – Chapter 7 (adjustment income: UK property businesses), Chapter 8 (rent receivable in connection with a UK section 12 concern), Chapter 9 (rent receivable for UK electric-line wayleaves) and Chapter 10 (post-cessation receipts);
- Part 4 – Chapter 2 (interest, including funding bond interest), Chapter 9 (gains from contracts for life insurance etc.), Chapter 11 (transactions in deposits) and Chapter 12 (disposals of futures and options involving guaranteed returns); and
- Part 5 – section 579 (royalties and other income from intellectual property), section 583 (income from disposals of know-how), section 587 (income from sales of patent rights), Chapter 3 (films and sound recordings: non-trade businesses), Chapter 4 (certain telecommunication rights: non-trading income), Chapter 5 (settlements: amounts treated as income of settlor), section 682(3) (estates in administration: assessments, adjustments and claims after the administration period) and Chapter 8 (income not otherwise charged).

14. Additionally, amendments have been made to all of the Schedule D Case VI provisions in ICTA and other enactments which are not being rewritten in this Act but which apply for income tax purposes (see the table in Part 1 of section 836B of ICTA, inserted by paragraph 339 of this Schedule, referred to in the amendment in paragraph 167 of this Schedule for section 392 of ICTA). The amendments remove references to income tax being charged under Schedule D Case VI and create free standing income tax charges. The Schedule D Case VI references have been retained where needed for corporation tax purposes.

15. Some of the Schedule D Case VI provisions which are not rewritten in this Act are of an administrative nature. These provisions typically withdraw reliefs and operate under the

source legislation by way of an assessment under Schedule D Case VI (see particularly section 30(4) of TMA, sections 307(1), 384(8), 384A(6) and 703(3) of and paragraph 4(2) of Schedule 15B to ICTA and paragraph 27(2) of Schedule 16 to FA 2002). These provisions are rewritten as simple assessments (in the case of section 30(4) of TMA, by the omission of subsection (4)). This is because the provisions that apply generally to income and amounts treated as income charged to income tax under Schedule D Case VI (sections 18, 59, 69 and 392 of ICTA) have no application to these provisions.

Paragraph 10: section 20 of ICTA

16. Section 20 of ICTA, Schedule F, is rewritten in Chapter 3 of Part 4 of this Act (dividends etc. from UK resident companies etc.). It is repealed for all tax purposes.

Section 20(1) paragraph 1 of ICTA – the Schedule F charging provision

17. Section 20(1) paragraph 1 of ICTA is an income tax only provision. It therefore applies *directly* to persons subject to income tax (unless they are dealers or certain individual members of Lloyd's in which case they are taxed under Schedule D Case I or II).

18. As an income tax only provision, section 20(1) paragraph 1 of ICTA does not directly apply to persons subject to corporation tax. This is clear from the wording of section 20(1) paragraph 1 of ICTA itself but confirmation of this is also given by section 6 of ICTA.

19. Therefore, section 20(1) paragraph 1 of ICTA could only apply to corporation tax *indirectly*, that is, via section 9 of ICTA.

20. However, section 9 of ICTA is subject to exceptions. On one interpretation of the legislation section 208 of ICTA is one such exception.

21. Applying this interpretation, where section 208 of ICTA applies section 9 of ICTA does not and so section 20(1) paragraph 1 of ICTA cannot apply.

22. An alternative interpretation is that section 208 of ICTA is not an exception to section 9 of ICTA but an exemption from corporation tax on dividends and other distributions charged under Schedule F.

23. Applying this interpretation, section 9 of ICTA applies and so section 20(1) paragraph 1 of ICTA applies, but section 208 of ICTA prevents the dividend or other distribution from being chargeable to corporation tax.

24. On either interpretation, if section 208 of ICTA applies there is no liability under section 20(1) paragraph 1 of ICTA. Conversely, if section 208 of ICTA does not apply, there is.

25. There are three exceptions to section 208 of ICTA. These are:

- section 95(1A)(c) of ICTA (dealers);
- section 219(4A) of FA 1994 (Lloyd's underwriters); and
- section 434(1) of ICTA (franked investment income and life assurance profits).

26. However, in each case Schedule F does not apply. Instead, dividends and other distributions are taxed under Schedule D Case I or Schedule D Case VI.

27. There are therefore no instances where a body corporate acting in a beneficial capacity is chargeable to corporation tax under section 20(1) paragraph 1 of ICTA.

Section 20(1) paragraph 2 of ICTA – the income chargeable

28. Section 20(1) paragraph 2 of ICTA determines the income chargeable and is expressed to apply for "all purposes of the Tax Acts". It therefore applies directly to a company subject to corporation tax unless there is an express provision to the contrary.

29. Section 20(1) paragraph 2 of ICTA is expressly disapplied in the case of:

- dealers;
- Lloyd's underwriters; and
- certain life assurance companies.

30. Where section 20(1) paragraph 2 of ICTA might otherwise be relevant, that is, in order to establish that income is the aggregate of the dividend etc and the tax credit (for example, under section 13 of ICTA (small companies' relief), in connection with the surplus ACT rules etc), the relevant legislation uses the term "franked investment income". Franked investment income is defined in almost identical terms as section 20(1) paragraph 2 of ICTA.

31. Section 20(1) paragraph 2 of ICTA therefore serves no practical purpose in a corporation tax context.

Section 20(2) of ICTA –priority provision

32. Section 20(2) of ICTA applies to a distribution "which is chargeable under Schedule F". It does not therefore apply in a corporation tax context because section 20(1) paragraph 1 of ICTA does not apply.

Section 20(3) of ICTA - signpost

33. In a corporation tax context, section 20(3) of ICTA introduces Part 6 of ICTA but this introduction is no longer required.

Replacement expressions for special tax rates

34. The following replacement terms are used:

- Schedule F ordinary rate becomes "dividend ordinary rate";
- Schedule F upper rate becomes "dividend upper rate"; and
- Schedule F trust rate becomes "dividend trust rate".

Paragraph 36: section 60 of ICTA

35. This paragraph omits section 60 of ICTA and the section is repealed by Schedule 3 to this Act.

36. Section 60(4) of ICTA deals with the death of a taxpayer. It ensures that on the death of a person carrying on a trade the necessary cessation adjustments can be made, and the tax collected from the personal representatives.

37. The rule in section 60(4) of ICTA dates from the time when adjustments on cessation could involve not only an adjustment for the year of death (the assessment for which might already have been made on a previous year basis) but also adjustments to the two previous

years to increase the amount of the assessments to the profits of those years on a current year basis.

38. Under Self Assessment any return of income for the year of death will naturally take account of the death. And there is no question of adjusting assessments for previous years on account of the death.

39. The general rule in section 74 of TMA (that the personal representatives inherit the tax liabilities of the deceased) is enough. There is no need for the special rule in section 60(4) of ICTA for trade profits.

40. See also the commentary on the repeal of section 113(6) of ICTA.

Paragraph 43: section 71 of ICTA

41. This paragraph omits section 71 of ICTA and that section is repealed in Schedule 3 to this Act.

42. Section 71 of ICTA applies to all the Cases of Schedule D when a preceding year basis of assessment applies. It provides that a person will remain chargeable in a year when no income from the relevant source arises. It is based on section 22 of FA 1928 which was enacted in response to the House of Lords decision in Whelan v Henning (1926), 10 TC 263 to the effect of "no income in year of assessment, no liability to tax".

43. There is no longer a preceding year basis of assessment for any Schedule D Case. So the provision is redundant.

Paragraph 45: section 74 of ICTA

44. Section 74(1) of ICTA lists various items in respect of which no deduction is allowed in computing profits to be charged under Schedule D Case I or II.

45. Section 74(1)(b) of ICTA prohibits deductions in respect of expenditure on "maintenance of the parties, their families or establishments, or any sums expended for any other domestic or private purposes distinct from the purposes of the trade, profession or vocation".

46. Section 74(1)(b) of ICTA is not rewritten for income tax purposes because the deductions which it prohibits are covered by section 34 which rewrites the general prohibition on deductions not "wholly and exclusively laid out for the purposes of the trade, profession or vocation" in section 74(1)(a) of ICTA. And because it applies only to individuals, there is no need to preserve section 74(1)(b) of ICTA. It is therefore omitted.

47. Section 74(1)(h) of ICTA prohibits deductions for interest forgone on capital used in the trade or in improving the trade premises. It is unlikely that any accounts drawn up in accordance with generally accepted accounting practice would include a deduction for notional interest. Section 74(1)(h) of ICTA is not rewritten for income tax purposes as it is considered to be redundant.

48. Section 74(1)(k) of ICTA prohibits deductions for "any average loss beyond the actual amount of loss after adjustment". This rule applies to the practice in shipping and aviation trades of sharing between all parties with a financial interest in a vessel and its cargo the financial loss incurred where *part* of a vessel or its cargo is lost or damaged in an attempt to save the vessel, the crew and passengers or the rest of the cargo. The term "average loss" is

applied to the share of the loss allocated to each party. The amount of the average loss "after adjustment" may not be known for some years after the actual loss has occurred.

49. Section 74(1)(k) of ICTA is not rewritten for income tax purposes. This allows the tax treatment of the average loss to follow the generally accepted accountancy practice in such cases. This is to make a provision in the year of loss and to review that provision in subsequent years.

50. Section 74(1)(m) of ICTA prevents a deduction for any annuity and other annual payment "payable out of the profits". Because the rule applies only to amounts payable "out of the profits", it has no application to the calculation of those profits. The rule is not rewritten for income tax purposes.

51. Section 74(1)(o) of ICTA prevents a deduction in calculating trade profits for any interest that has qualified for Mortgage Interest Relief At Source. When MIRAS was available for mortgage interest generally this rule against double deductions served an important function. Since 1999 MIRAS has been available only on loans to buy a life annuity and secured on the private residence of a person aged 65 years or over. The relief is given only to loans in existence on 9 March 1999 or replacement loans.

52. It is very unlikely that any interest would satisfy the conditions to qualify both for MIRAS and as a deduction in calculating trade profits. For this reason this Act does not rewrite section 74(1)(o) of ICTA.

Paragraph 53: section 82 of ICTA

53. This paragraph omits section 82 of ICTA and the section is repealed in Schedule 3 to this Act.

54. There are two reasons for repealing this section:

- the section no longer achieves its original purpose; and
- the section is, in part, out of step with modern tax principles.

55. Section 82 of ICTA is a complex provision which prevents a deduction in computing trade profits for payments of annual interest to a non UK resident except in two circumstances.

56. The first is when the payer has made the payment as required by section 349(2) of ICTA under deduction of tax and has accounted to the Inland Revenue for the tax: section 82(1)(a) of ICTA. (This is interpreted to include payments within section 349(2) of ICTA made gross solely because of a double taxation agreement.)

57. The second is when the interest is not within section 349(2) of ICTA but is paid by a UK resident trader under a liability incurred exclusively for the purposes of the trade. The interest has to be payable and paid outside the United Kingdom and either incurred for the purposes of activities outside the United Kingdom or paid in foreign currency: section 82(1)(b) of ICTA.

58. Section 82 of ICTA originates from FA 1949. At the time it was introduced annual interest was not a permitted trading deduction: relief was obtained by the payer deducting income tax before paying the interest. But in certain circumstances, notably where the source of the interest was outside the United Kingdom, the payer could not legally deduct tax and

could therefore get no effective relief for the interest. So what is now section 82(1)(b) of ICTA was introduced to give relief by allowing the gross payment as a Schedule D Case I or II deduction.

59. FA 1969 ended deduction of tax at source from most interest paid and with it the general relief for interest paid that the deduction at source system gave. New rules were introduced which gave relief for interest only on loans for particular purposes, mainly the purchase or improvement of land. Where, however, the interest was for a trading purpose it could be deducted in computing trading profits.

60. The FA 1969 reforms preserved deduction of tax at source for payments of annual interest only in a limited number of circumstances and the tax deducted had to be paid over to the Inland Revenue (rather than be retained by the payer). One such circumstance was when it was paid to a person whose usual place of abode was outside the United Kingdom. It was recognised that what is now section 82(1)(b) of ICTA could no longer operate as an exception to the former general rule against allowing interest as a deduction in computing trading profits: that rule had gone. But it was preserved in a form which allowed a deduction only when its original conditions were satisfied. In addition, what is now section 82(1)(a) of ICTA was grafted onto it as new legislation to take account of the new deduction at source rule.

61. The current position is that what started life as a permissive provision, allowing relief as a trading deduction in circumstances where none would otherwise have been available, has become a restrictive one. It restricts relief where, on general principles, it would otherwise be due: interest paid gross would normally have to satisfy only the "wholly and exclusively" test in section 74(1)(a) of ICTA to be deductible. The linking of a right to deduction as a trading expense with the obligation to deduct tax on payment does not reflect modern principles of determining deductibility of trade expenses.

62. The section no longer fulfils any practical purpose and is therefore redundant.

Paragraph 60: section 86 of ICTA

63. This section allows a person carrying on a trade to deduct the cost of an employee who is seconded to a charity or educational establishment in calculating the profits of the trade.

64. Section 86(5) of ICTA lists educational establishments in Scotland for the purposes of relief under section 86 of ICTA. Section 86(5)(d) of ICTA refers to "a self-governing school within the meaning of the Self-Governing Schools etc (Scotland) Act 1989".

65. Section 86(5)(d) of ICTA is not rewritten for income tax purposes because such schools were abolished on 1 April 2003. But there is a transitional rule in paragraph 21 of Schedule 2 to this Act to deal with the case of a secondment being relevant to a period of account ending on or after 6 April 2005.

Paragraph 65: section 89 of ICTA

66. Section 89 of ICTA is not rewritten for income tax purposes. See the commentary on section 35 and *Change 7* in Annex 1.

Section 92 of ICTA (no paragraph in Schedule 1)

67. Section 92 of ICTA applies to regional development grants under Part 2 of the Industrial Development Act 1982. The Industrial Development Act 1982 was repealed by the Statute Law (Repeals) Act 2004 with effect from 22 July 2004. No applications under Part 2 of the 1982 Act could be made after 31 March 1988 and there are no payments outstanding in respect of grants made before that date. So section 92 of ICTA is not rewritten for income tax purposes.

Paragraph 94: section 113 of ICTA

68. This paragraph omits section 113 of ICTA and the section is repealed in Schedule 3 to this Act.

69. Section 113(1) of ICTA applies to trade profits. But it is extended to property businesses by section 21B of ICTA. It ensures that a trade is treated as ceasing when there is a change in the persons carrying it on. The need for the rule arises from the fact that some rules in ICTA are expressed in terms of the commencement and cessation of a trade, rather than the position of the person carrying it on.

70. The rewritten basis period rules in Chapter 15 of Part 2 of this Act are expressed in terms of the person carrying on the trade. Other rules that depend on the commencement or cessation of a trade are also rewritten in terms of the person carrying on the trade.

71. So there is no need for a special rule deeming there to be a cessation where the trade is carried on by a successor.

72. In many cases, a rule in ICTA is explicit that a change in the persons carrying on a trade to which section 113(1) of ICTA applies is to be treated as a cessation for the purposes of the rule: for instance, the post-cessation receipts rules in sections 103 to 109A of ICTA (see section 110(2)(a) of ICTA).

73. In other cases there is no explicit indication that section 113(1) of ICTA applies to treat the trade as ceasing. In each of the following sections the rewritten rule makes it clear that the trade is not treated as ceasing unless there is a complete change in the persons carrying it on. This retains the effect of section 113(1) of ICTA as limited by section 113(2):

- Section 77: Payments in respect of employment wholly in employer's trade;
- Section 79: Additional payments;
- Section 173: Valuation of trading stock on cessation; and
- Section 182: Valuation of work in progress on cessation.

74. Section 113(6) of ICTA deals with the death of a taxpayer. It ensures that on the death of a person carrying on a trade the necessary cessation adjustments can be made and the tax collected from the personal representatives.

75. The rule in the subsection dates from the time when adjustments on cessation could involve not only an adjustment for the year of death (the assessment for which might already have been made on a previous year basis) but also adjustments to the two previous years to increase the amount of the assessments to the profits of those years on a current year basis.

76. Under Self Assessment any return of income for the year of death will naturally take account of the death. And there is no question of adjusting assessments for previous years on account of the death.

77. The general rule in section 74 of TMA (that the personal representatives inherit the tax liabilities of the deceased) is enough. There is no need for the special rule in section 113(6) of ICTA for trade profits (or property income, to which it is applied by section 21B of ICTA).

78. See also the commentary on the repeal of section 60(4) of ICTA.

Paragraph 106: section 122 of ICTA

79. In section 122(2) of ICTA the reference to section 121(2) of ICTA has been amended to "section 121(3)". This corrects a minor error in ICTA.

80. Section 122(4) of ICTA has been omitted. It became redundant when FA 1995 removed the requirement to deduct income tax from the payment of rent within section 119 of ICTA.

Paragraph 141: section 333 of ICTA

81. Section 333 of ICTA is rewritten in Chapter 3 of Part 6 of this Act but section 333(4)(e) of ICTA allows the regulations to include provisions generally for the administration of corporation tax. Since this cannot be rewritten in this Act and a repeal of all of section 333 of ICTA but for that small part would be ungainly this new section has been substituted.

Paragraph 146: section 347A of ICTA

82. In the source legislation, section 347A(1) of ICTA makes provision about the tax treatment of certain annual payments both from the perspective of the payer and the recipient. Section 347A(1) of ICTA provides that a payment to which the section applies is not a charge on income for the person paying it. Section 347A(1)(a) of ICTA then denies the payer a deduction from his income in respect of the payment and section 347A(1)(b) of ICTA deals with the recipient and gives the recipient an exemption from income tax or corporation tax (as the case may be).

83. Section 347A(2) of ICTA describes the payments to which section 347A(1) of ICTA applies for both these purposes.

84. The income tax exemption is rewritten in Chapter 8 of Part 6 of this Act. So section 347A(1)(b) of ICTA has been amended by this Schedule (see paragraph 146(2)) so that section 347A(1)(b) of ICTA is an exemption from corporation tax only.

85. Further, the Schedular/Case system of classification of income has been abolished for income tax purposes. So section 347A(2) of ICTA now applies to annual payments which, but for the exemption, would be within the charge to corporation tax under Schedule D Case III of Schedule D (except to the extent those payments are excluded by subparagraphs (a) to (d)). And a new subsection "(2A)" has been inserted by this Schedule (see paragraph 146(3)) to deal with the income tax equivalent of section 347A(2) of ICTA (as amended). Because the conditions in section 347A(2) of ICTA are rewritten in sections 727 to 729 of this Act, new subsection (2A) refers to the payments which are exempt from income tax as a result of section 727 of this Act.

86. This Schedule also omits section 347A(5) of ICTA (see paragraph 146(4)) and the subsection is repealed by Schedule 3 to this Act.

87. Section 347A(5) of ICTA is rewritten so far as deductions under sections 65(1)(b) and 68(1)(b) of ICTA are concerned. The reference to section 355 of ITEPA in section 347A(5) of ICTA is not rewritten. Section 347A(5) of ICTA denies a deduction for an annual payment paid out of certain foreign income if that annual payment would not have been within the charge to tax if the payment had arisen in the United Kingdom.

88. Section 355 of ITEPA allows an employee to claim a deduction against foreign earnings for certain payments made abroad which if the payments had been made in the United Kingdom would have given rise to tax relief. If there is no such tax relief in the United Kingdom, section 355 of ITEPA effectively denies a deduction. So in the context of section 347A(5) of ICTA the reference to section 355 of ITEPA is superfluous.

Paragraph 147: section 348 of ICTA

89. Paragraph 147(3) of this Schedule inserts a new subsection into section 348 of ICTA. It is based on sections 233(1)(c), 249(4)(c), 249(6)(c), 421(1)(c), 547(5)(c) and 699A(6) of ICTA. The new subsection applies for the purposes of section 348 and 349 of ICTA. The new subsection gathers together the provisions which would otherwise be "stranded" in the source legislation about amounts not being brought into charge to tax for the purposes of sections 348 and 349.

Paragraph 148: section 349 of ICTA

90. The new section 349ZA(3) of ICTA defines "the net amount of the proceeds or instalment" for the purposes of the application of section 349 of ICTA in the context of section 524 of ICTA (taxation of receipts from sale of patent rightrs). Any incidental expenses of the sale which are deducted before payment are taken into account for this purpose. The source legislation does not explicitly mention incidental expenses of sale, although the words "net proceeds of sale" in section 524(1) of ICTA imply that some deduction is available.

91. The reference in section 524(3) of ICTA to the net proceeds of sale had significance for the purposes of the rule that the payer must deduct income tax from the capital sum comprised in the net proceeds of sale. In deducting tax, the payer is required to leave out of account certain matters that affect the seller's ultimate liability to tax. Although the seller's liability may be reduced if he bought the rights for a capital sum, such a reduction does not affect the amount of tax that is to be deducted by the payer (see section 524(7) to (9) of ICTA). And if the seller makes an election to spread his tax liability over six years, that election does not affect the amount of tax that is to be deducted by the payer (see section 524(4)(a) of ICTA).

92. These rules ensure that the payer is not required, in deducting tax, to take account of matters that may be outside his knowledge. Against this background, it makes sense for the rule requiring the deduction of income tax at source to require the payer to take into account only those incidental expenses that are deducted before payment of the sale proceeds. The payer would otherwise be required to take into account matters that he could not readily ascertain. The rule requiring the payer only to take account of those incidental expenses that are deducted before payment does not affect the seller's ultimate liability to tax.

Paragraph 167: section 391 of ICTA

93. Section 391 of ICTA provides relief for the losses of a trade, profession or vocation taxed under Schedule D Case V. Such losses can be used only against the losses of another Case V trade, profession or vocation (or certain income within ITEPA).

Paragraph 168: section 392 of ICTA

94. The amendment of section 392 of ICTA by paragraph 168 of this Schedule preserves the loss regime that applies to income that is, in the source legislation, income within Schedule D Case VI.

95. Section 392 of ICTA is an income tax only provision that provides relief for losses in income types that, in the source legislation, are charged to tax under Schedule D Case VI. It provides the only avenue of relief available in respect of such losses.

96. In the source legislation the charge under Schedule D Case VI comprises three elements:

- a cornerstone, "sweeping-up" charge that catches any income not caught by the other Schedules and Cases;
- a range of specific charges on miscellaneous transactions and receipts; and
- a range of specific charges of an administrative nature to recover excess relief or undercharges of tax.

97. On account of its breadth and diversity, Schedule D Case VI is often referred to as a "sweep-up" charge. Subject to some important qualifications mentioned below, the purpose of section 392 of ICTA is to allow set-off of losses arising from these different types of swept-up income against swept-up profits. Losses are allowed, and profits relieved, on an undifferentiated basis. That is, once within section 392 of ICTA, a loss can be set off against a profit of any sort (provided it is a Schedule D Case VI profit or, in addition, since ITEPA, certain pension profit) and is not limited to set off only against profit of the same type.

98. But not all of the items within the Schedule D Case VI charge fall automatically within the section 392 of ICTA loss regime because not all are inherently capable of producing a loss. And section 392 of ICTA requires the presence of a "transaction" from which the loss or profit must arise.

99. If there *is* a transaction, section 392 of ICTA provides:

- (where a loss can arise) for the loss to be allowable provided that, had the transaction from which it arises been profitable, that profit would have been chargeable under Schedule D Case VI; and
- for the set-off of such a loss against the profits of any other transactions chargeable under Schedule D Case VI (or against certain pension income chargeable under ITEPA) for the current year and carry-forward of any surplus against similar profits of later years.

100. This Act makes wide-ranging changes in the way Schedule D Case VI income is charged. Specifically:

- the labels "Schedule D" and "Case VI" disappear;

- certain income charged under Schedule D Case VI is transferred to other heads of charge such as trading income or property income;
- other income is charged under various bespoke sections in Parts 4 and 5; and
- there is a pure "sweep-up" section in Part 5 (section 687).

101. The amendment of section 392 of ICTA will ensure that, notwithstanding these recategorisations, the scheme of loss relief provided by the source legislation will continue unchanged. The table in the new section 836B of ICTA lists the provisions that, as they apply before the commencement of this Act, contain a Schedule D Case VI charge and to which section 392 of ICTA is, therefore, potentially relevant. Provisions of an administrative nature to recover excess relief and undercharges of tax are excluded: see the commentary on the amendment in Schedule 1 to this Act of section 18, Schedule D Case VI, of ICTA . These are:

FA 1950

- section 40(3) (recovery of relief);

TMA

- section 30(4) (recovery of over-repayment of tax; repealed, see paragraph 15 of this volume of Explanatory Notes and Schedule 3);

ICTA

- section 118ZH(3) (recovery of relief);
- section 307(1) (withdrawal of relief not due);
- section 384(8) (withdrawal of certain loss relief);
- section 384A(6) (withdrawal of certain loss relief);
- section 399(3) (withdrawal of certain loss relief);
- section 703(3) (recovery of inappropriate tax repayment);
- section 788(7) (double taxation relief adjustment);
- section 790(11) (double taxation relief adjustment);
- paragraph 4 of Schedule 15B (recovery of venture capital trust relief); and

FA 2002

- paragraph 27(2) of Schedule 16 (withdrawal of community investment tax relief).

102. There is one Schedule D Case VI provision in the source legislation where the position in the source legislation has not been preserved. That is section 127 of ICTA (enterprise allowance) which is rewritten as section 207 in Chapter 15 of Part 2 of this Act. The amount charged under Schedule D Case VI in the source legislation is dealt with in this Act as part of the calculation of trade profits: see *Change 53* in Annex 1. So it does not need to be included in the amendment of section 392 of ICTA.

Section 443 of ICTA (no paragraph in Schedule 1)

103. Section 443 of ICTA is repealed for income tax purposes. This is achieved by retaining the text of this provision, as Schedule D Cases I and VI will apply solely for corporation tax purposes after this Act.

104. Section 443 of ICTA deals with the case in which the proceeds of a life assurance policy are paid out in the form of assets and not in cash. When section 443 of ICTA was introduced as section 35 of FA 1967 the section governed the treatment of the assets for the purposes of both capital gains and short term gains (Schedule D Case VII).

105. At that time the disposal by the insurance company would usually be taxed as a capital gain. The main purpose of the 1967 legislation was to make clear that the disposal was at market value. It seems the reference to Schedule D Cases I, VI and VII was to deal with the less common case in which the corporation tax charge on the company on disposal was taxed under these Cases.

106. The section also put it beyond doubt that the base cost of the asset to the policy holder was market value either for capital gains or short term gains purposes.

107. The reference to short term gains was repealed in 1971. And with the consolidation of the capital gains tax code, the capital gains tax rule can now be found in section 204(3) of TCGA. These changes to the section mean that, in the income tax context, section 443 of ICTA now deals only with the policy holder's acquisition of the assets for the purposes of Schedule D Cases I and VI. But of course the mere acquisition of the assets cannot give rise to any liability under Schedule D Cases I or VI.

108. The value of the assets acquired would be reflected in a Schedule D Case I computation only if the policy itself were held as trading stock. In that unlikely event the Inland Revenue is content to follow generally accepted accounting practice in calculating the profits of the trade.

109. It is very difficult to envisage any circumstances in which the disposal of assets acquired on the maturity of an insurance policy would give rise to a Schedule D Case VI liability. But in that most unlikely event the application of the decision in Curtis Brown Ltd v Jarvis (1929), 14 TC 744 HC would suggest a similar result as for Schedule D Case I.

Paragraphs 209 to 228: sections 539 to 554 of ICTA

110. The amendments for these sections do three things. First, they ensure that any liability arising under Chapter 2 of Part 13 of ICTA is chargeable to corporation tax only (see, in particular, the amendments of sections 539 and 547 of ICTA). Second, sections 552 to 552B of ICTA (information: duty of insurers) are amended to reflect the fact that the same event will be a chargeable event under both Chapter 2 of Part 13 of ICTA and Chapter 9 of Part 4 of this Act, and the gain produced by the event is treated as arising under both Chapters. (But the gain, or a part of the gain, is only charged on any taxpayer under or by virtue of one of those Chapters according to that taxpayer's liability for tax.) Third, the redundant section 554 of ICTA is repealed.

111. The amendment of the definition of a life annuity in section 539 of ICTA recognises that the determination of what is, or is not, a purchased life annuity depends on whether the annuitant is within the corporation tax or income tax charge. The annuitant may be subject to one tax charge and the person who is liable for a gain arising on a chargeable event in respect

of the annuity contract may be subject to the other. Both provisions for determining an annuity have to be mentioned here to avoid restricting the scope of the charge under section 547(1)(b) of ICTA. The amendment of section 543 of ICTA is made for the same reasons as regards the calculation of the gain.

112. A new section, section 539ZA (policies and contracts in which persons other than companies are interested), is inserted in ICTA. This section deals with the circumstance where the application of Chapter 2 of Part 13 of ICTA (and related provisions) – that is, whether there is a chargeable event and what the amount of the gain is – has to take into account anything that occurred (or may yet occur) in respect of the policy or contract at a time when any liability may, wholly or in part, arise or have arisen under Chapter 9 of Part 4 of this Act. It mirrors section 544 of this Act.

113. The section makes clear that Chapter 2 of Part 13 of ICTA and related provisions, "the corporation tax provisions", apply in respect of any other circumstance regardless of any application of Chapter 9 of Part 4 of this Act at that time. For example, if there has been a chargeable event under section 540(1)(a)(v) of ICTA (so that there was also a chargeable event under section 509) at a time when liability on the gain arose wholly or in part under Chapter 9 of Part 4 of this Act, that event is still to be taken into account in the later application of the corporation tax provisions to that policy or contract.

114. This new section therefore recognises that both the corporation tax provisions and the provisions in Chapter 9 of Part 4 of this Act apply to a policy or contract. There is a chargeable event under each, but the two sets of provisions apply separately as regards liability. (There are a number of reliefs and other rules that affect income tax liability only.)

115. As a consequence of the repeal of section 547(1)(a) of ICTA (rewritten in section 465) and section 547(1)(e) of ICTA (rewritten in section 468), the subsections in section 547 of ICTA interpreting the meaning of trusts created by an individual and providing the definition of a "foreign institution" have been relocated to section 547A of ICTA.

116. The amendments of sections 552 to 552B of ICTA provide for a single certificate to be given to each relevant policy holder (and, where required, to the Inland Revenue) in respect of an event and the gain which it produces, notwithstanding that the event is a chargeable event under both Chapter 2 of Part 13 of ICTA and Chapter 9 of Part 4 of this Act, and the gain is treated as arising under both Chapters. The amendments also reflect the different language in the two Chapters and the fact that certain provisions of Chapter 9 of Part 4 of this Act have no equivalent in the amended Chapter 2 of Part 13 of ICTA.

117. Section 553C of ICTA is amended so that it is a corporation tax provision, as the income tax application of the section and the related parts of the Personal Portfolio Bonds (Tax) Regulations 1999 (SI 1999/1029, as amended by SI 2001/2724 and SI 2002/455) are rewritten in Chapter 9 of Part 4 of this Act.

118. Section 553C(9A) to (9E) of ICTA enables regulations under that section to provide for a chargeable event gain to arise in relation to a policy or contract which is a personal portfolio bond despite the fact that, at the time, rights in the policy or contract are so held that liability on a gain would be charged under, or by virtue of, Chapter 9 of Part 4 of this Act. The power is limited so that the regulations may make provisions only for the purposes of enabling the gain to be taken into account on the later application of Chapter 2 of Part 13 of ICTA to the policy or contract.

119. Section 554 of ICTA is omitted. It is spent.

Paragraph 247 and 248: sections 586 and 587 of ICTA

120. These amendments repeal sections 586 and 587 of ICTA for income tax purposes. Both sections apply only when the United Kingdom is in a declared state of war. They disallow payments made in connection with war damage indemnity schemes and in respect of war injuries to employees. The sections were enacted to deal with the particular circumstances of the second world war when high rates of taxation meant that payments could be made almost entirely at the Exchequer's expense. They are now obsolete.

Paragraphs 284 and 285: sections 695 and 696 of ICTA

121. This concerns the amendment of sections 695(4)(b) and 696(6) of ICTA so that they will apply for corporation tax purposes without references to the charge to income tax under Schedule D Case IV.

122. Part 16 of ICTA deems certain payments made to beneficiaries from estates in administration to be income. Although Part 16 of ICTA principally applies to beneficiaries within the charge to income tax, it is also capable of applying to beneficiaries within the charge to corporation tax. Chapter 6 of Part 5 of this Act rewrites the provisions which apply for income tax purposes, and Schedule 1 amends Part 16 of ICTA so that it will only apply for corporation tax purposes.

123. Section 695 (limited interests in residue) and section 696 (absolute interests in residue) of ICTA apply respectively to persons who have a limited interest in the residue of an estate at any time during the administration period or an absolute interest in the residue.

124. Under sections 695(2) and 696(3) of ICTA payments made in respect of those interests are deemed to be paid to the persons with the interests as income for the tax year in question. Section 695(4) of ICTA makes different provision about the amount of the income deemed to have been paid and the way it is treated for tax purposes according to whether the estate is a United Kingdom estate or a foreign estate in the tax year in which the amount is deemed to have been paid. Similar provision is made by section 696(4) and (6) of ICTA for persons with absolute interests in estates. (The relevant parts of these sections are rewritten for income tax purposes in sections 649(1), 656 and 657.)

125. In the case of UK estates, a free-standing non-Schedular charge is imposed because the provisions merely say that the amount is income, but do not specify a charging Schedule. In the case of foreign estates, sections 695(4)(b) and 696(6) of ICTA provide that the amount deemed to have been paid as income is to be "chargeable to income tax under Schedule D Case IV as if it were income arising from securities in a place out of the United Kingdom". This operates successfully for persons liable to income tax. But there is no longer any charge under Schedule D Case IV for corporation tax purposes. Paragraph 5 of Schedule 14 to FA 1996 introduced a new Schedule D Case III for corporation tax purposes to replace the previous Cases III and IV (see section 18(3A) of ICTA). This income does not fall within the ambit of the new Schedule D Case III.

126. So, since there are no Schedular charges imposed on this income from foreign estates for corporation tax purposes, the amendments of sections 695(4)(b) and 696(6) of ICTA in Schedule 1 omit the words referring to the charge under Schedule D Case IV. This leaves the

income subject to non-Schedular charges in the same way as the income from United Kingdom estates.

Paragraph 327: section 817 of ICTA

127. This amendment repeals section 817 of ICTA for income tax purposes. The section is an income calculation rule because it applies "in arriving at the amount of profits or gains for tax purposes". It can trace its origins back almost unchanged to the 1803 Act.

128. The primary purpose of the section is set out in subsection (1)(a). This provides no deduction is allowed in calculating the profits unless it (the deduction) is "expressly enumerated in the Tax Acts". This clarification may have served some purpose in the early years of income tax. But as both ITEPA and this Act set out what deductions are to be allowed there is no need for a general rule that says no other deductions are to be allowed.

Paragraph 333: section 827A of ICTA

129. This new section replaces the territorial provisions in section 18(1)(a) of ICTA, which will be repealed for income tax purposes, as they affect those charges under Schedule D Case VI which are not rewritten in this Act.

130. Such charges would otherwise lose the benefit of the territoriality rules in section 18(1)(a) of ICTA. This new section aims to replace those rules. It is modelled on the territorial scope sections in Chapter 1 of Parts 4 and 5 of this Act.

131. See the commentary on section 368 of this Act as to how section 18(1)(a) of ICTA and the rules on territorial scope apply to charges under Schedule D Case VI.

132. Some provisions in Tables 1 and 3 of new section 836B of ICTA have their own territoriality rules or the provisions may otherwise make clear how income from a source outside the United Kingdom is to be taxed. For this reason the territoriality rules are to apply, subject to any express or implied provision to the contrary (*subsection (5)*).

Paragraph 338: section 833 of ICTA

133. Section 531(6) of ICTA provides that income from the disposal of know-how is to be earned income in certain cases. However, the concept of earned income is not rewritten in this Act. This paragraph rewrites section 531(6) of ICTA as subsection (5A) of section 833 of ICTA.

134. Section 529 of ICTA provides that "income from patent rights" is to be earned income in certain cases. However, the concept of earned income is not rewritten in this Act. This paragraph rewrites section 529 of ICTA as subsections (5B) to (5E) of section 833 of ICTA.

135. There is no definition of "income from patent rights" in Chapter 1 of Part 13 of ICTA. Section 833(5B) of ICTA provides for "patent income" to be earned income in certain circumstances, mirroring the circumstances specified in section 529(1) of ICTA. The definition of "patent income" in new section 833(5D) of ICTA follows the definition of "income from patents" in section 533(1) of ICTA (except that it is drafted by reference to the intellectual property provisions in this Act rather than in ICTA). See *Change 152* in Annex 1.

Paragraph 348(3): paragraph 7A of Schedule 22 to ICTA

136. This new paragraph rewrites paragraph 7(1), (3) and (4) of Schedule 13 to FA 1996. These sub-paragraphs deal with how relief is to be given for losses on deeply discounted

securities incurred by pension trustees where the securities have been held since 26 March 2003 and are listed on a recognised stock exchange. Because this provision is likely to be of extremely limited application and will disappear with the repeal of Schedule 22 to ICTA with effect from 6 April 2006 it has been relegated from Chapter 8 of Part 4 of this Act to this Schedule.

Paragraph 352(2): paragraph 5 of Schedule 30 to ICTA

137. This amendment repeals paragraph 5 of Schedule 30 to ICTA for income tax purposes.

138. Paragraph 5 of Schedule 30 to ICTA is a transitional measure that relates to the pre-1963 version of Schedule A. Under that version of Schedule A a trader who owned the property from which he or she carried on a trade was allowed a Schedule D Case I deduction equal to the amount of the Schedule A charge on the property. The right to the deduction was removed when Schedule A moved from a charge on the annual value of the property to a charge on the rent received.

139. Timing differences between Schedule D Case I and Schedule A could result in a loss of relief if the taxpayer ceased to occupy the property for the purposes of the trade in a period in which he or she did not also cease to carry on the trade. FA 1963 introduced a relief to compensate for this loss of relief. It is based on the relief that would have been given for the tax years 1963-64 and 1964-65 and is allowed as a deduction in calculating the trade profits for the tax year in which they cease to carry on the trade.

140. While in theory it is still possible to claim the relief, given the passage of over 40 years and the effects of inflation it is almost certain no new claims will be made in or after the tax year 2005-06.

Paragraph 352(3): paragraph 18 of Schedule 30 to ICTA

141. This amendment repeals paragraph 18 of Schedule 30 to ICTA.

142. Paragraph 18 of Schedule 30 to ICTA is a transitional measure that applies to stock relief. Stock relief was available under different schemes from 1976 to 1984. It was given as a deduction in computing trade profits. Although FA 1984 abolished stock relief with effect from 12 March 1984 it allowed any unused relief to be carried forward and deducted in later years. The relief brought forward has to be used in the first tax year that has the capacity to absorb it. Paragraph 10 of Schedule 9 to FA 1981 provided that any unused relief brought forward which is not used in six years would be lost.

143. It was necessary to preserve the transitional right to deducted unused relief brought forward when ICTA consolidated the earlier legislation in 1988. But this transitional measure is no longer required.

Part 2: Other Enactments

Taxes Management Act 1970

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

144. These amendments repeal the sections of TMA that give effect to the "Crown Option". Under the "Crown Option" the Inland Revenue has the right to determine under what Case of Schedule D to charge income that falls both within Cases I or II and Cases III,

IV or V. In practice this option is always exercised to tax the income under Schedule D Cases I or II.

145. This Act includes sections that enact the Crown Option by giving priority to the trading income Part if income that is taxed under Schedule D in the source legislation falls within more than one Part. See *Change 66* in Annex 1. These priority sections mean that the determination powers in TMA are not required.

Taxation of Chargeable Gains Act 1992

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

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

Section 148A Futures and options involving guaranteed returns

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

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

148. Section 564 (deemed disposal where futures run to delivery or options are exercised) deems a disposal to take place immediately before a future runs to delivery or an option is exercised. Eventually the asset acquired under that future or option may itself be sold for a capital gain. Any gain on that disposal will, under the TCGA rules, include that part of the gain that has already been taxed under Chapter 12 of Part 4 of this Act as a result of the deemed disposal. This new section of TCGA provides rules to prevent that double taxation by excluding that element of the gain from the chargeable gain. It is based on paragraph 4A of Schedule 5AA to ICTA.

149. *Subsection (2)* provides for the rules in sections 37 and 39 of TCGA to be disregarded. These sections prevent an amount taxed as income from being included in the disposal proceeds of an asset or sums deductible in an income tax computation from being deductible against the capital gains computation.

150. *Subsection (4)* prevents indexation allowance being added to the increase in the acquisition cost made under subsection (3). This is because that adjustment is a notional adjustment only and not actual expenditure.

151. *Subsection (6)* provides for the grant of an option and its deemed disposal to be treated as a single acquisition for the purposes of adjusting the capital gains computation under subsections (3) to (5). Treatment as a single acquisition allows the premium received by the grantor of the option to be taken into account in calculating the consideration for acquisition of the asset. Section 144 of TCGA, which applies by virtue of section 562 (when disposals of futures or options occur: general), performs the same service for disposals under Chapter 12 of Part 4 of this Act other than deemed disposals (see commentary on section 563 (timing of certain grants of options where related disposals occur later)). This subsection is

needed because deemed disposals under section 564 (deemed disposals where futures run to delivery or options are exercised) are not disposals for the purposes of section 144 of TCGA.

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

152. Section 564 (deemed disposal where futures run to delivery or options are exercised) deems a disposal to take place immediately before a future runs to delivery or an option is exercised. Eventually the asset acquired under that future or option may itself be sold for a capital loss. Any loss on that eventual disposal will, under the TCGA rules, include that part of the loss that may be relieved under Chapter 12 of Part 4 of this Act as a result of the deemed disposal. This new section of TCGA provides rules to prevent a double allowance of that loss by excluding the loss allowable under Chapter 12 of Part 4 of this Act from the capital loss. The section is based on paragraph 4A of Schedule 5AA to ICTA.

153. *Subsection (2)* provides for the rules in sections 37 and 39 of TCGA to be disregarded. These sections prevent an amount taxed as income from being included in disposal proceeds of an asset or sums deductible in an income tax computation from being deductible against the capital gains computation.

154. *Subsection (3)* provides for the grant of an option and its deemed disposal to be treated as a single acquisition for the purposes of adjusting the capital gains computation under subsections (4) and (5). This allows the premium received by the grantor of the option to be taken into account in calculating the consideration for acquisition of the asset. Section 144 of TCGA which applies by virtue of section 562 (when disposals of futures or options occur: general) performs the same service for disposals under Chapter 12 of Part 4 of this Act other than deemed disposals (see commentary on section 563 (timing of certain grants of options where related disposals occur later)). But deemed disposals under section 564 (deemed disposals where futures run to delivery or options are exercised) are not disposals for the purposes of section 144 of TCGA.

155. *Subsections (4)* and *(5)* apply where an asset has been disposed of at a loss by means of a future running to delivery or an option being exercised. The consideration for that asset for the purposes of the capital gains computation is decreased by the amount of the loss arising under Chapter 12 of Part 4 of this Act, thus effectively preventing a double allowance of the loss that arises on the deemed disposal under that Chapter. Under subsection (4) two distinct situations are foreseen, first where the person sustaining a loss on the deemed disposal acquires an asset as a result of a future running to delivery or the exercise of an option and, second, where the person sustaining a loss on the deemed disposal disposes of an asset as a result of a future running to delivery or the exercise of an option.

156. *Subsection (5)* ensures that the consideration cannot be reduced below zero. Where the loss under Chapter 12 of Part 4 of this Act exceeds the consideration, the consideration is reduced to nil and the excess is treated as a chargeable gain.

157. *Subsections (6)* and *(7)* deal with occasions where the loss under Chapter 12 of Part 4 of this Act on the deemed disposal exceeds the consideration for the asset and is treated as a capital gain under subsection (5). The capital gain arises either when an asset acquired under the future or option is eventually disposed of, or, if the asset is already held but disposed of under the future or option, on that disposal.

158. *Subsections (8)* and *(9)* supplement the rule in subsections (6) and (7). They establish when a chargeable gain under subsection (5)(b) is treated as arising in circumstances which involve special capital gains tax provisions.

Paragraph 438: section 151C of TCGA

159. This new section of TCGA provides that where a capital loss accrues as part of any scheme or arrangement which has an unallowable purpose that loss is disregarded. Schedule 13 to FA 1996, relevant discounted securities, is rewritten in Chapter 8 of Part 4 of this Act. Because this paragraph of the Schedule deals with capital losses on such securities it is more appropriate to TCGA. The section is based on paragraph 14C of Schedule 13 to FA 1996.

160. *Subsection (1)(b)* requires payment to be made other than for the acquisition or disposal of a strip – these payments will typically be payments under option agreements. An allowable loss may accrue on a payment while a comparable gain on a strip escapes tax under section 115 of TCGA. "Disposal" in this subsection takes the meaning in Chapter 8 of Part 4 of this Act (*subsection (4)*).

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

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

Finance Act 1993

Paragraph 464: section 171(2) of FA 1993

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

163. This amendment also uses the concept of "relevant foreign income" to reproduce the reference to Schedule D Case I in section 171(2)(a) of FA 1993.

Income Tax (Earnings and Pensions) Act 2003

Paragraph 592: section 325A of ITEPA

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

165. This rewrites section 580A(7) of ICTA to the extent that it relates to employment income.

166. The payment must first have the capacity for exemption under section 735 (health and employment insurance payments) on the assumption that it is an annual payment (and thus exempt under that section). But it must also meet two further conditions.

167. First the payments must be to an employee (or to his or her spouse) who contributed under a policy that another person took out for his or her benefit and secondly the payments must represent the contributions the employee has made.

Paragraph 594: section 360A of ITEPA

168. This new section of ITEPA rewrites part of the rule in section 617(3) and (4) of ICTA, which prohibits the deduction of most social security contributions in calculating income for tax purposes. The remainder of the rule is rewritten, for income tax, in section 868 (social security contributions) of this Act.

169. In some circumstances an employee may be allowed a deduction for wages paid. In that case, the associated employer's national insurance contributions may also be allowed. The deduction is allowed if it would meet the tests in section 336 of ITEPA (see section 617(4)(d) of ICTA). But it should also be allowed if it meets the tests in any of sections 337 to 342 of ITEPA. See *Change 153* in Annex 1.

Paragraph 606: section 575 of ITEPA

170. Section 575 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.

171. The paragraph provides rules for calculating the income charged by virtue of Chapter 4 of Part 9 of ITEPA. The income is treated as relevant foreign income for the purposes of Chapters 2 and 3 of Part 8 of this Act. See section 830(4) of this Act (meaning of "relevant foreign income") and the commentary on Part 8 of this Act (overview and Chapter 1 of that Part) for further detail.

172. *Sub-paragraph (3)* rewrites the 10% deduction given from pension income in the source legislation by sections 65(2) and 68(5) of ICTA. It does not rewrite one of the conditions for that deduction imposed by section 68(5) of ICTA for pension income arising in the Republic of Ireland. See *Change 154* in Annex 1.

173. Section 575(4) of ITEPA, which is inserted by sub-paragraph (3), reflects small differences in the source legislation between the conditions attached to the deduction for annual payments in section 68(3) of ICTA (income from the Republic of Ireland) and section 65(1) of ICTA (other foreign income).

Paragraph 607: section 613 of ITEPA

174. Section 613 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.

175. The commentary on paragraph 606, amending section 575 of ITEPA, applies equally here, with the necessary modifications for the fact that this section deals with annuities rather than a pension. See *Change 154* in Annex 1.

176. The 10% deduction given in the source legislation by sections 65(2) and 68(5) of ICTA does not extend to annuities from the Republic of Ireland. This paragraph extends the deduction to such annuities. See *Change 155* in Annex 1.

Paragraph 608: section 631 of ITEPA

177. Section 631 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65 and 68 of ICTA.

178. Some of the commentary on paragraph 606, amending section 575 of ITEPA, applies equally here. See *Change 154* in Annex 1.

179. The main difference between that section and this is that, although the income to which this section applies is treated as relevant foreign income, it is income paid in the United Kingdom. Chapters 2 and 4 of Part 8 of this Act (which rewrite sections 584 and 585 of ICTA) cannot apply. And the only provision in Chapter 3 of that Part which can apply is section 838 as the other provisions in that Chapter do not apply to income paid in the United Kingdom.

Paragraph 609: section 635 of ITEPA

180. Section 635 of ITEPA is amended because the ICTA references on which it depends are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.

181. The commentary on the paragraph 606, amending section 575 of ITEPA, applies equally here. See *Change 154* in Annex 1.

Paragraph 610: section 644A of ITEPA

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

183. This rewrites section 580A(7) of ICTA to the extent that it relates to pension income.

184. The commentary on new section 325A of ITEPA applies equally to this section except that the insurance payments must be to the pensioner rather than the employee.

Paragraph 611: section 646A of ITEPA

185. This new section of ITEPA provides a similar exemption for consular employees' foreign pension income to that in section 771 of this Act.

186. The section is based on section 322 of ICTA and brings into ITEPA the exemption for income within subsection (1A)(b) and (c) of that section. This is income that was previously charged under Schedule D Case V. This section now brings the exemption for foreign pension income into ITEPA under which the income would be charged if it were not exempt.

187. The commentary on section 771 (relevant foreign income of consular officers and employees) applies also to this paragraph when read as for pension income.

Paragraph 613: section 679 of ITEPA

188. Section 679 of ITEPA is amended because the ICTA references on which it depended are rewritten and repealed for income tax purposes. This paragraph is based on sections 65, 68, 584 and 585 of ICTA.

189. The commentary on paragraph 606, amending section 575 of ITEPA, applies substantially here, with the necessary modifications for the fact that this section deals with social security income rather than a pension. This income does not benefit from the 10% deduction provided for pension income, nor are there any special rules affecting social security income from the Republic of Ireland to be mentioned.

Paragraph 614: section 681A of ITEPA

190. This new section of ITEPA provides a similar exemption for consular employees' foreign social security benefits to that in section 771 of this Act.

191. This new section is based on section 322 of ICTA and brings into ITEPA the exemption for income within subsection (1A)(d) of that section. This is income that was previously charged under Schedule D Case V. This section now brings the exemption for foreign benefits into ITEPA under which the income would be charged if it were not exempt.

192. The commentary on section 771 of this Act (relevant foreign income of consular officers and employees) applies to this new section of ITEPA also when read as for foreign benefits.

Schedule 2: Transitionals and savings etc.

Part 1: General provisions – continuity of the law

193. These paragraphs ensure continuity of the law, despite the fact that this Act repeals and rewrites provisions.

194. Paragraph 2 makes clear that the proposition about the continuity of the law in paragraph 1 does not apply to changes in the law made by this Act.

195. 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

196. This paragraph allows anyone affected by a minor change in the law made by this Act to elect that the change does not apply to events occurring before 6 April 2005. This allows the Act to be applied as soon as possible without imposing charges retrospectively.

197. The Act applies for the purposes of income tax. But it makes numerous consequential amendments to corporation tax. So corporation tax is also provided for here.

Part 3: Trading income

Paragraphs 22 and 23: Training courses for employees

198. These two paragraphs ensure continuity in the training expenses tax recovery provisions in the source legislation which are rewritten in section 75. They are based on section 588 of ICTA.

199. Paragraph 37 of Schedule 7 to ITEPA keeps sections 588(5)(a) and 589(3) and (4) of ICTA in force in relation to tax years before 2003-04. It also preserves the reference to section 589(3) and (4) of ICTA in section 588(6) of ICTA in relation to such tax years.

200. The first paragraph ensures that the rewrite of section 588 of ICTA does not stop paragraph 37 of Schedule 7 to ITEPA from working: where section 588 has effect by virtue of paragraph 37 of Schedule 7 to ITEPA the amendments do not apply in relation to the section.

201. The second paragraph ensures continuity in the case of determinations of an employer's income tax liability for the tax years between the dates that ITEPA and the rewrite of section 588 of ICTA come into force. Those determinations will be made on the assumption that a deduction is allowed under section 588(3) of ICTA. Doubt might arise

whether section 75 applies in such cases: section 75(1) says that the section applies if an employer's liability has been determined on the assumption that a deduction is allowed under section 74.

202. The effect of the transitional is that even though a deduction has been allowed under section 588(3) of ICTA, section 75 will operate if there is a later breach of section 311(4)(a) or (b) of ITEPA.

203. If the expenditure is incurred on or after 6 April 2005, the employer's right to a deduction will arise under section 74 and section 75 will operate if there is a later breach of section 311(4)(a) or (b) of ITEPA.

204. *Sub-paragraph (1)(c)* of the second paragraph makes it clear that this transitional does not apply if an assessment has already been made before the rewritten provisions come into force.

Paragraph 48: Apportionment of profits or losses to tax years before tax year 2005-06 – basis periods

205. Section 883 provides that the Act takes effect for income tax purposes for the tax year 2005-06. For trade profits taxed under Chapter 2 of Part 2 of this Act the income chargeable for 2005-06 is determined by reference to the basis period for that tax year.

206. Chapter 15 of Part 2 of this Act sets out the rules for relating basis periods to periods of account. In the case of an established trade the basis period for 2005-06 will usually be the 12 month period of account ending in the year 2005-06. That period of account will not normally form the basis period for any other tax year.

207. But if the trade has just started it may be necessary to apportion the result of a period of account. For example, if a trade starts on 1 January 2005 and the first accounts are made up to 31 December 2005 that period of account will form the following basis periods:

- tax year 2004-05 basis period 1 January 2005 to 5 April 2005; and
- tax year 2005-06 basis period 1 January 2005 to 31 December 2005.

208. Section 72 of ICTA, rewritten as section 203 allows the profits for the basis period 1 January to 5 April 2005 to be arrived at by apportionment.

209. In calculating the amount of overlap relief, (see section 204), it is important that the same figure of taxable profit is attributed to the period 1 January 2005 to 5 April 2005 for both tax years.

210. The purpose of this paragraph is to allow the profits of a period of account that straddles 6 April 2005 to be calculated using the rewritten legislation even though tax years earlier than 2005-06 will be affected. This Act includes a number of minor changes in the law. Without this paragraph it would be necessary for traders to take account of those changes only for the tax year 2005-06.

211. If a taxpayer does not want the new law to apply to a transaction that occurred before 6 April 2005 he or she can elect for the old legislation to continue to apply.

Paragraph 50: Profits or losses of a trade, profession or vocation previously chargeable in accordance with section 65(1) of ICTA

212. This transitional provision relates to *Change 1* in Annex 1. The profits of a trade, profession or vocation may exceptionally not be charged in accordance with section 65(3) of ICTA (because they are not "immediately derived" from it). In that case this Act may produce a change from assessment on a tax year basis to assessment on the basis of the profits of a basis period. This transitional provision ensures that profits are not assessed twice.

Paragraph 51: Profits of mines, quarries and other concerns not chargeable by reference to a basis period

213. Section 55 of ICTA, rewritten as section 12, provides that the profits of certain concerns are taxed under Schedule D Case I. It is not clear in the source legislation whether or not the basis period rules rewritten as Chapter 15 of Part 2 of this Act apply to these profits. It is possible that some taxpayers may be returning the profits by reference to the full amount arising in the tax year and not by reference to the period of account ending in the basis period for the tax year.

214. Section 12 makes clear that all the Schedule D Case I rules apply including the basis period rules. This paragraph deals with the transition to that regime if the taxpayer has not used the basis period rules in the tax year 2004-05. Deeming the trade to start on 6 April 2005 means the taxpayer will be taxed on the full amount of the profit arising in the tax year 2005-06 and no part of that profit will also be taxed in the earlier year.

215. If a taxpayer has arrived at the profits for the tax year by apportioning the profits of periods of account the paragraph also allows the taxpayer to use the rules in this Act to calculate the profits in any part of the period that straddles 6 April 2005.

Paragraph 55: Averaging profits of farmers and creative artists

216. This transitional provision relates to *Change 60* in Annex 1. It preserves a taxpayer's right (if one exists under ICTA) to claim averaging for 2004-05 and 2005-06 even if one of those years is the year in which the taxpayer starts or ceases to carry on the trade, profession or vocation.

Paragraph 58: Adjustment on change of basis: paragraph 12 of Schedule 22 to FA 2002

217. This transitional provision relates to *Change 62* in Annex 1. It preserves the FA 2002 spreading arrangements if an election has been made under the FA 2002 rules.

Paragraph 59: Adjustment on change of basis: section 104 of ICTA

218. Section 109 of ICTA provides a special relief for individuals born before 6 April 1917 who are chargeable to tax under section 104 of ICTA. The relief takes the form of a fractional reduction in the amount charged under section 104 of ICTA. This transitional provision replaces the relief with an exemption. So section 109 of ICTA is repealed without being rewritten. See *Change 156* in Annex 1.

Part 4: Property income

Paragraph 62: Apportionment of profits or losses to tax years before tax year 2005-06

219. Section 21(2) of ICTA, rewritten as section 270 provides that income from a property business is taxed on the full amount of the profit arising in the tax year. If the taxpayer does not prepare accounts to 5 April it may be necessary to apportion accounts made up to a different date to calculate the amount arising in the tax year. Section 72 of ICTA, rewritten as section 275, applies to the profits of a property business through section 21A(2) of ICTA and allows the profits of the period of account to be apportioned to tax years.

220. Section 883 provides that the Act takes effect for income tax purposes for the tax year 2005-06. This paragraph provides that the profits of a period of account that straddles 6 April 2005 are calculated by reference to the rewritten legislation even though years earlier than 2005-06 will be affected. This Act includes a number of minor changes in the law. Without this paragraph it would be necessary for taxpayers to take account of those changes only for 2005-06.

221. If a taxpayer does not want the new law to apply to a transaction that occurred before 6 April 2005 he or she can elect for the old legislation to continue to apply.

Part 5: Savings and investment income: general

Paragraph 78: Open-ended investment companies: saving for powers to make provision corresponding to provisions applicable to unit trusts

222. Section 152 of FA 1995 enables regulations to be made for securing that the Tax Acts and TCGA and some other enactments have effect in relation to open-ended investment companies, their holdings and assets and transactions relating to them in a way corresponding to that in which they have effect in relation to unit trusts. However, this Act rewrites the effect of some of the regulations made under this power as free-standing provisions without reference to unit trusts. (See sections 373 to 375 and sections 386 to 388). So this saving is necessary to preserve the power in section 152 of FA 1995 so that regulations may continue to be made for achieving any purpose that could be achieved by such regulations before enactment of those sections, because after their enactment they will not be provisions that relate to unit trusts.

Paragraph 80: Deeply discounted securities: deemed transfers of strips on 5th April

223. Paragraph 14(4) of Schedule 13 to FA 1996 provides that a strip of a government security is deemed to be transferred on 5 April and reacquired the following day. This is rewritten in section 445 of this Act as a disposal and reacquisition on the same day. See *Change 87* in Annex 1. This change will not work as it should for the tax year beginning 6 April 2005, when this Act first has effect, because while paragraph 14(4) of Schedule 13 to FA 1996 will deem a disposal on 5 April it will have been repealed on 6 April. There will therefore be no deemed reacquisition.

224. This provision ensures that the strip will be deemed to have been reacquired on 6 April 2005.

Paragraphs 82 and 83: Profits from deeply discounted securities: saving for charities' losses and ***Profits from deeply discounted securities: saving for pension trustees' losses***

225. These two provisions rewrite paragraph 7(1) and (3) of Schedule 13 to FA 1996. These sub-paragraphs deal with losses on deeply discounted securities incurred by charities and pension trustees where the securities have been held since 26 March 2003 and are listed on a recognised stock exchange. Because these provisions are likely to be of extremely limited application they have been relegated from Chapter 8 of Part 4 of this Act (deeply discounted securities) of this Schedule.

Paragraph 84: Exclusion of deeply discounted securities from section 711 to 718 of ICTA (accrued income profits)

226. Section 710(3) of ICTA lists securities which are excluded from the accrued income scheme in Chapter 2 of Part 17 of ICTA. Section 710(3)(f) of ICTA (securities which are relevant discounted securities within Schedule 13 to FA 1996) has been consequentially amended by Schedule 1 to this Act to refer to deeply discounted securities within Chapter 8 of Part 4 of this Act.

227. Before FA 2003, paragraph 11 of Schedule 13 to FA 1996 was the only exclusion of relevant discounted securities from the accrued interest scheme. As part of the provisions for removing loss relief on relevant discounted securities, paragraph 5(2)(c) of Schedule 39 to FA 2003 repealed paragraph 11 of Schedule 13 to FA 1996 and added relevant discounted securities to the list of securities outside the accrued income scheme in section 710(3)(f) of ICTA.

228. But paragraph 6(1)(b) of Schedule 39 to FA 2003 repeals paragraph 11 of Schedule 13 to FA 1996 only in relation to a *loss* on a relevant discounted security on or after 26 March 2003 and applies section 710(3)(f) of ICTA only in relation to *losses* on or after that date.

229. Moreover paragraph 6(2)(b) of Schedule 13 to FA 1996 provides a saving for changes introduced by paragraphs 5(2) and (4) of that Schedule if the security is quoted on a recognised stock exchange and has been held continuously since before 27 March 2003. In those circumstances paragraph 7 of Schedule 13 to FA 1996 continues to apply.

230. The complex position that emerges is:

- section 710(3)(f) of ICTA applies only where losses arise unless the loss arises on a quoted security held since before 27 March 2003; and
- paragraph 11 of Schedule 13 to FA 1996 continues to apply for all gains but also for losses arising on a quoted security held since before 27 March 2003.

231. It serves no purpose to have one provision applying to gains and another to losses and the repeal of paragraph 11 of Schedule 13 to FA 1996 and insertion of section 710(3)(f) of ICTA suggest that this was not the intention.

232. This paragraph therefore applies section 710(3)(f) of ICTA for all disposals after 6 April 2005.

Paragraph 85: Gains from contracts for life insurance etc: foreign policies of life insurance

233. This paragraph preserves the status of certain foreign policies of life insurance as *qualifying policies* under Schedule 15 to ICTA where the policy had that status prior to the amendment of section 553(2) and (7) of ICTA by section 55(8) of FA 1995. That amendment removed qualifying policy status from policies which depended for it on satisfying the condition in paragraph 24(4) (rather than paragraph 24(3)) of Schedule 15 to ICTA. Some foreign policies were issued by insurers who were, at that time, subject to UK tax under section 445 of ICTA and such policies were only qualifying policies within the meaning of Schedule 15 to ICTA by virtue of paragraph 24(4) of that Schedule. This paragraph is based on section 55(8) of FA 1995.

234. Where this paragraph applies, the provisions mentioned in section 474(2) apply to the policy in question. But an individual or trustee who is chargeable on a gain arising in respect of such a policy will get the income tax allowance provided by section 530 where condition B in section 531 is met.

Paragraph 86: Gains from contracts for life insurance etc: exclusion of pension policies

235. Chapter 9 of Part 4 of this Act anticipates the amendment by FA 2004 of Part 14 of ICTA (pension schemes, social security benefits, life annuities etc.), so that it uses the descriptions which will be substituted from 6 April 2006. This paragraph preserves the original descriptions in the unamended source legislation for the tax year 2005-06.

Paragraphs 87 and 88: Gains from contracts for life insurance etc: rights partially assigned

236. FA 2001 introduced rules, inserted as section 546A of ICTA, to determine what assignments are regarded as taking place when certain assignments of part or a share of the rights under a policy or contract are assigned. Paragraph 87 ensures that any question of what is or is not an assignment of such a part or share, in relation to times before section 546A of ICTA applies, is determined without regard to section 505 (which rewrites section 546A of ICTA). This paragraph is based on section 83 of FA 2001.

237. FA 2001 also amended Chapter 2 of Part 13 of ICTA so that an assignment of rights under the policy or contract before 6 April 2001 which is not for money or money's worth is ignored. Paragraph 88 ensures that such assignments which occurred before that date continue to be valued as they were valued prior to the amendments of FA 2001 if the value of such an assignment is material to the operation of Chapter 9 of Part 4 of this Act. This paragraph is based on section 83 of FA 2001.

Paragraph 89: Gains from contracts for life insurance etc: regulations providing for relief where foreign tax chargeable

238. This paragraph preserves the original scope of the powers in section 56(3) of FA 1995 which are rewritten in section 534. It is based on section 56(3) of FA 1995.

Paragraph 90: Gains from contracts for life insurance etc: pure protection group life policies

239. FA 2003 amended the law in respect of group life policies to ensure that such policies do not give rise to gains chargeable under Chapter 2 of Part 13 of ICTA. Provision was also

made to disregard as a chargeable event any event happening before 9 April 2003, if it happened in respect of a particular type of group life policy (a "pure protection group life policy"). This paragraph preserves that disregard should it be necessary to consider, for the purposes of Chapter 9 of Part 4 of this Act, whether any event happening before that date in relation to such a policy has been a chargeable event. This paragraph is based on paragraph 3 of Schedule 34 to FA 2003.

Paragraph 91: Gains from contracts for life insurance etc: assessment of trustees etc

240. This paragraph preserves the commencement date for the FA 1998 amendments to Chapter 2 of Part 13 of ICTA (liability of trustees in respect of gains from life policies etc.), so that the FA 1989 rules on the assessment of trustees (as amended by paragraph 411 of Schedule 1 to this Act) do not refer to gains from chargeable events before 6 April 1998. This paragraph is based on paragraph 7 of Schedule 14 to FA 1998.

Paragraphs 92 and 93: Transactions in deposits

241. Paragraph 92 is based on section 56(3) of ICTA. It preserves a commencement rule for the source legislation rewritten in Chapter 11 of Part 4 of this Act should there be any extant pre-7 March 1973 certificates of deposit. See the commentary on that Chapter in Volume 2 of these Explanatory Notes.

242. Paragraph 93 is based on paragraph 6 of Schedule 8 to FA 1992. It preserves a commencement rule for the source legislation rewritten in Chapter 11 of Part 4 of this Act should there be any extant pre-16 July 1992 uncertificated deposits.

Paragraph 94: Disposals of futures and options involving guaranteed returns: certain pre-6th February 1998 transactions

243. This paragraph ensures that section 564 (deemed disposal where futures run to delivery or options are exercised) will not apply where the transaction took place before 6 February 1998.

Paragraph 95: Disposals of futures and options involving guaranteed returns: rates of tax for pension trustees

244. This paragraph modifies Condition C in section 568 (special rule for certain income of trustees) for the tax year 2005-06. It rewrites paragraph 7(2)(c) of Schedule 5AA to ICTA as it stands before the amendments made by FA 2004, which only apply for the tax year 2006-07 onwards.

Part 6: Savings and investment income: insurance contracts and policies made before certain dates

Overview

245. This Part of Schedule 1 applies for the purposes of Chapter 9 of Part 4 of this Act.

246. The paragraphs in this Part set out the further rules that apply to policies issued in respect of insurances made or contracts made before certain dates. The paragraphs appear in the chronological order of those dates. These rules largely reflect the commencement provisions applying to the various amendments to the source legislation.

247. Part 7 of this Schedule contains further rules that apply in respect of policies and contracts pre-dating 17 March 1998 that may be personal portfolio bonds.

248. Other transitional provisions in respect of Chapter 9 of Part 4 of this Act are provided in Part 5 of this Schedule.

Paragraph 96: Pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4

249. This paragraph excludes certain policies and contracts from the scope of Chapter 9 of Part 4 of this Act. It is based on section 539 of ICTA.

250. *Sub-paragraph (2)* removes that exclusion where the policy or contract is varied after the relevant date in certain circumstances. This is a common feature of the chargeable event gains regime. It prevents the exploitation of policies and contracts which benefit from a particular rule in relation to a specific date, where the later variation could increase the value of that benefit to a degree not contemplated by the provision.

251. *Sub-paragraph (3)* restricts the effect of sub-paragraph (2) where the variation was made by 31 December 1968 to comply with certain provisions for qualifying policies (as at that time, under the predecessor to Schedule 15 of ICTA).

Paragraph 97: Pre-27th March 1974 policies and contracts: disapplication of section 500(c)

252. This paragraph reflects the commencement provisions in the source legislation for sections 500(c) and 501, which treat certain loans as part surrenders of a policy or contract. It is based on section 548(1) of ICTA.

Paragraph 98: Pre-27th March 1974 contracts: disapplication of section 531(3)(c)

253. This paragraph reflects the commencement provisions in the source legislation for the treatment of gains from certain contracts for a life annuity. It is based on section 547(5A) of ICTA.

Paragraph 99: Pre-10th December 1974 contracts for a life annuity: disapplication of section 484(1)(d)

254. This paragraph reflects the commencement provisions in the source legislation for the treatment of death as giving rise to a surrender of the rights under a contract for a life annuity. It is based on section 542(2) of ICTA.

Paragraph 100: Pre-14th March 1975 policies and contracts: calculation of gains under section 507

255. This paragraph applies to policies and contracts which are more than 20 years old. Premiums paid on such policies 20 or more years ago will be 100% allowable in computations of gains, subject to the restriction this paragraph applies in respect of years beginning before 14 March 1975. It introduces, for the policies and contracts to which it applies, the concept of a "reference period", defined in *sub-paragraph (6)* as insurance years beginning after 13 March 1975. Where the paragraph applies, it affects the periodic calculation under section 507. It is based on section 546(1) of ICTA.

256. *Sub-paragraph (3)* limits by reference to that reference period the period within which certain assignments contribute amounts in the calculation under section 507 of the "net total value" of rights assigned.

257. *Sub-paragraphs (4)* and *(5)* amend the calculation to allow a portion of each premium paid before the reference period and during the reference period in the total of "net total allowable payments". The portion allowed cannot exceed 100% of a premium paid in a year falling wholly in the reference period. If the premium was paid in an insurance year beginning before the reference period, the allowable amount diminishes the earlier the premium was paid. For each such premium, one-twentieth is "lost" for each year beginning before the reference period, back to and including the year the premium was paid.

Paragraph 101: Pre-25th March 1982 replacement policies: disapplication of section 542

258. This paragraph is based on paragraph 20(4) of Schedule 15 to ICTA. A replacement policy issued before 25 March 1982 is not treated as a single policy with the one it replaced, but as a freshly issued policy in, for example, the calculation of "N" in section 536 (calculations for top slicing relief).

Paragraph 102: Certain pre-26th June 1982 policies and contracts excluded from Chapter 9 of Part 4

259. Before FA 1983, gains on "second hand" life insurance policies and life annuity contracts (that is, where all the rights had previously been assigned for money or money's worth) were subject to capital gains tax rather than income tax. The gain was computed under capital gains tax rules.

260. This paragraph preserves that treatment so long as none of the events set out in *sub-paragraphs (3)* to *(5)* occurs after 23 August 1982. Should such an event occur, the policy or contract comes again within the scope of Chapter 9 of Part 4 of this Act. The paragraph is based on sections 540, 542 and 544 of ICTA.

261. *Sub-paragraphs (5)* to *(9)* provide that certain loans made by, or by arrangement with, the issuer of the policy or contract to, or at the direction of, an individual bring the assigned policy or contract back into the scope of Chapter 9 of Part 4 of this Act. They ensure that the treatment of such loans corresponds with the rules (including exceptions) in section 501.

262. Sub-paragraph (6) ensures that the individual mentioned in sub-paragraph (5) is within the scope of that provision even where the rights under the policy or contract are held under a charitable trust that individual created (although a gain would not be attributed to that individual under section 465 in such circumstances).

263. Sub-paragraph (9) ensures that the loan bringing the policy back within the scope of Chapter 9 of Part 4 of this Act is treated as a part surrender by virtue of section 500.

Paragraph 103: Certain pre-18th November 1983 policies not foreign policies of life insurance

264. This paragraph is based on section 553A of ICTA. The paragraph reflects the commencement provisions for the source legislation.

265. The exclusion of a policy to which this paragraph applies from the scope of Chapter 9 of Part 4 of this Act is lost if the policy is varied in certain ways. See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4).

266. See also the commentary below for paragraph 111 (certain pre-17th March 1998 policies not foreign policies of life insurance).

Paragraph 104: Certain pre-23rd February 1984 policies not foreign capital redemption policies

267. This paragraph is based on section 553(10) of ICTA. That section defines a "new offshore capital redemption policy" (the equivalent term in the source legislation for a "foreign capital redemption policy"). This paragraph reflects the commencement provisions for that source legislation. See also the commentary for paragraph 113 (certain pre-23rd March 1999 policies not foreign capital redemption policies).

Paragraph 105: Pre-14th March 1984 policies: disregard of amounts deducted and repaid after tax relief by deduction from premiums abolished

268. Certain amounts were treated under section 72(9) of FA 1984 as additional premiums paid on 5 August 1984 only. This treatment arose exceptionally from the abolition of the right to deduct tax relief from premiums paid to the insurer and applied for limited purposes (which did not include the calculation of chargeable event gains). This paragraph ensures that such amounts are disregarded in computing gains for the purposes of certain calculations in Chapter 9 of Part 4 of this Act. It is based on section 541(6) of ICTA.

Paragraph 106: Certain pre-20th March 1985 policies: application of section 529(1)

269. This paragraph is based on section 553(5) of ICTA. It reflects the insertion by FA 1985 of an exception to rules introduced by FA 1984. The FA 1984 rules provided for the reduction of gains where the policy holder was not UK resident during all or part of the policy period (see section 528 of this Act).

270. The exception applies when the policy is held at the time of the chargeable event by one or more non-UK resident trustees.

271. The paragraph reverses the exception made by section 529 if the policy was held by such a trustee or trustees on 19 March 1985 and the policy was issued in respect of an insurance (for a policy of life insurance) or contract (for a capital redemption policy) made on or before that date.

272. The paragraph also repairs an omission in the source legislation which would exclude a capital redemption policy from the benefit of the paragraph. In the source legislation, the reduction under section 553(3) of ICTA is only made if, under section 553(5A)(a) of ICTA, the policy was *issued in respect of an insurance* made before 17 March 1998. The term used in that paragraph is only apt for a policy of life insurance, although section 553(5) of ICTA covers capital redemption policies too, and the opening words of section 553(5) of ICTA are apt for both since they just refer to "the policy". Instead of saying "issued in respect of an insurance made", section 553(5)(a) of ICTA should have also have referred to a capital redemption policy "issued in respect of a contract made". In practice, section 553(5) of ICTA is interpreted as if it referred also to the making of contracts for capital redemption policies.

Paragraph 107: Pre-14th March 1989 qualifying policies: application of section 485(2)(b) and (3)(b)

273. This paragraph reflects the commencement provisions for paragraph (b) in section 485(2) and (3). Paragraph (b) affects the incidence of chargeable events, in respect of a qualifying policy, where the rights under the policy are held as security for a debt owed by a company. This paragraph is based on section 540(5A) of ICTA.

274. But the modification by this paragraph of section 485(2) and (3) is removed (and the incidence of chargeable events thereby increased) if the pre-14th March 1989 policy is varied in certain ways. See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4). *Sub-paragraphs (2)* and *(3)* are based on section 539(9) of ICTA.

Paragraph 108: Pre-14th March 1989 policies and contracts: application of section 501

275. This paragraph is based on section 548(3A) of ICTA. It limits the application of section 501 (loans by insurers giving rise to part surrenders) where:

- the policy or contract dates from before 14 March 1989; and
- the rights under the policy or contract were held in circumstances such that a company would be liable to tax under section 547(1)(b) of ICTA on a gain arising on that policy or contract.

276. *Sub-paragraphs (2)* and *(3)* remove the limitation on the scope of section 501 if the policy is varied in certain ways. See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4). These sub-paragraphs do not apply to a life annuity contract. They are based on section 539(9) of ICTA.

Paragraph 109: Contracts in accounting periods beginning before 1st January 1992: disapplication of sections 530* and *539(3)

277. This paragraph modifies the application of a number of provisions in Chapter 9 of Part 4 of this Act to certain life annuity contracts. The contracts affected are defined by reference to dates in 1974 (as regards the contract) and 1992 (as regards the insurer). Between those dates, the investment profits of the insurer in respect of such contracts did not bear UK tax. These contracts are therefore treated similarly to foreign policies and contracts. The paragraph is based on sections 547 and 549 of ICTA.

278. *Sub-paragraphs (2)* and *(3)* deny such contracts the income tax allowance etc provided by section 530 unless either section 532 or section 534 applies. Certain other life annuity contracts are also denied that allowance (subject to the same exceptions) by section 531.

279. This sub-paragraph does not apply in the computation of top slicing relief. The effect of this is to give equal, rather than more favourable treatment under that relief, compared to that given to policies and contracts whose underlying investment profits have borne UK tax.

280. *Sub-paragraph (4)*, however, provides that the tax relief due under section 539 for a corresponding deficiency may extend to rates other than the higher rate for such a contract. This recognises the fact that a gain on a calculation event in respect of such a contract will have been charged at the starting and lower rates as well as the higher rate (where applicable).

281. *Sub-paragraph (5)* amplifies the source legislation by providing a definition of "accounting period". The term is used in Chapter 2 of Part 13 of ICTA (see section 547(5A)(b) of ICTA) but the meaning there has to be assumed, given that the terms of reference of the definition in section 834(1) of ICTA (which refers to section 12 of that Act) do not include that Chapter as it applies for income tax purposes.

Paragraph 110: Certain pre-17th March 1998 policies: application of section 529(1)

282. This paragraph deals with a similar circumstance to that in paragraph 106 (certain pre-20th March 1985 policies: application of section 529(1)). It is based on section 553(5A) of ICTA.

283. FA 1998 introduced an exception which limits the availability of the reduction of a gain for periods of non-UK residence on the part of the policy holder (see section 528), where the policy of life assurance or capital redemption policy is held by a foreign institution (see the definition of that term in section 468(5)).

284. The paragraph reverses the exception made by section 529 if the policy was held by a foreign institution on 16 March 1998 and the policy was issued in respect of an insurance (for a policy of life insurance) or contract (for a capital redemption policy) made on or before that date.

285. As in paragraph 106 (certain pre-20th March 1985 policies: application of section 529(1)), this paragraph repairs an omission in the source legislation which would exclude a capital redemption policy from the benefit of the paragraph.

Paragraph 111: Certain pre-17th March 1998 policies not foreign policies of life insurance

286. This paragraph reflects the fact that the commencement provisions for the source legislation relevant to the paragraph (a) and paragraph (b) elements of the definition of a "foreign policy of life insurance", in section 476(3), use different dates. It is based on section 553A of ICTA.

287. *Sub-paragraph (1)* effectively states the general rule that policies issued in respect of an insurance made before 17 March 1998 are not foreign policies of life insurance unless certain conditions are met. This ensures that policies falling within the paragraph (b) element of the definition do so only if they are issued in respect of an insurance made on or after that date.

288. The sub-paragraph then identifies the conditions which disapply the basic rule. These are where policies are within the paragraph (a) element of the definition (subject to the commencement provisions in paragraph 103 (certain pre-18th November 1983 policies not foreign policies of life insurance)).

289. As was the case for paragraph 103 (certain pre-18th November 1983 policies not foreign policies of life insurance), the paragraph is based on section 553A of ICTA.

290. *Sub-paragraphs (2)* and *(3)* disapply the general rule in sub-paragraph (1) if the policy is varied in certain ways. See the commentary on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4).

Paragraph 112: Pre-17th March 1998 policy or contract: UK resident trustees

291. This paragraph reflects the commencement provisions for the source legislation, which deals with the liability of UK resident trustees. It is based on paragraph 7 of Schedule 14 to FA 1998.

292. In addition to the usual provision in *sub-paragraph (3)* defining the policies and contracts, gains from which are not to be attributed to trustees, and the usual reservation in

sub-paragraph (4) for policies and contracts subsequently varied, *sub-paragraph (1)* prescribes a date condition and a settlor condition.

Paragraph 113: Certain pre-23rd March 1999 policies not foreign capital redemption policies

293. This paragraph reflects the fact that the commencement provisions for the source legislation relevant to the paragraph (a) and paragraph (b) elements of the definition of a "foreign capital redemption policy", in section 476(3), have different dates. It is similar in approach to that in paragraph 111 (certain pre-17th March 1998 policies not foreign policies of life insurance). As was the case for paragraph 104 (certain pre-23rd February 1984 policies not foreign capital redemption policies), the paragraph is based on sections 553(10) and 553B of ICTA.

294. The paragraph sets out a general rule that policies issued in respect of an insurance made before 23 March 1999 are not foreign capital redemption policies, unless conditions are met which only affect policies within the paragraph (a) element of the definition in section 476(3). This ensures that policies falling within the paragraph (b) element of the definition do so only if they are issued in respect of a contract made on or after that date.

295. Those conditions, under which an older policy is a foreign capital redemption policy, are that the policy is within the paragraph (a) element of the definition, subject to the commencement provisions in paragraph 104 (certain pre-23rd February 1984 policies not foreign capital redemption policies).

Paragraph 114: Pre-9th April 2003 contract or policy: UK resident trustees

296. This paragraph reflects the commencement provisions for the source legislation which introduced the provision rewritten as condition C in section 467(5). It is based on section 547(4A) of ICTA.

297. *Sub-paragraphs (2)* and *(3)* define the policies and contracts, gains from which benefit from this exception to the scope of section 467, and disapply the exception in *sub-paragraph (1)* if the policy or contract is varied in certain ways. (See the commentary above on the similar provision in paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4).) These sub-paragraphs are based on paragraph 12 of Schedule 34 to FA 2003.

298. *Sub-paragraphs (3)* and *(4)* incorporate a correction to the source legislation, so that it applies in the case of a life annuity contract as it does in the case of a policy of life insurance or a capital redemption policy. Paragraph 12(4)(a) of Schedule 34 to FA 2003 finishes with the words "(any exercise of rights conferred by *the policy* being regarded for this purpose as a variation)". It should refer to *the policy or contract*.

299. No distinction between policies and contracts was intended and it is clear from the opening words of paragraph 12 of Schedule 34 to FA 2003, which refer to "A policy or contract", that both are in mind. This paragraph makes clear that, if rights conferred by a contract for a life annuity made before 9 April 2003 are exercised on or after that date, the contract is regarded as having been varied. These sub-paragraphs are based on paragraph 12 of Schedule 34 to FA 2003.

Paragraph 115: Pre-9th April 2003 contract or policy: loans to trustees

300. This paragraph reflects the commencement provisions for the source legislation which added loans to trustees to the scope of the provisions rewritten in sections 500(c) and 501. It is based on paragraph 9 of Schedule 34 to FA 2003.

Paragraph 116: Pre-9th April 2003 contract or policy: excepted group life policies

301. This paragraph is based on paragraph 4 of Schedule 34 to FA 2003. *Sub-paragraphs (1)* and *(4)* of this paragraph carry the benefit of paragraph 4(1) of Schedule 34 to FA 2003 for certain group life policies through the date (6 April 2005) from which this Act has effect. The policies in question were taken out before 9 April 2003, and would not otherwise satisfy the conditions in sections 481 and 482 for the exclusion provided by section 480, but had benefited under paragraph 4(1) of Schedule 34 to FA 2003.

302. Paragraph 4(1) of Schedule 34 to FA 2003 provided a period in which, subject to conditions, a group life policy, not satisfying the conditions in section 539A of ICTA for exclusion under section 539(2)(f) of ICTA from the scope of Chapter 2 of Part 13 of that Act, could be varied to comply with section 539A of ICTA. That paragraph also provided that such a policy, if varied, would be treated as having complied with those conditions.

303. *Sub-paragraphs (2)* and *(3)* similarly preserve the treatment of a replacement policy and the replaced policy under paragraph 4(3) of Schedule 34 to FA 2003 as a single policy, where the replacement was made to comply with section 539A of ICTA.

Paragraph 117: Pre-3rd March 2004 contract or policy: calculation of deficiencies

304. This paragraph reflects the commencement provisions for the restriction in section 541 of relief for a deficiency under section 539 by reference to gains for which the individual in question has been liable to tax. It is based on section 140 of FA 2004.

305. As is usual, the benefit of this paragraph is lost if the policy or contract is varied in certain ways after the relevant commencement date.

Paragraph 118: Pre-1st January 2005 contracts for immediate needs annuities: income tax treated as paid

306. FA 2004 placed certain annuities in a different category, for the purposes of the tax charge on insurance companies, and provided an exemption from income tax on the annuity payments (see section 725 of this Act). This paragraph ensures that any such annuities in existence at the beginning of 2005 do not, by reason of the change to the taxation rules for insurance companies, lose entitlement to the income tax allowance under section 530. It is based on section 147 of FA 2004.

Part 7: Savings and investment income: gains from contracts for life insurance etc. (personal portfolio bonds)

Overview

307. This part of this Schedule is wholly concerned with that part of the Personal Portfolio Bonds (Tax) Regulations SI 1999/1029 (abbreviated in this commentary as "PPB(T)R") which applies to policies and contracts in existence before 17 March 1998. It is based on regulation 3 of PPB(T)R. It also takes into account part of ESC B53 as it applies to such policies and contracts.

Paragraph 119: Pre-17th March 1998 contract or policy: conditions to be met for contract or policy not to be a personal portfolio bond

308. This paragraph sets out the conditions to be satisfied if such a pre-17 March 1998 policy or contract is to avoid being a personal portfolio bond. It is based on regulation 3 of PPB(T)R. The "date condition" and the "non-variation condition" are similar to the commencement provisions commonly met when the scope of the chargeable event gains regime has been amended. See the notes on those paragraphs in Part 6 of this Schedule where such similar conditions apply (for example: paragraph 96 (pre-20th March 1968 policies and contracts excluded from Chapter 9 of Part 4)).

Paragraph 120: The date condition

309. This paragraph is based on regulation 3 of PPB(T)R.

Paragraph 121: The non-variation condition

310. This paragraph is based on regulation 3 of PPB(T)R.

Paragraph 122: The first selection condition

311. A policy or contract must meet the first or second selection condition. This paragraph sets out the simpler of the two, that any index or property used to determine benefits under the policy or contract has, at all times in the period from 6 April 1994 (or from the commencement of the policy or contract, if later) to the date the policy or contract is being assessed against the conditions, fallen within permitted categories. The 1994 terminal date is a pragmatic reflection of the potential difficulty of establishing compliance with this condition in more distant periods. This paragraph is based on regulation 3 of PPB(T)R.

Paragraph 123: The second selection condition

312. This paragraph is based on regulation 3 of PPB(T)R. The second selection condition applies where a policy:

- which does not meet the first selection condition; but
- whose benefits have not in fact been determined by reference to an index or property outside the permitted categories;
- is varied by the end of the first insurance year beginning on or after 6 April 1999 to eliminate from the determination of benefits any such index or property outside the permitted categories.

313. In effect, the second selection condition provides a period of grace for a policy or contract to put itself into a comparable state to one meeting the first selection condition.

Paragraph 124: Policy holders becoming UK resident after 17th March 1998

314. This paragraph defines and may extend the period of grace in the second selection condition where the holder of the policy or contract is non-UK resident on 17 March 1998 but subsequently becomes so, although *not* then intending to become permanently UK resident or to stay at least two years. It is based on regulations 3 and 5 of PPB(T)R.

315. Where such a holder is an individual, Part 1 of ESC B53 (rewritten in part in section 465(1)) would excuse such a holder from the income tax for which that holder is liable on a gain for a tax year in which the holder is not UK resident.

316. This paragraph (which incorporates material from Part 3 of ESC B53) seeks to give a newly UK resident holder of a policy or contract time in which to make the necessary variation to the policy or contract, so as to meet the second selection condition.

317. *Sub-paragraph (2)* provides the terminal date by which the policy must be varied if it is to meet condition C of the second selection condition (see paragraph 123 (the second selection condition)).

318. As the holder does not intend to become permanently UK resident, or to stay for at least two years, the variation must be carried out before the end of the first insurance year to begin after UK residence first begins by virtue of arrival after 17 March 1998 (or the first insurance year ending on 5 April 2000 or later, where that is more beneficial). Given that residence is in strictness for a year, UK residence will begin on 6 April preceding arrival. The holder may have as little as a day or two in which to make the variation. Although ESC A11 splits income in that first year of United Kingdom residence, treating income up to the day of arrival as not chargeable, and uses similar criteria regarding a person's intentions for UK residence, it has no bearing on the operation of the rule here.

319. *Sub-paragraph (3)* further relaxes the incidence of the special personal portfolio bond charge where a policy or contract meets the second selection condition (and otherwise meets the terms of paragraph 119) by virtue of the extended period of grace given by the modification of the second selection condition (see paragraph 123 (the second selection condition)).

320. Until the required variation is made, and the second selection condition is met, the policy or contract may be a personal portfolio bond. An insurance year may end after the relevant date and before the variation is made, so triggering a gain under section 525 if there has been a chargeable event in that year.

321. This sub-paragraph sets aside that gain, so that no chargeable event under section 525 occurs, and no-one is liable under sections 465 to 468. If need be, corrective action will be taken under the Self Assessment system to negate any assessment made before the variation took effect.

322. See *Change 157* in Annex 1.

Paragraph 125: Policy holders becoming permanently UK resident after 17th March 1998

323. This paragraph performs the same function as the preceding paragraph, with the difference that it deals with policyholders who intend to become permanently UK resident or to stay at least two years. It is based on regulation 3 of PPB(T)R.

324. The effect of that difference of intention shows up in *sub-paragraph (2)(b)*. The terminal date by which the policy must be varied if it is to meet condition C of the second selection condition is reckoned from the policy year beginning after the relevant date of arrival in the United Kingdom, rather than that beginning after the commencement of UK residence. The holder will therefore have at least 12 months from arrival, perhaps nearly two years, in which to effect the necessary variation.

325. *Sub-paragraph (3)* has the same effect as the equivalent sub-paragraph in paragraph 124 (policy holders becoming UK resident after 17th March 1998), but with effect over a longer period.

326. See *Change 157* in Annex 1.

Paragraph 126: Meaning of "permitted index"

327. This paragraph is based on regulation 3 of PPB(T)R.

Paragraph 127: Meaning of "permitted property"

328. This paragraph is based on regulation 3 of PPB(T)R.

329. It extends the categories of permitted property, for the purposes of paragraphs 122 and 123 (the first and second selection conditions), beyond those listed in section 520. The added categories are all stocks and shares listed or dealt with in open markets after the beginning of the period mentioned in those paragraphs. (The Alternative Investment Market succeeded the Unlisted Securities Market.)

330. *Sub-paragraph (2)* puts a cap on stocks and shares listed on those markets which are not a recognised stock exchange, where the investment in the company exceeds 10% of:

- the issued share capital of the company; or
- the total amount of premiums paid under the policy or contract.

331. The reference to "the total amount of premiums paid" in sub-paragraph (2)(b) is to be construed in accordance with the definitions in section 545.

Paragraph 128: Other definitions

332. This paragraph is based on regulations 2 and 3 of PPB(T)R.

Part 8: Miscellaneous income

Paragraph 132: Income treated as income of settlor: exception for pension income

333. Section 627 excludes benefits from relevant pension schemes from being treated as the settlor's income under section 624. The exclusion for "relevant pension scheme" in subsection (3) of that section apply for the tax year 2006-07 onwards. This paragraph gives the rules that apply for the tax year 2005-06 and represents a rewrite of section 660A(11) of ICTA as it stands before the amendments made by FA 2004.

334. Subsection (3)(g) of section 627 refers to regulations made under the Welfare Reform and Pensions Act 1999 and its Northern Ireland equivalent although section 660A(11)(g) of ICTA simply refers to regulations made by the Secretary of State. See *Change 105* in Annex 1.

335. *Subparagraph (4)* attracts the consequential and transitional powers for pensions in FA 2004 to the rewrite of those provisions in this Act.

Paragraph 133: Amounts treated as income of settlor: income paid to unmarried minor child of settlor

336. Section 64 of FA 1999 amended section 660B of ICTA principally to enable a charge on the settlor to be made where a settlor's minor child benefited from a bare trust arrangement. The income arising in the trust did not have to be paid to or for the benefit of the child for a charge on the settlor to arise. It was simply sufficient for the income to be treated as the child's income. The new provision applied only where the settlement was made or entered into after 8 March 1999 or, if it was not, to income that arose from funds provided

after that date. This paragraph enables the pre-amendment legislation to apply to pre-March 1999 settlements.

337. *Sub-paragraph (3)* applies instead of *sub-paragraph (2)* where the income paid to the minor child is partly from pre-March 1999 funds and partly other funds, such as where there has been an injection of funds into the settlement after 9 March 1999.

Paragraph 134: Amounts treated as income of settlor: capital sums paid to settlor by trustees of settlement

338. This paragraph applies where it is necessary to consider years before 1995-96 in applying the charge under section 633.

339. Section 677(2) of ICTA excludes from income available to cover capital payments made to a settlor income within the settlement that has already been treated as the settlor's. Section 677(2) of ICTA is rewritten in section 635. *Sub-paragraphs (2)* and *(3)* rewrite the categories in section 677(2) of ICTA that only apply in respect of income arising under a settlement before the tax year 1995-96 but which may still have effect when calculating the income available up to the end of a tax year for the purposes of section 633.

340. *Sub-paragraph (5).* This saving may still have application where the direction or assignment precedes by some years the capital payment. (Capital payments are no longer charged after 11 years or 16 years if made through a company associated with the settlement. See sections 633 and 643).

Part 9: Exempt income

Paragraph 143: Purchased life annuity payments: old determinations concerning capital elements

341. This paragraph ensures that determinations as to the capital element of a purchased life annuity made before 6 April 2005 translate into exempt amounts for the purposes of Chapter 7 of Part 6 of this Act so that the determination continues to have effect after 6 April 2005.

Paragraph 144: Purchased life annuity payments: carry forward of excess capital elements

342. If the amount of an annuity payment is less than the capital element calculated under the constant sum method in section 656(2) of ICTA, ESC A46 allows the excess of the capital element over the gross annuity to be carried forward to increase the capital element to be set against the next annuity payment. Section 719(5) of this Act gives statutory effect to that concession. This paragraph enables such excesses that were not absorbed by annuity payments made before the tax year 2004-05 to be carried forward by increasing the exempt amount of the first payment made after 5 April 2005. See *Change 119*.

Paragraph 145: Purchased life annuity payments: penalty for false statements

343. This paragraph makes clear that it is the date of the statement or representation which determines which penalty provision applies.

Paragraph 146: Certain annual payments by individuals

344. Sections 727 and 730 of this Act provide exemption from income tax in respect of certain annual payments. They are based on section 347A of ICTA. Section 347A of ICTA applies to all payments falling due on or after 6 April 2000 and also to certain payments

falling due before that date but on or after 16 March 1988. Although unlikely, it is possible for payments to fall due at a time when section 347A of ICTA did not apply but to be paid after 6 April 2005. The transitional provision determines whether the exemptions apply.

Paragraph 147: Annuity payments for non-taxable consideration

345. A payment made by an individual is not exempt from income tax in the recipient's hands under section 729 of this Act if the payment is made for non-taxable consideration unless either condition B or C in that section is satisfied. This paragraph adds a further condition which, if satisfied, renders the payment exempt in the recipient's hands.

Paragraph 148: Periodical payments of personal injury damages etc.

346. Sections 731 and 732 provide exemptions from income tax for periodical payments in respect of damages for personal injury and annuity payments under annuities purchased under an award made under the Criminal Injuries Compensation Scheme. They are based on sections 329AA and 329AB of ICTA as amended by section 100(2) of the Courts Act 2003. Section 100(2) of the Courts Act 2003 was not in force when the Bill was introduced into Parliament. But sections 731 and 732 were rewritten on the assumption that on enactment of this Act, section 100(2) of the Courts Act 2003 would be in force. The transitional provision was added to ensure that the pre-Courts Act 2003 version of the legislation in ICTA continued in effect until such time as section 100(2) of the Courts Act 2003 was brought into effect.

Part 11: Foreign income: special rules

Paragraph 150: Relevant foreign income charged on remittance basis: income arising before the tax year 2005-06

347. This paragraph ensures that Chapter 2 of Part 8 of this Act is not restricted in its operation to income that arose after the tax year 2004-05 (whenever the earlier income is remitted).

Paragraph 151: Relevant foreign income charged on remittance basis: delayed remittances

348. This paragraph is based on section 585 of ICTA. It ensures that the relief given by section 835 is not restricted to income that arose after the tax year 2004-05. It also preserves the rules in section 585(4) and (5) for tax years before 1997-98 (that is, years before Self Assessment came into effect) when the basis period for many charges was a period other than the current tax year.

Paragraph 152: Relief for back-dated pensions charged on arising basis

349. This paragraph ensures that the relief given by section 840 is not restricted to income that arose after the tax year 2004-05. See *Change 139* in Annex 1.

Paragraph 153: Unremittable income that arose before the tax year 2005-06

350. This paragraph ensures that the relief given by Chapter 4 of Part 8 of this Act, and any withdrawal of that relief by virtue of sections 843 or 844, is not restricted to income that arose after the tax year 2004-05 or, as regards withdrawal of relief, to claims under that Chapter.

351. The paragraph also preserves access to the jurisdiction of the Special Commissioners on an appeal involving the application of Chapter 4 of Part 8 of this Act (and of section 584

of ICTA, which that Chapter rewrites), where income arising in a year before the tax year 2005-06 is material to the appeal. This sub-paragraph is based on section 584(9) of ICTA. See *Change 142* in Annex 1.

Part 12: Other provisions

Paragraph 158: Apportionment of profits or losses to tax years before tax year 2005-06

352. Section 871 applies to various sources of income that are taxed under Schedule D Case VI in the source legislation. It rewrites section 72 of ICTA which allows the profits of a period of account to be apportioned.

353. The basis of assessment for income taxed under Schedule D Case VI is the full amount of the profit arising in the tax year. This is rewritten in the income charged sections for each source of income to which section 871 applies. If accounts are prepared for any of these sources it may be necessary to apportion the profits of accounts made up to a period other than the tax year to arrive at the figure of profit that arises in the tax year.

354. Section 883 provides that the Act takes effect for income tax purposes for the tax year 2005-06. This paragraph provides that the rewritten legislation applies to a period of account that straddles 6 April 2005 even though tax years earlier than 2005-06 will be affected. This Act includes a number of minor changes in the law. Without this paragraph it would be necessary for taxpayers to take account of those changes only for the tax year 2005-06.

355. If the taxpayer does not want the new law to apply to a transaction that occurred before 6 April 2005 he or she can elect for the old legislation to continue to apply.

Paragraph 159: General deduction rules

356. This paragraph reflects the fact that in certain sections detailed rules have been provided for the calculation of amounts charged to tax but similar rules have not been spelled out at other places where those rules may apply. Those detailed rules in part reflect the interpretation of the source legislation in case law. This paragraph ensures that the absence of the provision of detailed rules at any point does not prejudice the continued application of existing rules for the meaning of words such as "the full amount of the income".

Schedule 3: Repeals and revocations

357. This Schedule contains repeals and revocations of enactments including some spent enactments.

Schedule 4: Abbreviations and defined expressions

Part 1: Abbreviations of Acts

358. Part 1 provides a list of abbreviations used in referring to other Acts.

Part 2: Index of expressions defined in this Act etc.

359. Part 2 lists expressions defined in this Act or in other Acts.

COMMENCEMENT

360. The substantive provisions of this Act will come into force on 6 April 2005. Section 883 provides for it to have effect:

- for the purposes of income tax, for the year 2005-06 and subsequent tax years; and

- for the purposes of corporation tax for accounting periods ending after 5 April 2005.

HANSARD REFERENCES

361. The following table sets out the dates and Hansard references for each stage of this Act's passage through Parliament.

Stage	**Date**	**Hansard reference**
House of Commons		
Introduction	30 November 2004	Vol. 428 Col 513
Second Reading Committee	14 December 2004	
Second Reading (formal)	20 December 2004	Vol. 428 Col 2037
Third Reading	7 March 2005	Vol. 431 Cols 1289 - 1292
House of Lords		
Introduction	8 March 2005	Vol. 670 Col 627
Second and third readings	23 March 2005	Vol. 671 Cols 324 - 335

Royal Assent – 24 March 2005	House of Lords Hansard Vol. 671 Col 412 House of Commons Hansard Vol. 432 Col 1036

Annex 1: Minor changes in the law made by the Act

Change 1: Income taxed as trade profits: omit the words "immediately derived from" in the identification of the foreign income to which the trade profit rules apply: section 7

This change omits the words "immediately derived from" in the identification of the foreign income to which the trade profit rules apply.

Section 65(3) of ICTA deals with the calculation "under Case IV or V of Schedule D" of profits "immediately derived … from the carrying on … of any trade …". Those words date from FA 1907.

For trading income generally, this Act refers simply to the profits of a trade.

The change brings the rules for calculating all foreign trade profits (whether "immediately derived" or not) into line with the rules for calculating trade profits within Schedule D Case I. It is in line with the general approach of the source legislation in applying the same calculation rules to foreign and United Kingdom trades.

In the case of foreign trade profits that are not immediately derived from the carrying on of a trade, the income will be calculated in accordance with the trade profit rules, instead of being "computed on the full amount of the income arising" as in section 65(1) of ICTA. There is unlikely to be any practical difference.

If the foreign trade profits that are not immediately derived from the carrying on of a trade are profits of an overseas property business the profits will instead be charged as trade profits.

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 2: Profits of mines, quarries and other concerns: section 12

This change identifies three consequences of the approach taken to the rewrite of section 55 of ICTA.

Section 55 of ICTA provides that profits arising out of land in the case of certain listed concerns shall be charged to tax under Schedule D Case I. The concerns listed include mines, quarries, railways and canals.

Section 55 of ICTA is rewritten as section 12. It treats the profits and losses of the concern as if they were the profits or losses of a trade. This has three consequences.

(A) Section 55 of ICTA does not specify how the profits to be taxed under Schedule D Case I are to be calculated. Treating the profits and losses of the concern as if they were the profits or losses of a trade makes clear that the profits are calculated in the same way as trade profits. This means that the calculation rules in Part 2 of this Act will apply. In particular the starting point for the calculation of the profits is generally accepted accounting practice.

(B) Section 55 of ICTA does not identify what profits are to be taxed for the tax year. In practice many taxpayers use the profits of the basis period. Treating the profits of the concern as if they were profits of a trade gives this practice statutory effect. A taxpayer who, under the law as it applies before the commemcement of this Act, returns the profits of the tax year can retain this treatment by adopting a 5 April accounting date.

(C) Section 55 of ICTA refers only to profits. In practice loss relief is allowed for losses of concerns as if they were trade losses. Section 12(1) gives that practice statutory effect by referring to both the profits and losses of the concern.

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 3: Caravan sites where trade carried on: section 20

This change gives statutory effect to ESC B29 (caravan sites where there is both trading and letting income).

ESC B29 states:

> Where the proprietor of a caravan site carries on material activities associated with the operation of that site which constitute trading, there may be included as receipts of that trade any site income from the letting of pitches for static or touring caravans, and any income from letting caravans where the letting does not of itself amount to a trade.

The concession was introduced in 1984 along with the legislation subsequently consolidated in sections 503 and 504 of ICTA under which the letting of furnished holiday accommodation which does not amount to a trade is treated as a trade for certain purposes.

ESC B29 puts operators of caravan sites which include an element of trading into the same position as persons running furnished holiday letting businesses. In practice there is an element of trade, such as the operation of a site shop or the provision of leisure facilities such as a café, included in the operation of most caravan sites.

This change gives taxpayers who meet the qualifying conditions a statutory right to treat receipts from letting caravans or pitches as receipts of the trade of operating a caravan site.

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 4: Surplus business accommodation: section 21

This change gives statutory effect to the Inland Revenue practice on receipts from surplus business accommodation known as Revenue Decision 9.

The case of Salisbury House Estate Ltd v Fry (1930), 15 TC 266 HL is authority for the proposition that the income tax Schedules are mutually exclusive so any amount received by a trader from the letting of premises surplus to the requirements of the trade should not be taken into account in calculating the profits of the trade but assessed separately to tax as income from property under Schedule A. Similarly, any outgoings in respect of the premises should be apportioned between the part which is let and the part used for the purposes of the trade.

In practice, the Inland Revenue does not object to a trader including receipts from letting surplus business accommodation in trade receipts provided certain conditions are met. This practice, published in the February 1994 edition of Tax Bulletin under the heading “Revenue Decisions - Schedule D Cases I and II – Letting Surplus Business Accommodation”, is referred to in some in some reference books as Revenue Decision 9. The practice extends to trades within Schedule D Case V.

The conditions in Revenue Decision 9 are:

- the accommodation is temporarily surplus to the current requirements of the trade;
- part of the accommodation is used for trade purposes;
- the rental income is comparatively small; and
- the rent is in respect of the letting of surplus business accommodation only - not surplus land.

In legislating the conditions in Revenue Decision 9, section 21 sets out rules for determining whether accommodation is temporarily surplus to requirements. These are:

- that the accommodation must have been used for the purposes of the trade within the last three years (or acquired within that period);
- that the accommodation must be let for a term of not more than three years; and
- that the trader must intend to use the accommodation for trade purposes at a later date.

This gives taxpayers increased certainty as to whether the condition is met.

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: Rents in respect of wayleaves where associated with a trade: sections 22 and 344

This change shifts the charge on rents from certain wayleaves associated with a trade from Schedule D Case V and Case VI to a charge on trade profits.

Section 120 of ICTA makes provision about rent payable in respect of "any easement enjoyed in the United Kingdom in connection with any electric, telegraphic or telephonic wire or cable" other than an easement of a kind mentioned in section 119(1) of ICTA. Section 119 of ICTA applies to certain easements which are or might be used or enjoyed in connection with any of the concerns listed in section 55 of ICTA. Those concerns include mines, quarries, certain industrial concerns, canals, docks, markets, bridges, ferries, and railways. "Rent" and "easement" both have wide meanings for this purpose (see section 119(3) of ICTA).

Section 120(1) of ICTA provides for the rent from electric-line easements to be charged under Schedule D unless other income from the land to which the easement relates is charged under Schedule A. In that case the rent is charged to tax under Schedule A, section 120(1A) of ICTA.

Section 120(1) of ICTA does not specify under which Case of Schedule D the rent is to be charged. In practice, where the easement relates to land on which a person carries on a trade, the rent is charged under Case I of Schedule D and, in other cases, under Case VI. In the absence of section 120 of ICTA the rent would be charged to tax under Schedule A. Section 120 of ICTA does not apply to rent from easements relating to land outside the United Kingdom, which is charged to tax under Schedule D Case V.

Section 120(1) of ICTA as it applies to trades is rewritten in section 22. Under section 22:

- the word "easement" is rewritten as "wayleave". The rest of this note refers to wayleaves;

- rents from wayleaves related to land associated with a trade will be charged to income tax under Part 2 of this Act (as profits of the trade) if the taxpayer so chooses and has no other income from the land in question; and
- all other rents from wayleaves will be charged to income tax under Part 3 of this Act (property income).

This enacts the existing non-statutory practice for easements to which section 120 of ICTA applies which are associated with a trade but represents a change both in practice and in the law as respects:

- wayleaves other than those connected with "electric, telegraphic or telephonic wire or cable";
- wayleaves relating to land outside the United Kingdom; and
- wayleaves of a kind mentioned in section 119(1) of ICTA.

Section 22 applies the same treatment to land occupied for the purposes of a profession or vocation. It also makes clear that any expenses incurred in respect of the wayleave can also be allowed as deductions in calculating the profits.

Section 119(1) of ICTA is rewritten as Chapter 8 of Part 3 of this Act. Under the law as it applies before the commencement of this Act, rent in respect of a wayleave that meets the conditions in both sections 119(1) and 120(1) of ICTA is taxed under section 119 of ICTA. Section 262(2) of this Act reverses that order of priority. This is necessary to allow the taxpayer to have such rent taxed as the profits of a trade. It will not prevent a claim for relief under section 340 of this Act as rent for an electric-line wayleave would not qualify for such relief.

All rents that are in practice charged to tax under Schedule D Case VI by virtue of section 120(1) of ICTA, as that section applies before the commencement of this Act, will be charged under section 344 (charge to tax on rent receivable for a UK electric-line wayleave).

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 6: Relationship between rules prohibiting deductions and rules allowing deductions: sections 31 and 274

This change resolves any conflict between the rules prohibiting a deduction in calculating trade profits and the rules allowing a deduction in calculating trade profits in favour of the rule allowing the deduction. But any conflict is unlikely.

Part 2 of this Act sets out a number of rules that restrict the deductions allowed in the calculation of trade profits. Each of these is a "prohibitive rule". Sections 34 and 35 are prohibitive rules of general application. The other restrictions apply in more closely defined circumstances.

Part 2 of this Act also sets out a number of rules that allow deductions in the calculation of trade profits. Most of these rules are in Chapter 5 of Part 2 of this Act. Each of these is a "permissive rule".

In some cases the source legislation for a permissive rule overrides a specific prohibitive rule. See, for example, section 112 of FA 1989 rewritten as section 82 which overrides section

74(1)(a) and (b) of ICTA. In other cases the source legislation provides that a deduction is allowed "notwithstanding anything in section 74 [of ICTA]". Such a form of words overrides all the restrictive rules in section 74 of ICTA. See, for example, section 82A of ICTA rewritten as section 88. In other cases the source legislation says merely that a deduction is allowed. See, for example, section 77 of ICTA (incidental costs of loan finance) rewritten as section 59.

If the source legislation makes clear that a permissive rule overrides a specific prohibitive rule that limitation is included in the rewrite of the permissive rule. See, for example, section 82 (personal security expenses). In other cases section 31 makes clear that the permissive rule has priority over any prohibitive rule with two exceptions. The exceptions are the restriction on crime-related expenditure and the restriction on the costs of hiring a car or motor cycle.

In the case of crime-related expenditure the order of priority reflects the view that in enacting section 577A of ICTA Parliament intended that there should be no circumstances in which anyone should obtain a tax deduction by making a crime related payment.

In the case of car and motor cycle hire section 578A of ICTA makes clear that the provision restricts the amount of any deduction.

The order of priority given by section 31 will be relevant only if the expenditure is capable of falling within both a permissive rule and a prohibitive rule. This is most likely to happen in the case of one or both of the general restrictions in sections 34 and 35. In these cases the source legislation leaves no uncertainty about the extent to which the prohibitive rule is overridden. The only area of uncertainty is where the restriction is imposed by a provision other than section 74 of ICTA. For example, the restriction that section 577 of ICTA imposes on business expenditure.

It is unlikely there is scope for overlap between a specific permissive rule and a specific prohibitive rule. This is because the terms for either rule to apply are so closely defined. As a question of fact the expenditure will fall into one category or the other. But in the event of any overlap section 31 changes the law by giving priority to the permissive rule.

For example, it is unlikely that expenditure that meets the conditions for section 83 of ICTA (patent fees etc) to apply would also be business expenditure disallowed by section 577 of ICTA. If it does the source legislation is silent on which rule takes priority. Section 31 gives priority to the permissive rule.

Section 274 applies the same order of priority to the profits of a property business.

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 7: Align rules for debts proving irrecoverable after trade deemed to have ceased with general rules for bad and doubtful debts: section 35

This change aligns the relief given for bad debts by section 89 of ICTA with the relief given by section 74(1)(j) of ICTA.

Section 113(1) of ICTA provides that where there is a complete change in the persons carrying on a trade the trade is deemed to cease and recommence. (Before Self Assessment the trade was also deemed to cease and recommence on a partial partnership change, unless the partners elected otherwise.)

Section 89 of ICTA provides relief for bad debts where there has been a change in the persons carrying on the trade and the trade is deemed to cease under section 113 of ICTA. It gives relief for bad debts which meet certain conditions and which are assigned to the successor to the trade. Since the trade carried on prior to the change is deemed to be different from the trade carried on after the change section 74(1)(e) of ICTA would otherwise prohibit a deduction for bad debts. The desired effect is to treat the trade as continuing as far as bad debts are concerned.

Although the aim of section 89 of ICTA is the same as that of section 74(1)(j) of ICTA (that is, to give relief for bad trade debts), there are significant differences between the two sections and the nature of the relief given. Specifically:

- section 89 gives relief for debts which are "irrecoverable", whereas section 74(1)(j) gives relief for debts which are bad or doubtful;
- the requirement for proof that a debt is bad or doubtful in section 74(1)(j) was removed by FA 1996 to assist in the introduction of Self Assessment; section 89 still has this;
- relief in section 89 is specifically related to the period in which the debt becomes in whole or in part irrecoverable; section 74 is silent on this;
- section 74(1)(j) refers to debts released as part of a "relevant arrangement or compromise"; section 89 makes no mention of this; and
- section 89 does not make specific reference to the bankruptcy or insolvency of debtors; this is referred to in section 74(1)(j)(iii).

This Act does not rewrite section 89 of ICTA. Section 89 of ICTA is not needed because the approach adopted in this Act is to focus on the person carrying on the trade rather than the trade. The effect is to extend the more generous provisions of section 74(1)(j) of ICTA to debts within section 89 of ICTA. This simplifies the law by bringing the bad debt relief provisions for income tax payers into one section.

This change is in taxpayers' favour in principle and may in practice benefit some. But the numbers affected and the amounts involved are likely to be small.

Change 8: Unpaid remuneration of employees: payment made after return submitted but within 9 months of the end of the period of account: sections 37 and 865

This change drops the requirement to make a claim for a deduction for remuneration paid after the return is submitted but within nine months of the end of the period of account in which it is charged.

Section 43(5) of FA 1989 deals with profit calculations made within nine months of the end of the period of account. Paragraph (a) requires the assumption that any remuneration unpaid at the time of the calculation will not be paid by the end of that nine month period. That means the proposed remuneration cannot be deducted in making the calculation. Paragraph (b) provides an adjustment procedure that applies when the remuneration is paid after the calculation is made but before the end of the nine month period. If a claim is made within two years of the end of the period of account the calculation may be adjusted.

This change brings the adjustment procedure into line with the normal Self Assessment rules and deals with the adjustment as an amendment to a return. Section 9ZA(2) of TMA sets a time limit for making such amendments. It is 12 months from the filing date for the relevant return.

The change alters the time available for making the adjustment from two years after the end of the period of account in every case to a date that depends on when the accounting date falls in the tax year. To be within the scope of the provision the taxpayer must submit his or her return within nine months of the end of the period of account.

In the normal case of a continuing trade and a return issued on 6 April the earliest date to which accounts can be prepared and meet this condition is 6 July in the previous calendar year. In principle the change gives taxpayers seven months extra to include the deduction in their self-assessment. The latest date to which accounts can be prepared and meet the condition is 5 April. In principle the change then gives taxpayers two months less to include the deduction in their self-assessment. In practice the return will usually be submitted at a time when it is known whether or not the remuneration has been paid within nine months of the period of accounts.

In the case of a new trade the time limit may be shorter if the period of account ends after a tax year for which it provides the basis period.

Example

A new trader makes up his or her accounts for the calendar year to 31 December 2006. These accounts form the basis period for the tax year 2005-06. If the return is issued on 6 April 2006 the latest date for amending the return is 31 January 2008. This is 11 months before the date allowed by section 43(5) of FA 1989.

This change puts the method of allowing relief on the same basis as that in paragraph 6 of Schedule 24 to FA 2003 rewritten as section 43. Schedule 24 to FA 2003 is a similar provision to section 43 of FA 1989. It denies a deduction for amounts charged in respect of employee benefit contributions unless the benefits are provided within nine months of the end of the period in respect of which they are charged.

Paragraph 6 of Schedule 24 to FA 2003 deals with the case in which the return is made before the end of the nine month period. Unlike section 43(5) of FA 1989 it does not require a claim. It provides merely that the calculation can be adjusted. This is the most appropriate way of dealing with the point under Self Assessment.

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 9: Exceptions to the rule restricting deductions for business gifts: section 47

This change provides for the monetary limit on the cost of gifts excluded from the general rule prohibiting deduction for expenses incurred in providing gifts in section 45 to be increased by Treasury order.

Section 47(3) is based on section 577(8)(b) of ICTA. The £50 limit in section 577(8)(b) of ICTA (previously £10) was inserted with effect from 2001-02 by section 73 of FA 2001 in line with an increase in the corresponding VAT provision made by Treasury order.

Section 577(8)(b) of ICTA was rewritten as it applied to employees in section 358(3)(b) of ITEPA. Section 716(2) of ITEPA provides that the Treasury may by order increase, or further increase, the sum specified in various provisions in ITEPA including section 358(3)(b) of ITEPA. Incorporating a similar provision in section 47 allows the limit to be increased in line with the corresponding limits in ITEPA and in the VAT provisions by Treasury order rather than by primary legislation.

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 10: Car hire: release of debt after debtor has ceased trading: section 48

This change reduces the amount charged as a post-cessation receipt when a debt relating to the hire of a car with a new retail value of more than £12,000 is released after the debtor has ceased trading.

Section 578A of ICTA restricts the amount which a person carrying on a trade can deduct in respect of the cost of hiring a car with a retail value, when new, of more than £12,000. The restriction takes the form of a reduction calculated by reference to the difference between the £12,000 ceiling and the retail price.

Section 578A(4) of ICTA provides that where there is a rebate of a hire charge, or a debt to which section 94 of ICTA applies is released, the amount brought into account in respect of the rebate or release is reduced in the same proportion as that in which the trading deduction was restricted.

Section 578A(4) of ICTA deals only with a continuing trade. This change extends the same treatment to debts wholly or partly released after the debtor has ceased to trade and taxed as post-cessation receipts under section 103(4) 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 11: Car hire: hire agreements without option to purchase: section 49

This change extends the definition of "qualifying hire car" for the purpose of the restriction on the amount allowed as a deduction for the cost of hiring a car to include cars hired under a hire purchase agreement where there is no option to purchase.

Section 578A of ICTA restricts the amount which a person carrying on a trade can deduct in respect of the cost of hiring a car with a retail value, when new, of more than £12,000. Section 578A of ICTA does not apply to a car which is a "qualifying hire car" as defined in section 578B(2) of ICTA.

Section 578B(2) of ICTA defines a "qualifying hire car" as a car which is:

> (a)… hired under a hire-purchase agreement … under which there is an option to purchase exercisable on the payment of a sum equal to not more than 1 per cent. of the retail price of the car when new, or
>
> (b)… a qualifying hire car for the purposes of Part 2 of the Capital Allowances Act (under section 82)…

The definition of "qualifying hire car" in section 578B(2) of ICTA does not extend to cars hired under a hire purchase agreement where there is no option to purchase. In practice, the Inland Revenue does not apply the restriction in section 578A of ICTA to cars hired under such agreements. This section legislates that practice by including cars hired under a hire-

purchase agreement where there is no option to purchase in the definition of hire car in subsection (2)(a).

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: Trade profits: exclusion of double relief for interest: final variation of claim: section 52

This change makes clear when a claim under section 353 of ICTA is finally determined for the purposes of rewriting 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 trade profits. Section 368(4) of ICTA provides that a trade deduction is not allowed if relief has been given under section 353 of ICTA.

Section 368(4) of ICTA is subject to section 368(6) of ICTA. That subsection provides that the references to relief given or a deduction allowed refer to relief given or a deduction allowed on a claim or in an assessment that has been finally determined.

The term "finally determined" does not fit well with Self Assessment. Section 52(5) makes clear that it means when the claim can no longer be varied. This wording is based on section 43C(4) of TMA.

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 13: Deduction for tenant under taxed lease if land is outside the United Kingdom: sections 60 and 64

This change makes the relief available to tenants under taxed leases of land in the United Kingdom used in connection with a trade, profession or vocation available where the land is outside the United Kingdom.

Section 34 of ICTA provides that if a premium is, or certain other amounts are, payable in respect of a lease, the landlord is treated as receiving an amount by way of rent. If the premium or other amount is due to a person other than the landlord, generally that person is treated as receiving income in consequence of entering a transaction within Schedule A. Section 35 of ICTA treats a person who assigns at a profit a lease which has been granted at an undervalue as receiving income in consequence of entering into a transaction within Schedule A.

Section 65A(5) of ICTA provides that:

> the income from an overseas property business shall be computed for the purposes of Case V of Schedule D in accordance with the rules applicable to the computation of the profits of a Schedule A business.

So if the lease is of land outside the United Kingdom, sections 34 and 35 of ICTA apply by virtue of section 65A(5) of ICTA. The amount which would be treated as income of a Schedule A business in the case of land in the United Kingdom is treated instead as income of an overseas property business.

Section 87(1) and (2) of ICTA provide that if land in relation to which an "amount chargeable" arose is occupied or otherwise used for the purposes of the tenant's trade,

profession or vocation, the tenant is treated in computing his or her profits as paying rent in respect of the land.

Section 87(1) of ICTA defines "the amount chargeable" as:

> (a) any amount [that] falls to be treated as a receipt of a Schedule A business by virtue of section 34 or 35, or
>
> (b) any amount [that] would fall to be so treated but for the operation of section 37(2) or (3).

Section 87(1) and (2) of ICTA are rewritten in sections 60 and 61. The "amount chargeable" on the landlord is referred to in those sections as the "taxed receipt".

Section 65A(5) of ICTA provides that income from an overseas property business is computed for the purposes of Schedule D Case V in accordance with the rules applicable to the calculation of the profits of a Schedule A business. But section 65A of ICTA does not deem Schedule D Case V income to be income of a Schedule A business. So a receipt which falls to be taxed under Schedule D Case V by virtue of section 34 or 35 of ICTA as applied by section 65A of ICTA is not an amount which falls to be treated as "a receipt of a Schedule A business" and is not therefore within section 87(1) of ICTA.

This means that if a tenant occupies land outside the United Kingdom under a lease in respect of which the landlord has been taxed under Schedule D Case V by virtue of section 34 or 35 of ICTA as applied by section 65A(5) of ICTA, the tenant is not entitled to relief in circumstances in which he or she would have been entitled to relief under section 87(2) of ICTA if the land had been in the United Kingdom.

Section 60 applies to land wherever it is situated and to taxed receipts brought into account in calculating the profits of an overseas property business as well as a UK property business. Section 64 limits the expenses a tenant is treated as incurring under section 61 where there is a reduction under Chapter 4 of Part 3 of this Act in a receipt of an overseas property business as well as where there is a reduction in a receipt of a UK property business.

This change will result in a tenant receiving relief by reference to a taxed receipt in respect of land outside the United Kingdom in circumstances where, under the law as it applies before the commencement of this Act, there is no entitlement to relief. But this may, in certain circumstances, reduce the amount of relief subsequently available by reference to the taxed receipt under Chapter 4 of Part 3 of this Act.

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 14: Requiring an apportionment to be just and reasonable: sections 61, 65, 78, 93, 289, 294, 316, 471, 472, 645, 719 and 722

This change requires any apportionment that is not required by the source legislation to be made on a just and reasonable basis to be made on such a basis.

In some cases where there is an apportionment under legislation rewritten in this Act, the apportionment is required by the source legislation to be made on a just and reasonable basis. In other cases, it is required to be made only on a just basis or only on a reasonable basis, or there are no requirements. In new tax legislation it is now the practice to require an apportionment to be just and reasonable. For example, before it was replaced by ITEPA, section 140B(4) of ICTA (inserted by FA 1998) required a just and reasonable apportionment to be made of any consideration given partly in respect of one thing and partly in respect of

another. 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, where an apportionment under legislation rewritten in this Act is not required to be made on a just and reasonable basis, the rewritten provision requires the apportionment to be made on a just and reasonable basis. The changes are as follows:

- section 87(3) of ICTA (apportionment of deemed rent attributable to part of land not occupied for the purposes of a trade, profession or vocation required to be just) (see section 61(5));
- section 87(5) of ICTA, which applies section 37(6) of ICTA (amount chargeable on the superior interest to be proportionately adjusted between parts of premises; no requirements as to the basis on which the adjustment is to be made) (see section 65(6));
- section 579(5) of ICTA (apportionment of a redundancy payment where the employee is employed in different capacities; no requirements as to the basis on which the apportionment is to be made) (see section 78(2));
- sections 80(4) and (8) and 81(5) of ICTA (apportionment of expenses between foreign trades required to be made on a reasonable basis) (see section 93(2), (3) and (5));
- section 37(3) of ICTA (apportionment of appropriate fraction of the amount chargeable on the superior interest attributable to a part of premises required to be just) (see section 289(3));
- section 37(6) of ICTA (amount chargeable on the superior interest to be proportionately adjusted between parts of premises; no requirements as to the basis on which the adjustment is to be made) (see section 294(6));
- section 30(2)(a) of ICTA (apportionment of deemed payment in respect of expenditure on sea walls, as may be just) (see section 316(2));
- section 547A(12) of ICTA (non-fractional interest in the rights conferred by a policy or contract treated as if it were such a share in the rights as may justly and reasonably be regarded as representing the interest) (see section 471(7));
- section 547A(7) of ICTA (apportionment of any property that represents property provided for the purpose of a trust and other property required to be just) (see section 472(4));
- section 660E(5) of ICTA (apportionment of any property that represents both property provided by the settlor and other property required to be just) (see section 645(1));
- section 656(3) of ICTA (in the case of certain purchased life annuities, the proportion which the capital element in any annuity payment bears to the total amount of the payment is in certain circumstances to be such as may be just, having regard to certain factors) (see section 719(8)); and
- section 656(4) of ICTA (apportionment of consideration given in connection with the grant of an annuity required to be just) (see section 722(3) and (4)).

This change makes minor amendments to a number of existing rules, but is expected to have no practical effect as it is in line with current practice.

Change 15: Restrictions on expenses under sections 61 and 292: sections 64, 65, 293 and 294

This change clarifies how expenses that a tenant is treated as incurring by reference to a taxed receipt under sections 61 or 292 are affected in cases in which there is a reduction under section 288 by reference to the taxed receipt in calculating the amount of a receipt.

Section 37(4) of ICTA provides:

> Subject to subsection (5) below, the person for the time being entitled to the head lease shall be treated for the purpose, in computing the profits of a Schedule A business, of making deductions in respect of the disbursements and expenses of that business as paying rent for those premises (in addition to any actual rent), becoming due from day to day, during any part of the period in respect of which the amount chargeable on the superior interest arose for which he was entitled to the head lease, and, in all, bearing to that amount the same proportion as that part of the period bears to the whole.

Section 37(4) of ICTA is rewritten in sections 291 and 292.

Section 37(5) of ICTA modifies section 37(4) of ICTA, if the reduced amount of a later chargeable amount has been calculated under section 37(2) of ICTA by reference to the amount chargeable on the superior interest. Section 37(5) of ICTA provides:

> Where subsection (2) above applies, subsection (4) above shall apply for the period in respect of which the later chargeable amount arose only if the appropriate fraction of the amount chargeable on the superior interest exceeds the later chargeable amount, and shall then apply as if the amount chargeable on the superior interest were reduced in the proportion which that excess bears to that appropriate fraction.

Section 37(5) of ICTA is rewritten in section 293.

The general principle behind section 37(5) of ICTA is that if part of the amount chargeable on the superior interest has been used to reduce the amount of a later chargeable amount, only the balance of the amount chargeable on the superior interest should be available under section 37(4) of ICTA. This is achieved by reducing the amount of rent that the tenant is treated as paying under section 37(4) of ICTA for the period in respect of which the later chargeable amount arose. If in the calculation under section 37(2) of ICTA the appropriate fraction of the amount chargeable on the superior interest did not exceed the later chargeable amount, section 37(4) of ICTA does not apply. So the tenant is not treated as paying rent under section 37(4) of ICTA for the period in respect of which the later chargeable amount arose.

Section 87(5) of ICTA applies section 37(5) of ICTA if a tenant under a taxed lease is treated as paying rent under section 87(2) of ICTA in circumstances in which section 87(4) of ICTA applies.

(A) It is possible that the reduced amount of a later chargeable amount calculated under section 37(2) of ICTA by reference to more than one amount chargeable on the superior interest has been reduced to zero but that the appropriate fraction of the amount chargeable on the superior interest does not, in any one case, exceed the later chargeable amount. In these circumstances, section 37(5) of ICTA prevents any relief under section 37(4) of ICTA for the period in respect of which the later chargeable amount arose.

But it is more consistent with the principle behind section 37(5) of ICTA that if the *total* of the appropriate fractions of the amounts chargeable on the superior interest involved exceeds

the later chargeable amount, rent equal to that excess should be treated as paid for the period in respect of which the later chargeable amount arose. Otherwise, that excess will not be available to provide relief under section 37(4) of ICTA. It will be lost, unless it can be used in the calculation of a reduced amount for a different later chargeable amount.

It is also possible that the reduced amount of more than one later chargeable amount has been calculated under section 37(2) of ICTA by reference to an amount chargeable on the superior interest and that the amount of each of the later chargeable amounts has been reduced to nil. In these circumstances, section 37(4) and (5) of ICTA work satisfactorily if there is no overlap between the periods in respect of which each of the later chargeable amounts arose. But it is not at all clear how section 37(4) and (5) are intended to operate if there is such an overlap.

If there is an overlap between the periods in respect of which each of the later chargeable amounts arose, it is reasonable that section 37(5) of ICTA should apply so that the *total* of the reductions in all later chargeable amounts by reference to the amount chargeable on the superior interest should be taken into account in determining how much, if any rent should be treated as paid under section 37(4) of ICTA.

Section 293(3) replaces the test that the appropriate fraction of the amount chargeable on the superior interest must exceed the later chargeable amount in section 37(5) of ICTA with the test that the "daily amount" of the taxed receipt must exceed the "daily reduction" of the lease premium receipt (as defined in section 293(6)). Section 290(6) provides that references to a reduction under section 288 by reference to a taxed receipt are to a reduction under that section as far as is attributable to the taxed receipt.

Section 293(5) deals with the application of section 37(5) of ICTA if more than one later chargeable amount has been reduced by reference to the amount chargeable on the superior interest.

Without these changes, section 293 would produce the same result as section 37(5) of ICTA if there is one taxed receipt and one lease premium receipt. These changes make section 293 work if a later chargeable amount is reduced by reference to *more than one* amount chargeable on the superior interest or an amount chargeable on the superior interest is reduced by reference to *more than one* later chargeable amount.

Section 64(2), (5) and (6) are based on that part of section 87(5) of ICTA that applies section 37(5) of ICTA. It includes similar changes to those in section 293.

(B) Section 37(6) of ICTA provides for the application of section 37(4) and (5) of ICTA if the later chargeable amount is in respect of a lease for only part of the premises subject to the head lease. Section 37(6) of ICTA is rewritten in section 294.

Section 37(6) of ICTA does not deal with the possibility that more than one lease may have been granted out of the head lease and that there may be a later chargeable amount reduced under section 37(3) of ICTA by reference to the amount chargeable on the superior interest in respect of each such lease. This is dealt with in section 294(4) .

Section 65 is based on that part of section 87(5) of ICTA that applies section 37(6) of ICTA. Section 65(4) includes a similar change to that in section 294.

The relief to which a person is entitled by reference to a taxed receipt under sections 288 and 292 is restricted by section 295 to the amount of the taxed receipt after any deductions under

section 61. So if, as a result of this change, the relief to which a person is entitled is increased or decreased, this may affect the amount of relief to which somebody else is entitled.

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 16: Clarification of position of employees seconded to charities: section 70

This change provides that a trader who seconds an employee to a charity or educational establishment is entitled to a deduction in calculating the trade profits, irrespective of the duties undertaken by the employee while on secondment.

Section 86 of ICTA gives relief for employers who second employees to charities or educational establishments. It does this by providing that, notwithstanding anything in the general rules on deductions not allowable in section 74 of ICTA, the cost of the seconded employee:

> shall continue to be deductible in the manner and to the like extent as if, during the time that his services are so made available…they continued to be available for the purposes of the employer's trade…

So if the costs of the employee would not be allowed under the normal rules – for example because the employee is employed on a capital project – the employer is not entitled to any deduction under section 86 of ICTA.

In practice, the costs of the secondment are allowed whatever the nature of the work carried out by the employee during the secondment. So if, for example, an employee is seconded to a medical charity to help build a hospice, the employer is allowed to deduct the cost of employing the seconded person. This change gives statutory effect to that 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 17: Retraining courses: deduction no longer dependent on employee's exemption: section 74

This change removes the link in the source legislation between the employee's exemption and the employer's entitlement to a deduction.

Section 588(3)(b) of ICTA permits a deduction in calculating the employer's trade profits when:

> by virtue of section 311 of ITEPA 2003, no liability to income tax arises in respect of the payment or reimbursement [of retraining course expenditure].

The requirement for the deduction to be allowed in section 74(1) is that the "relevant conditions" in section 311 of ITEPA are met. "Relevant conditions" is defined in section 74(2) which cross-refers to the detail of the conditions in section 311of ICTA. That does not include the employee's exemption from tax under that provision.

The effect is that the employer's entitlement to a deduction ceases to be dependent, in part, on the employee's exemption.

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: Redundancy payments: legislate the practice of allowing voluntary payments made in connection with a cessation: section 79

This change legislates the practice of allowing as a deduction voluntary redundancy payments made in connection with the cessation of part of a trade.

Statement of Practice 11/81 extends the operation of section 90 of ICTA to payments in connection with the cessation of *part* of a trade. Section 79 of this Act gives effect to that practice in subsections (1) and (5).

If part of the trade continues, it would be possible to allow the deduction in the period of account in which the payment is made. But it is logical, and usually beneficial to the taxpayer, to make the deduction in the last period of account in which the part of the trade was carried on.

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: Devolution: sections 80, 83, 110, 167, 207, 732, 755, 769, 879 and 880.

This change concerns the effect of the devolution settlements.

Scotland

The approval function in section 79(4) of ICTA conferred on the Secretary of State is exercisable in relation to Scotland by the Scottish Ministers (see SI 1999/1750 made under section 63 of the Scotland Act 1998). Section 83 of this Act reflects that transfer of functions.

In Schedule 1 to the Interpretation Act 1978 "Act" is defined to mean an Act of Parliament and "enactment" is defined as not including "an enactment comprised in, or in an instrument made under, an Act of the Scottish Parliament". The definitions in that Schedule apply "unless the contrary intention appears" (see section 5 of the 1978 Act).

Section 581 of ICTA confers an exemption from tax in relation to foreign currency securities, including those issued by a statutory corporation. The definition of "statutory corporation" refers in a number of places to an "Act". Because of the definition of "Act" in the Interpretation Act 1978, the definition of "statutory corporation" may not include bodies corporate established by an Act of the Scottish Parliament (ASP) (eg Scottish Water established by section 20 of the Water Industry (Scotland) Act 2002).

Section 879 of this Act widens the definition of "Act" as that term is used in section 755 to include such corporations. If this is a change in the law, it reflects current practice, and the fact that it can be assumed that the devolution settlement did not intend section 581 of ICTA to operate differently in relation to England and Wales on the one hand and Scotland on the other. The change also widens the scope of the exemption and is therefore favourable to the taxpayer.

Section 578 of ICTA confers an exemption from tax in relation to housing grants made under any enactment. Again the Interpretation Act 1978 means that it is not clear that "enactment" covers ASPs or Scottish statutory instruments.

Section 879 of this Act provides that ASPs and Scottish statutory instruments are covered by the reference to "enactment" in section 769, so that payments under them are capable of

falling within the exemption in that section. If this is a change, it is in line with practice, reflects the intention of the devolution settlement and widens the scope of the exemption.

Northern Ireland

The reference to the Department for Employment and Learning in section 80 reflects the transfer of functions to that Department from the Department of Economic Development under Part II of Schedule 2 to SR (NI) 1999 No. 481.

Section 207 of this Act refers to the Department for Employment and Learning, which is the current name for the former Department of Higher and Further Education, Training and Employment (see the Department for Employment and Learning Act (Northern Ireland) 2001).

Section 91A(6)(ba) of ICTA refers to a permit under regulations under section 2 of the Pollution Prevention and Control Act 1999. That reference was inserted by regulations made under that Act. The provision in Northern Ireland corresponding to section 2 of that Act is Article 4 of the Environment (Northern Ireland) Order 2002 (N.I. 7). An amendment along the lines of section 91A(6)(ba) of ICTA would have been ultra vires that Order because taxation is an excepted matter for the purposes of the Northern Ireland Act 1998.

In order to maintain parity of treatment throughout the United Kingdom, the definition of "waste disposal licence " in section 167(1)(c) of this Act is expanded to include a permit under any corresponding provision for the time being in force in Northern Ireland. The "corresponding provision" formula is preferred to specifying the 2002 Order. If the Order is subsequently re-enacted by the Northern Ireland Assembly, the Interpretation Act 1978 cannot be relied on to update the statutory reference.

A criminal injuries compensation scheme for Northern Ireland was established under the Criminal Injuries (Northern Ireland) Order 2002 (SI 2002/ 796 (N.I. 1)). That scheme does not fall within the current definition of "the Criminal Injuries Compensation Scheme" in section 329AB(2) of ICTA. To maintain parity of treatment throughout the United Kingdom the definition of that expression in section 732 of this Act is extended to cover the Northern Ireland criminal injuries compensation scheme.

There is doubt whether, in the application of section 581 of ICTA to Northern Ireland, "Act" covers the full range of legislation which applies or could apply to Northern Ireland. This means that, as with Scotland, it may not be clear in every case whether the definition of "statutory corporation" in that section covers corporations incorporated by, or on which functions are conferred by, such legislation.

Section 880 of this Act widens the definition of "Act" as that term is used in section 755 to include such corporations. This change in the law reflects current practice and widens the scope of the exemption, and so is favourable to the taxpayer.

Section 578 of ICTA confers an exemption from tax in relation to housing grants made under any enactment. Again it is not clear that "enactment" covers all of the different kinds of legislation which may apply to Northern Ireland.

Section 880 of this Act makes it clear that such legislation is covered by the reference to "enactment" in section 769, so that payments under such legislation are capable of falling within the exemption in that section. Again, if this is a change in the law, it is in line with practice and is taxpayer favourable.

Wales

Sections 83 and 110 of this Act refer to functions exercisable by the National Assembly for Wales. The references reflect the transfer of functions from the Secretary of State to the Assembly under the Transfer of Functions Order made under the Government of Wales Act 1998 (SI 1999/672). So far as those functions are concerned, the Order is partly superseded by this Act (and any change in the persons by whom those functions are exercisable will also have to be made by primary legislation).

The changes are in line with current practice and reflect the devolution settlements.

Change 20: Contributions to local enterprise organisations or urban regeneration companies: disqualifying benefits: section 82

This change amends the anti-avoidance rules in sections 79(3) and (9), 79A(3) and (4) and 79B(3) and (4) of ICTA.

The aim of the anti-avoidance rules is to stop traders obtaining a deduction for contributions that have strings attached. For example, a trader may give money to a local enterprise agency which is used to meet the costs of a relative setting up in business. These costs would normally not be tax deductible. So the anti-avoidance rules are designed to prevent the costs becoming tax deductible by passing the money through a local enterprise organisation.

The denial of the deduction in the source legislation is "all or nothing". This may cause a problem. For example, a trader gives £1 million to a training and enterprise council, but asks that employees be given free places on a word processing course (worth say £5000). The anti-avoidance rule bars any deduction under these provisions.

When section 79A of ICTA was enacted in 1990 an assurance was given that in a case such as this a deduction would be allowed. In practice the Inland Revenue ignores such benefits, or treats the payment as split into two, one part for the training and one for the donation.

Paragraph 47610 of the Inland Revenue Business Income Manual makes it clear that relief is not denied if the costs of obtaining the benefit provided would have been allowable as a deduction if incurred directly on an arm's length basis. So the section disallows a deduction only if there is a "disqualifying benefit".

Even if there is a "disqualifying benefit" the deduction may not be lost entirely. Instead, the deduction is restricted to take account of the 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 21: Contributions to local enterprise organisations or urban regeneration companies: gifts of trading stock: charge any benefit by reference to periods of account: sections 82 and 109

This change deals with a benefit that arises to a trader in connection with:

- a contribution to a local enterprise organisation or urban regeneration company; or
- a gift of trading stock.

The benefit is charged to tax by treating the benefit as a trade receipt in the period in which it is received.

Sections 79(9), 79A(4), 79B(4) and 84A(4) of ICTA charge the benefit for the "chargeable period" in which it is received. For a person chargeable to income tax, this period is a year of assessment. If the benefit is received on a date in a tax year that is later than the accounting date, it is taxed in the same tax year as the profits of the period of account ended on that accounting date. This produces practical problems. It is in any event illogical to charge trading receipts to tax by reference to a tax year rather than a period of account.

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 22: Trade etc and other income charged on withdrawal of relief after source ceases: sections 82, 104, 109 and 844

This change treats certain amounts as post-cessation receipts and other amounts as if the source had not ceased.

Sections 79(9), 79A(4), 79B(4), 83A(4), and 84(4) of ICTA create a charge under Schedule D Case VI if the trader is not chargeable under Schedule D Case I or II in the "chargeable period" in which a benefit is received. Section 491(3) of ICTA creates a similar charge on a distribution by a mutual concern. Section 584(4) of ICTA creates a charge under Schedule D Case VI if income becomes remittable after the trade or other source of income has ceased.

This Act unpacks Schedule D Case VI charges and deals with the income where it logically belongs. In most of these cases, the income is trading income.

As regards a trade profession or vocation, by treating the benefit or distribution as a post-cessation receipt, this Act:

- allows the trader to make the same deductions as those available from other post-cessation receipts;
- makes it clear that the benefit or distribution may be earned income and relevant earnings;
- allows an election to carry the benefit or distribution back in accordance with section 257 of this Act;
- removes any possibility that the benefit is charged both by the specific rule about benefits and by any general rule; and
- preserves the loss relief position under section 392 of ICTA (by virtue of entries in the table in section 836B of ICTA, inserted by paragraph 340 of Schedule 1 to this Act).

Section 844(4) of this Act contributes to the unpacking of Schedule D Case VI charge. It treats the source of the foreign income as not having ceased, where income that was relieved under section 842 ceases to be unremittable after the source has actually ceased. The income is then charged under the provision that would apply had section 843 (withdrawal of relief) applied instead. In a very few cases, the income may be charged at a lower tax rate than was the case under section 584(4) of ICTA. The loss relief position under section 392 of ICTA is also preserved by virtue of an entry in the table in section 836B 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 23: Patent fees paid: sections 89 and 90

This change sets out the basis on which a deduction is allowed for patent fees. It brings the timing of the deduction into line with the vast majority of deductions allowed in calculating trading income.

Section 83 of ICTA allows a deduction for "fees paid or expenses incurred" in connection with the grant of patents etc. It is thought that the "fees paid" are those paid when a patent application is made. Such fees are incurred only when they are paid. So it is unlikely that business accounts would recognise the fees until they are paid.

There is no doubt that "expenses" include "fees".

These sections allow a deduction for all expenses on the basis of the amounts incurred. In principle the rule in these sections may allow taxpayers to take a deduction for fees earlier than the ICTA rule.

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 24: Payments to Export Credits Guarantee Department: section 91

This change allows payments to the Export Credits Guarantee Department ("ECGD") to be deducted in calculating the profits of a trade when the expense is payable rather than when it is paid.

Section 88 of ICTA allows a person carrying on a trade to deduct "sums paid" to the ECGD in calculating the profits of that trade.

Section 91 follows accounting treatment in allowing traders to deduct a payment to the ECGD at the time it is payable.

This change will not alter the amount charged to tax. The most it will do is affect the timing of the tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 25: Expenses connected with foreign trades: relax condition for family expenses: drop "functions" test: section 92

This change allows a deduction for "family expenses" if the trader's absence from the United Kingdom is partly for the purposes of a trade that is not carried on wholly outside the United Kingdom. It also drops the requirement that the taxpayer performs functions of the trade at each end of the journey.

Sections 80 and 81 of ICTA allow a trading deduction for three sorts of expenses. Each has a condition related to the purpose of the trader's absence from the United Kingdom. The expenses are:

- travelling etc expenses of the trader between the United Kingdom and a foreign trade (section 80(3) of ICTA);
- travelling expenses of the trader between foreign trades (section 81(4) of ICTA); and
- travelling expenses of the trader's family (section 80(5) of ICTA).

There is no need to have three separate conditions for these expenses.

The single condition relating to the purpose of the trader's absence is in section 92(1)(b) of this Act. It applies to all the expenses with which the section deals.

(A) The condition relating to family expenses in section 80(5) of ICTA is relaxed so that an absence for the combined purposes of a foreign trade and a United Kingdom-based trade will qualify.

(B) The condition in section 81(3) of ICTA is relaxed so that there is no need for "functions" to be performed at the place of departure.

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: Expenses connected with foreign trades: Irish trades: section 92

This change allows a deduction for certain expenses incurred in connection with trades carried on wholly in Ireland whatever the basis adopted for the assessment of a taxpayer's other foreign income.

Section 80 of ICTA allows a deduction for the expenses that would otherwise be disallowed as not being incurred wholly and exclusively for the purposes of a trade assessable under Schedule D Case V. But it excludes an individual who satisfies the Board of Inland Revenue "as mentioned in section 65(4) [of ICTA]". That individual is assessable under Schedule D Case V on the basis of sums received in the United Kingdom (the "remittance basis").

The remittance basis does not apply to income arising in the Republic of Ireland (see section 68(1) of ICTA). So a person with other foreign income assessable on the remittance basis may have Irish income assessed on the basis of the income arising. In such a case there is no reason why the rules in section 80 of ICTA should not apply to the Irish income.

Section 92(2) of this Act makes it clear that the rules apply in calculating the profits of any trade that are not assessed on the remittance basis.

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 27: Assets of mutual concerns: exclude distributions of capital gains from the charge to tax: section 104

This change defines the profits out of which a chargeable distribution is made so as to exclude distributions of chargeable gains.

Section 491(1) of ICTA excludes distributions of assets representing capital from the charge in subsection (3). Subsection (8) explains what is meant by such assets. It is generally understood that chargeable gains made by the concern do not represent capital as described in subsection (8). So distributions of such gains are within the charge in subsection (3).

Nevertheless, the Inland Revenue does not in practice seek to apply section 491 of ICTA to distributions of chargeable gains. The section adopts a positive approach to defining the distributions to which the section applies. The condition in section 104(1)(d) of this Act refers to profits of the mutual business. Chargeable gains are not profits of the mutual business and so the section reflects the current 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 28: Sums recovered under insurance policies, etc: section 106

This change gives statutory effect to the accountancy treatment for crediting a sum recovered under an insurance policy.

Section 74(1) of ICTA lists various items in respect of which no deduction is allowed in computing a trader's profits including:

> (l) any sum recoverable under an insurance or contract of indemnity

A sum recovered under an insurance policy or contract of indemnity is a receipt and not therefore an item in respect of which a trader would expect to make a deduction in calculating his or her profits.

The courts have interpreted section 74(1)(l) of ICTA and the enactments from which it is derived as prohibiting the deduction of a loss or expense incurred by the trader *to the extent that* the loss or expense is recovered under an insurance policy or contract of indemnity (even where that recovery is on capital account). See, for example, Lawrence LJ's description of the meaning of the equivalent provision in the Income Tax Act 1918[1] on page 381 of Green v J Gliksten and Sons Ltd (1929), 14 TC 364 HL:

> in arriving at the balance of profits or gains there has to be no deduction in respect of a loss which is covered by insurance to the extent by which that loss is so recovered.

Section 106 achieves the same effect as section 74(1)(l) of ICTA by bringing a capital amount recovered into account as a trade receipt rather than by prohibiting a deduction in respect of the loss or expense in respect of which it is recovered. This makes the proposition easier to understand without changing the law.

Section 74(1)(l) of ICTA requires a deduction in respect of a loss or expense to be reduced by the amount of any insurance recovery. But where the loss and the recovery fall in different periods the accountancy treatment is to deduct the loss or expense in the year in which it is incurred and to credit the recovery in the accounting period in which it arises.

In practice, the Inland Revenue allows traders to follow the accounting treatment in crediting the recovery. This informal concession is set out in paragraphs 40130 and 40755 of the Inland Revenue Business Income Manual. Section 106 gives the concession statutory effect.

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

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[1] Paragraph (k) of Rule 3 of the rules applicable to Cases I and II of Schedule D

Change 29: Gifts of trading stock: drop the need for the gift to be plant and machinery in the hands of the educational establishment: section 108

This change removes the requirement that a gift to an educational establishment should qualify as plant and machinery in the hands of the educational establishment.

Section 84(1) of ICTA gives relief for the gift of an article that "qualifies as plant or machinery". Subsection (2) sets out what those words mean. The similar relief for gifts of trading stock to charities does not have the same condition. So there is no need for the gift to qualify as plant or machinery in the hands of an educational establishment.

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 30: Gifts of trading stock: gifts "for the purpose of" a charity etc: section 108

This change brings the wording of the relief for a gift to a charity, a registered club or one of the special bodies listed in section 108(5) of this Act into line with that for a gift to an educational establishment.

Section 84 of ICTA allows relief for a gift of an article "for the purposes of a designated educational establishment". Those words ensure that the relief is available even if the gift is made to a person (such as a local education authority) who becomes the legal owner of the article so that it can be used in a school. In many cases the gift is not "to" the school.

Section 83A of ICTA allows similar relief for a gift "to" a charity. The section allows relief for a gift "for the purposes of" a charity, a registered club or one of the listed bodies.

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: Gifts of trading stock: drop the need for a claim: section 108

This change removes the requirement that a taxpayer should make a claim for relief on a gift to an educational establishment.

Section 84(3) of ICTA provides that the relief does not apply unless "the donor makes a claim". The general approach of this Act is not to require a claim for a trading deduction. In this case, the relief takes the form of removing the obligation to include a trade receipt. But the same principle applies here.

The similar relief for gifts to charities in section 83A of ICTA does not require a claim. So this change makes the two reliefs consistent.

The provisions that govern claims are not the same as the provisions that govern returns. But in practice the change from making a claim to allowing the relief will have only the following consequences, which both relate to the time available for "claiming" the relief.

First, the absolute time limit for making a claim is replaced by a time limit that may vary according to the particular circumstances. That may be because the return is issued late or because the taxpayer makes a late return. Accordingly, the Inland Revenue is no longer able to refuse a claim because it is late by reference to an absolute time limit: returns time limits and sanctions will apply and they depend on the date the return was issued and submitted.

Second, error or mistake relief claims under section 33 of TMA will be possible if too much tax is paid as a result of omitting to include the relief in the tax return. Claims under section

33 of TMA must be made within five years of 31 January following the tax year to which the return relates.

This change is in taxpayers' favour in principle and may benefit some taxpayers in practice. But the numbers affected and the practical effects are likely to be small.

Change 32: Herd basis rules: meaning of "substantial part of herd": section 113(6) and section 120(7)

This change gives statutory effect to the practice of treating 20% of the herd as substantial.

A number of sections in the herd basis rules refer to "a substantial part of the herd" or "a substantial difference":

- section 118(1)(b) (sale of animals from the herd);
- section 119(1) (sale of whole or substantial part of herd);
- section 120(7) (acquisition of new herd begun within 5 years of sale);
- section 122(1)(a) (replacement of part sold within 5 years of sale); and
- section 126(1)(a) (slaughter under disease control order).

What constitutes a substantial part of the herd or a substantial difference is primarily a question of fact. But this Chapter gives statutory effect to a long-standing practice set out in paragraph 55525 of the Inland Revenue's Business Income Manual. This provides that 20% of the herd will be regarded as substantial. This does not, however, prevent a smaller percentage from being regarded as substantial.

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 33: Herd basis rules: sale of whole or substantial part of herd: sections 119, 120 and 122

This change merges the rules in paragraph 3(7) to (9) of Schedule 5 to ICTA.

Paragraphs 3(7) to (9) of Schedule 5 to ICTA set out the rules relating to the sale of all or most of a herd within 12 months.

Paragraph 3(7) of Schedule 5 to ICTA applies when a herd is sold as a whole and then replaced. Paragraph 3(8) of Schedule 5 to ICTA deals with cases where the whole of a herd is sold "in circumstances in which sub-paragraph (7) above does not apply". Or when a substantial part of a herd is sold. Paragraph 3(9) of Schedule 5 to ICTA sets out rules for the circumstances where paragraph 3(8) but not 3(7) of Schedule 5 to ICTA is relevant, provided that replacement begins to take place within five years.

ICTA does not make clear how quickly a herd must be replaced in order for paragraph 3(7) - rather than paragraph 3(8) of Schedule 5 to ICTA - to apply. This Chapter merges these rules.

There are three practical differences between the application of the rules in paragraph 3(7) and those in paragraph 3(8) and 3(9) of Schedule 5 to ICTA.

First, paragraph 3(8) of Schedule 5 to ICTA directs that neither the profit nor the loss on the sale is to be taken into account. So, in effect, the farmer may obtain a tax-free gain on any

profit from the sale. By contrast paragraph 3(7) of Schedule 5 to ICTA does not say how to deal with the proceeds of sale before it is known how many of the old herd will be replaced.

Second, if the farmer subsequently acquires a new production herd (which must be treated as a replacement herd) or animals to replace the part of the herd sold, paragraph 3(9) of Schedule 5 to ICTA recovers any tax-free gain made on the sale of the old animals. To achieve this the proceeds of the sale of each animal are brought into account at the time the replacement animal is acquired. By contrast paragraph 3(7) of Schedule 5 to ICTA contains no timing rule.

Third, in providing for the sale proceeds to be brought into account, paragraph 3(9) of Schedule 5 to ICTA allows the trading receipt to be reduced if the replacement animal is of worse quality than the old animal (on an enforced sale). Paragraph 3(7) of Schedule 5 to ICTA, however, does not permit such a reduction to be made.

Merging these rules removes these differences. It gives a common set of rules where a whole herd is sold, whether at once or over a period of up to a year. These are the rules set out in paragraphs 3(8) and (9) of Schedule 5 to ICTA.

Section 119 begins the process of merger by providing that in all cases where a herd or a substantial part of a herd is sold within a year the profit or loss which arises from that sale is not to be taken into account. That rule is then made subject to the rules which follow in section 120 and section 122 which concern the acquisition of a new herd or replacement of a substantial part of a herd respectively.

It is possible that merging the rules may disadvantage the farmer who sells a herd over a period of 12 months and replaces it with a new, smaller herd. In this case section 120(4) taxes the profit on the difference if the difference is not substantial. That subsection is based on paragraph 3(11) of Schedule 5 to ICTA and is consistent with herd rules viewed as a whole.

But it is arguable that paragraph 3(11) of Schedule 5 to ICTA does not apply to all disposals within paragraph 3(8) of Schedule 5 to ICTA. This is because paragraph 3(11) applies "Where the herd is sold as a whole" while paragraph 3(8) applies both if the herd is sold "either all at once or over a period not exceeding twelve months". But unless the rule in paragraph 3(11) of Schedule 5 to ICTA is applied to all cases where a herd is sold within a year it would be difficult, if not impossible, to merge the rules in paragraphs 3(7) to 3(9) of Schedule 5 to ICTA. This is because it would be necessary to distinguish between the two circumstances in paragraph 3(8) in which a herd may be sold and apply different results to the two situations. This is more likely to involve a change in the law than the approach adopted in section 120(4).

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 34: Herd basis elections: time limit for making election: section 124

This change relates to the time limit for making a herd basis election under paragraph 2 of Schedule 5 to ICTA.

An election must normally be made within a specified period, based on when the farmer first keeps a production herd of the particular class. The ordinary rule for farmers except those trading in partnership is set out in paragraph 2(3)(a) of Schedule 5 to ICTA. This provides that the election must be made "not later than twelve months from the 31st January next

following the qualifying year of assessment". The qualifying year of assessment is then defined in paragraph 2(6) of Schedule 5 to ICTA as "the first year of assessment after the commencement year for which the amount of profits or losses … is computed for tax purposes by reference to the facts of a period during the whole or part of which [the farmer] kept such a herd".

For firms the position is slightly different. Paragraph 2(3)(b) of Schedule 5 to ICTA states that they must make an election "not later than twelve months from the 31st January next following the year of assessment in which the qualifying period of account ends". This means that, provided a partnership's first period of account extends into the second tax year, it will get longer to make an election.

Section 124 merges the two rules. This change of approach simplifies the law by having a common rule for all farmers. It sets the time limit for all farmers in the same way as for a firm, by referring to the period of account in which the herd is first kept. In most cases, this rule gives the same time limit as that in paragraph 2(3)(a) of Schedule 5 to ICTA. But it may also benefit some taxpayers by giving them longer to make the election if the first period of account in which they keep the production herd extends into a second tax year.

Example 1

A farmer starts to keep a herd of a particular class on 1 March 2006. The accounts of the farming trade are made up to 31 December annually:

- The ICTA rule: The first (basis) period in which the farmer keeps the herd is the year ended 31 December 2006. So the "qualifying year of assessment" is 2006-07 and the time limit is 31 January 2009.
- The rule in section 124: The "relevant period of account" is the year ended 31 December 2006. That ends in 2006-07. So the time limit is 12 months from 31 January 2008, that is 31 January 2009.

But, if the farmer has a period of account longer than 12 months and first keeps the herd early in the period, the time limit may change.

Example 2

A farmer starts to keep a herd of a particular class on 1 March 2006. This is in a period of account that runs from 1 January 2006 to 30 June 2007. The basis period for 2006-07 is the year ended 30 June 2006 (see section 214(4)). The basis period for 2007-08 is the year ended 30 June 2007, the new accounting date:

- The ICTA rule: The first (basis) period in which the farmer keeps the herd is the year ended 30 June 2006. So the "qualifying year of assessment" is 2006-07 and the time limit is 31 January 2009.
- The rule in section 124: The "relevant period of account" is the 18 months ended 30 June 2007. That ends in 2007-08. So the time limit is 12 months from 31 January 2009, that is 31 January 2010.

This change is in the taxpayers' favour in principle and may benefit some in practice. But the numbers affected and the amounts involved are likely to be small.

Change 35: Herd basis elections: date from which effective: section 124(7)

This change relates to the date from which a herd basis election is effective.

For farmers, except those trading in partnership, paragraph 2(4)(a) of Schedule 5 to ICTA refers to the election having effect for the qualifying year of assessment and all subsequent periods. For partnerships the rule in paragraph 2(4)(b) of Schedule 5 to ICTA is slightly different. The election has effect for the qualifying period of account.

As explained in Change 34 this Act merges the rules for making herd basis elections. This means that for all farmers the election will take effect by reference to periods of account.

This is a minor change in the law if "period" in the definition of "qualifying year of assessment" in paragraph 2(6) of Schedule 5 to ICTA means basis period not period of account. But in practice it is interpreted as meaning period of account.

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 36: Herd basis elections: 5 year gap in which no production herd kept: section 125

This change gives statutory effect to the practice in paragraph 55630 of the Inland Revenue's Business Income Manual (BIM 55630).

Paragraph 4 of Schedule 5 to ICTA provides a special rule for herd basis elections where there is a gap of at least five years when the farmer does not keep a production herd of a particular class. The farmer is treated as never having kept such a production herd at all.

This approach sits oddly with the rule in paragraph 2(4) of Schedule 5 to ICTA that a herd basis election is irrevocable. It is not clear which rule has priority.

The Inland Revenue's practice, set out in paragraph 55630 of the Business Income Manual (BIM 55630), is to allow the farmer to decide whether or not he or she wants the herd basis rules to continue to apply. This is achieved by ignoring the previous election for the purposes of allowing the farmer to make a fresh election: farmers can either make a fresh election or do nothing. Section 125 gives this practice statutory effect.

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 37: Herd basis elections: slaughter under disease control order: section 126

This change relates to the time limit for making a herd basis election under paragraph 6 of Schedule 5 to ICTA if the whole or a substantial part of a production herd is slaughtered under a disease control order.

An election must normally be made within a specified time based on when the farmer first keeps a production herd. Paragraph 6(1) of Schedule 5 to ICTA modifies the ordinary time limit for making a herd basis election if the whole or a substantial part of a production herd is slaughtered under a disease control order.

For farmers except those trading in partnership paragraph 6(2)(a) of Schedule 5 to ICTA provides the election must be made "not later than twelve months from the 31st January next following the qualifying year of assessment". That year is then defined by paragraph 6(4) of Schedule 5 to ICTA as the first year of assessment for which the amount of the profits or

losses of the trade are calculated "by reference to the facts of a period in which the compensation is relevant".

For firms the position is slightly different. Paragraph 6(2)(b) of Schedule 5 to ICTA provides the election must be made "not later than twelve months from the 31st January next following the year of assessment in which the qualifying period of account ends". Paragraph 6(4) of Schedule 5 to ICTA defines the "qualifying period of account" as "the first period of account in which the compensation is relevant".

Paragraph 6(5) of Schedule 5 to ICTA provides that compensation is deemed to be relevant in any period if is "taken into account as a trading receipt in computing the profits or losses of that or an earlier period".

Section 126 merges the two rules. This change of approach simplifies the law by having a common rule for all farmers. It sets the time limit for all farmers in the same way as for a firm by reference to first period of account in which the compensation is relevant. In most cases this rule gives the same time limit as that in paragraph 6(2)(a) of Schedule 5 to ICTA. But it may benefit some taxpayers by giving them longer to make the election if the compensation is received in a period of account that is longer than 12 months.

This change is in line with the approach adopted for the rewrite of the ordinary time limits in paragraph 2 of Schedule 5 to ICTA. Section 124 has a single rule for elections by all farmers. See Change 34.

Example

The accounts of an established farming business are made up for the period 1 January 2005 to 30 June 2006. No herd basis election is in place. In September 2005 compensation is received for a production herd slaughtered under a disease control order.

Unless the farmer is trading in partnership the time limit for making an election is 31 January 2008. The qualifying year of assessment is the tax year 2005-06. The 31 January next following this year is 31 January 2007. The election must be made within 12 months of that date.

If the farmer is a firm the time limit for making the election is 31 January 2009. The qualifying period of account ends on 30 June 2006. This ends in the tax year 2006-07. The 31 January next following this year is 31 January 2008. The election must be made within 12 months of that date.

In principle and in practice this change may benefit some taxpayers by giving them longer to make the election. But it has no implications for the amount of income liable to tax or who is liable for tax on it.

Change 38: Tax treatment of sound recordings: sections 130, 132 and 135

This change gives statutory effect to ESC B54 (tax relief on films, tapes and discs).

ESC B54 states:

> Notwithstanding section 113(2) of Finance Act 2000, master audiotapes or discs shall be deemed to be included in the definitions in section 68(2) of the Capital Allowances Act 1990. This ensures that treatment of the expenditure on production of master audio tapes or discs will continue to be treated as expenditure of a revenue nature.

Section 130 and sections 132 to 135 rewrite sections 40A to 40D of F(No 2)A 1992. Sections 40A to 40D of F(No 2)A 1992 contain rules for the tax treatment of films other than films that are "qualifying films" as defined in section 43 of F(No 2)A 1992. These rules were previously in section 68 of the Capital Allowances Act 1990 and were inserted in F(No 2)A 1992 when the Capital Allowances Act 1990 was repealed by CAA.

Before FA 2000, section 68(2)(c) of the Capital Allowances Act 1990 defined "disc" for the purposes of section 68 of that Act as "an original master film disc or original master audio disc". Section 113(2) of FA 2000 substituted a new definition of "film, tape or disc" (by reference to the definition of "film" in section 43 of F(No 2)A 1992).

Because the definitions in section 43 of F(No 2)A 1992 apply only to films - not to master audiotapes or discs - the effect of section 113(2) of FA 2000 is to exclude expenditure on master audiotapes or discs from relief under section 68 of the Capital Allowances Act 1990. This is not what was intended. So ESC B54 restores the position before section 113(2) of FA 2000.

Sections 130, 132 and 135 incorporate ESC B54 by referring to "sound recordings" in sections 130(1)(a),(2),(3) and (4), 132(1) and 135(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 39: Treatment of interest in production and acquisition expenditure on films and sound recordings: section 130

This change clarifies the treatment of interest and the incidental costs of obtaining finance in calculating expenditure on the production and acquisition of films and sound recordings.

Sections 40A to 43 of F(No 2)A 1992, section 48 of F(No 2)A 1997 and sections 99 to 101 of FA 2002 contain special rules for the tax treatment of expenditure on the production and acquisition of films.

It has always been the Inland Revenue's view that interest and the incidental costs of obtaining finance should be treated as the costs of borrowing money, not the costs of producing or acquiring the film. It follows that the normal rules for deducting such expenditure should apply, rather than the special rules for production or acquisition expenditure on films. The Inland Revenue understand from discussions and consultation with the film industry that the exclusion of interest etc from production costs is accepted industry practice.

Section 130(5) gives statutory effect to the practice of excluding interest etc from expenditure on the production or acquisition of a film or sound recording.

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: Allocation of expenditure to relevant periods: sections 135, 137 and 138

This change drops the requirement to make a claim to allocate expenditure to a relevant period under the "cost recovery" method in section 40B(5) of F(No 2)A 1992 and the special rules for preliminary expenditure and production and acquisition expenditure on a qualifying film in sections 41 and 42 of F(No 2)A 1992.

(A) Under section 40A of F(No 2)A 1992 expenditure on the production or acquisition of a film or sound recording is treated as revenue expenditure. Section 40B(4) of F(No 2)A 1992 gives the basic method for allocating expenditure to a relevant period with reference to the estimated value of that film expected to be realised in that period. This method, which is generally known as the "income matching" method, is rewritten in subsections (3) and (4) of section 135.

Section 40B(5) of F(No 2)A 1992 provides that a claim may be made to increase the amount allocated to the relevant period under section 40B(4) of F(No 2)A 1992 to the value actually realised in that period. This method, which is generally known as the "cost recovery" method, is rewritten in subsection (5) of section 135.

This change dispenses with the requirement for the taxpayer to make a claim for the "cost recovery" method to apply. Expenditure allocated under the "cost recovery" method in section 135(5) can simply be deducted in the calculation of income in the taxpayer's self-assessment return.

(B) Under section 41 of F(No 2)A 1992, a claim may be made to deduct preliminary expenditure on a film certified under the Films Act 1985 - or which was likely to qualify for certification under the Films Act 1985 if it had been completed - incurred in the relevant period, or in an earlier period, in computing the profits of a relevant period.

This change dispenses with the requirement for the taxpayer to make a claim for preliminary expenditure on a qualifying film to be allocated to a relevant period. Preliminary expenditure allocated under section 137 can simply be deducted in the calculation of income in the taxpayer's self-assessment return.

(C) Under section 42 of F(No 2)A 1992, a claim may be made to allocate up to one-third of the production or acquisition expenditure on a film certified as a qualifying film under the Films Act 1985 to the relevant period in which the film was completed and to any later relevant periods until all the expenditure has been allocated.

This change dispenses with the requirement for the taxpayer to make a claim for production or acquisition expenditure on a qualifying film to be written off over three years. Production or acquisition expenditure allocated under section 138 can simply be deducted in the calculation of income in the taxpayer's self-assessment return for the years in question.

The provisions that govern claims are not the same as the provisions that govern returns. But in practice, the only consequences of the change from claim to deduction relate to the time available for "claiming" the deduction.

The absolute time limit for making a claim is replaced by a time limit that may vary according to the particular circumstances. That may be because the return is issued late or because the taxpayer makes a late return. Accordingly, the Inland Revenue is no longer able to refuse a claim because it is late by reference to an absolute time limit: returns time limits and sanctions will apply and they depend on the date the return was issued and submitted.

This change is in taxpayers' favour in principle and may benefit some taxpayers in practice. But the numbers affected and the practical effects are likely to be small.

Change 41: Allocation of expenditure to relevant periods: sections 135 and 137

This change gives a choice of relief for preliminary expenditure on a qualifying film under either the basic rules for allocation of expenditure to a relevant period or the special rules for qualifying films.

Under sections 40A to 40D of F(No 2)A 1992, expenditure on any film or sound recording can be allocated to a relevant period under the "income matching" method in section 40B(4) of F(No 2) 1992 or the "cost recovery" method in section 40B(4) of F(No 2) 1992 as augmented by section 40B(5) of F(No 2)A 1992.

Section 42 of F(No 2)A 1992 provides that claims may be made to allocate up to one-third of the production or acquisition expenditure on a film certified as a qualifying film under the Films Act 1985 to the relevant period in which the film was completed and any later relevant periods until all the expenditure has been allocated.

Section 42(7) of F(No 2)A 1992 provides that production or acquisition expenditure in respect of a qualifying film may not be deducted under both section 40B and section 42 of F(No 2)A 92 in the same relevant period.

Section 40C(1) of F(No 2)A 1992 further provides that if production or acquisition expenditure has been allocated to a relevant period under section 42 of F(No 2)A 1992, neither that expenditure, nor any other expenditure on the production or acquisition of the same film, can be allocated to that period under section 40B of F(No 2)A 1992.

The combined effect of sections 40C and 42(7) of F(No 2)A 1992 is to give the taxpayer a choice in any relevant period between relief under the "income matching" or "cost recovery" methods in section 40B of F(No 2)A 1992 and the special rules for qualifying films in section 42 of F(No 2)A 1992.

Section 41 of F(No 2)A 1992 provides that a claim may be made to allocate preliminary expenditure on a film certified as a qualifying film under the Films Act 1985 to the relevant period in which it is incurred or a later relevant period.

Section 40C(1) of F(No 2)A 1992 does not apply to preliminary expenditure under section 41 of F(No 2)A 1992. There is no restriction in section 41 of F(No 2)A 1992 on the deduction of preliminary expenditure on a qualifying film under both section 40B and section 42 of F(No 2)A 1992 in the same relevant period equivalent to the restriction for production or acquisition expenditure in section 42(7) of F(No 2)A 1992.

It is possible therefore that the taxpayer could claim relief for preliminary expenditure on a qualifying film (but not for the same expenditure) under both section 40B and section 41 of F(No 2)A 1992.

This change removes the inconsistency between the treatment of preliminary and of production or acquisition expenditure to give the taxpayer a choice in any relevant period between relief under the "income matching" or "cost recovery" methods in section 40B of F(No 2)A 1992 and the special rules for qualifying films in sections 41 and 42 of F(No 2)A 1992.

This change has no implications for the amount of income liable to tax or who is liable for tax on it. It affects (in principle but not in practice) only when tax is paid.

Change 42: Securities held as circulating capital: section 150

This change dispenses with the requirement that securities within section 473 of ICTA must be beneficially held by the trader.

Section 473 of ICTA contains special rules for the tax treatment of certain securities held as circulating capital, the profit on the sale of which would form part of the trading profits. The effect is that that neither a profit nor a loss is crystallised on a conversion of the securities.

Persons carrying on a trade of dealing in securities on their own behalf would not normally bring a profit or loss on the sale of securities into account in calculating the profits of the trade if they were not beneficially entitled to the securities.

And there is no reason to calculate the profits of a trade carried on by a person in a fiduciary or representative capacity in a different manner from those of a trade carried on by a person beneficially.

So section 150 dispenses with the requirement that the person carrying on the business must be beneficially entitled to the shares in question. This means that section 150 will apply to transactions by trustees and by personal representatives who carry on a trade of dealing in securities as well as to individual dealers.

It also means that section 150 will apply to securities in stock lending or sale and repurchase arrangements where beneficial ownership has passed to the dealer's counterparty but where the dealer continues to account for profits and losses as if those securities had not been disposed of.

This change affects the timing of the tax liability. It 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 43: Ministers of religion: deductions to be allowed in calculating profits of profession or vocation: section 159

This change extends the way in which deductions are allowed by section 332(3) of ICTA.

Section 332(3) of ICTA allows deductions from any profits, which may mean particular income receipts. It is more logical for the deductions to be made in calculating the profits of the profession or vocation, in line with the other calculating rules in Part 2 of this Act. It will no longer be arguable that a taxpayer has to match the deductions against a particular income receipt.

This allows a deduction in calculating the profits of the profession or vocation instead of requiring the taxpayer to set a deduction against a particular receipt.

Section 332(3)(c) of ICTA refers to expenses "borne" by the taxpayer. It is more logical for the deductions to be made when the taxpayer incurs the expenses, in line with other deduction rules in Part 2 of this Act. The effect of this is that a deduction may be available earlier than it is under the ICTA rule.

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 44: Ministers of religion: omission of section 332(3)(a) of ICTA: section 159

This change drops section 332(3)(a) of ICTA.

Section 332(3)(a) of ICTA allows deductions for "any sums of money paid or expenses incurred by [the minister] wholly, exclusively and necessarily in the performance of his duty as a clergyman or minister". Those words are almost identical to the words of the employment income rule, in section 351 of ITEPA.

In practice, the Inland Revenue applies the more generous "wholly and exclusively" rule in section 74(1)(a) of ICTA in calculating the profits of a profession or vocation carried on by a minister of religion. This means that a deduction may be allowed for expenses that are not incurred *necessarily* or *in the performance of the duties*.

The change removes the more restrictive test for expenses and brings the statute into line 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 45: Ministers of religion: alter the deduction rule in section 332(3)(b) of ICTA so that it is applied without reference to an inspector: remove the special appeals mechanism: section 159

This change applies the deduction rule without reference to an inspector. And the special appeal mechanism against the inspector's decision is removed.

Section 332(3)(b) of ICTA provides that a deduction is allowed in respect of a dwelling-house for "such part of the rent (not exceeding one-quarter) as the inspector by whom the assessment is made may allow". The inspector's decision is subject to review by the General or Special Commissioners.

These rules do not fit with Self Assessment. So the section applies the deduction rule ("a deduction is allowed for …") without reference to an inspector and without a special appeal mechanism.

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 46: Combine pools payments rules: sections 162 and 748

This change combines sections 126 of FA 1990 and 121 of FA 1991.

Section 162 of this Act does not specify that payments in consequence of the 1990 reduction in pool betting duty must be made for football safety and comfort, and that payments in consequence of the 1991 reduction in pool betting duty must be made to the Foundation for Sport and the Arts. Instead payments in consequence of any reduction in pool betting duty for either purpose will qualify.

Lord Justice Taylor's report into the Hillsborough disaster, published on 18 January 1990, recommended that significant capital expenditure should be incurred to improve safety and comfort at football grounds. To facilitate this the rate of pool betting duty was reduced from 42.5% to 40% in FA 1990, in exchange for an agreement that the money saved by pools promoters would be given to the Football Trust 1990, which would use it to implement the Taylor recommendations.

The following year the government agreed to a further reduction of 2.5% in pool betting duty on condition that the money saved was paid to a charitable trust to be set up by the three main

pools companies. The trust is called the Foundation for Sport and the Arts. For legal reasons connected with pool betting duty, the Foundation's main purpose is the support of athletic sports and games, but up to one third of its funds may be used to promote the arts.

The objectives of sections 120 of FA 1990 and 126 of FA 1991 are to ensure that the money saved in pool betting duty can flow through to its intended purpose in full, without tax liabilities.

Because the source sections have very similar objectives and consequences, this Act combines them.

In principle a taxpayer could divert payments from one destination to the other and still obtain a deduction, but in practice (because the payments are made under agreements with the bodies concerned) this is not possible. Even if it were possible the payments would still be supporting the defined good causes.

Section 748 of this Act adopts the same approach to rewriting section 126(3) of FA 1990 and section 121(3) of FA 1991. The payments made are not treated as annual payments.

This change is in taxpayers' favour in principle. But is expected to have no practical effect as it is in line with current practice.

Change 47: Extend pools payments treatment to the 1995 reduction: sections 162 and 748

This change extends the treatment of payments in consequence of reductions in pool betting duty so that it applies to the reduction in pool betting duty made in any year.

Pool betting duty was reduced in 1990 and 1991 in exchange for agreements that the money saved would be paid to particular good causes (the Football Trust 1990 and the Foundation for Sport and the Arts, respectively).

Sections 126 of FA 1990 and 121 of FA 1991 were enacted in order to ensure that the money could flow through to the beneficiaries without tax consequences.

In 1995 pool betting duty was reduced again, with half of the money saved to be paid to the Football Trust and the other half to the Foundation for Sport and the Arts. But no equivalent tax legislation was enacted. In practice the payments are treated in the same way as those made from the 1990 and 1991 reductions.

Section 162 of this Act allows the tax treatment to apply to payments made because of any reduction in pool betting duty, so that the 1995 reduction and any further reductions which result in payments being made to the two "good causes" are covered.

Section 748 of this Act adopts the same approach to rewriting section 126(3) of FA 1990 and section 121(3) of FA 1991. The payments made are not treated as annual payments.

This change is in taxpayers' favour in principle. But is expected to have no practical effect as it is in line with current practice.

Change 48: Waste disposal: site preparation expenditure: drop requirements to make claim and submit plans and documents: section 165

This change drops the requirements to make a claim and submit plans and documents when making deductions under section 165.

Section 91B of ICTA allows a revenue deduction for capital expenditure on preparing a waste disposal site for use. The expenditure is spread over the life of the site by means of a formula based on the total capacity of the site and the amount of that capacity which has been used.

The taxpayer must make a claim for relief under section 91B of ICTA (in such form as the Board may direct), and submit such plans and documents as the Board may require.

The requirement to submit plans and documents sits uneasily with Self Assessment - the Self Assessment record-keeping rules require taxpayers to keep such information and produce it in the event of an enquiry.

The section also drops the requirement to make a claim for relief, with the result that relief will simply be a deduction in the taxpayer's self-assessment. Once the requirement to submit plans and documents is removed, there seems no reason to require a claim for this particular deduction as opposed to any other.

The claim under section 91B of ICTA must be made within 70 months from the end of the tax year. Removing the claim means that taxpayers will have 22 months from the end of the tax year in which to include the deduction in their self-assessment. However, error or mistake claims will be available if too much tax had been paid as a result of omitting to include the deduction on the tax return.

This change is adverse to some taxpayers and favourable to others in principle but is not expected to have any practical effect.

Change 49: Valuation of trading stock: adopt the normal self-assessment time limit for an election by connected persons: section 178

This change adopts the normal self-assessment time limit of 22 months for an election by connected persons.

This Act expresses time limits consistently. Where possible, the time limit for an election is the first anniversary of the "normal self-assessment filing date" (defined in section 878 as 31 January following the relevant tax year). The time limit for the election in section 100(1C) of ICTA was not changed to take account of the introduction of Self Assessment. So in that section the time limit for income tax is two years from the end of the tax year of cessation. This is inconsistent with most other time limits for income tax.

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 50: Deductions for unremittable amounts: sections 187 to 191

This change gives statutory effect to ESC B38 (tax concessions on overseas debts). In doing this the Act makes a number of changes to the approach in the extra-statutory concession.

ESC B38 provides relief for trade debts that cannot be remitted to the United Kingdom. It is similar in scope to section 584 of ICTA which provides relief for unremittable income arising outside the United Kingdom, including unremittable trade profits. But section 584 of ICTA does not extend to trade debts owed to, or paid to, the trader outside the United Kingdom if the profits of the trade arise in the United Kingdom. For example, debts or payments arising from export sales. The extra-statutory concession gives relief for such debts and payments.

(A) Chapter 13 of Part 2 of this Act gives statutory effect to the extra-statutory 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.

(B) ESC B38 requires the relief to be claimed. Section 189 provides for the relief to be allowed as a deduction in calculating the taxpayer's trade profits. This not only simplifies the procedure for giving the relief; it may also reduce the time a taxpayer has to wait before the relief is given and, in certain circumstances, extend the time limit for giving the relief.

Paragraph 5(d) of the extra-statutory concession gives the time limits for making the claim. Relief can be claimed no earlier than 12 months after the end of the accounting period in which the unremittable payment was received or the unremittable debt arose. Giving the relief by means of a deduction will apply the normal self-assessment time limits.

In certain circumstances the time limit for giving the relief may be extended:

- if the notice to make a return is issued late then an amendment to a simple deduction may also be made late; and
- an error or mistake claim may be made up to (almost) six years from the end of the tax year.

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.

(C) Paragraph 4 of the extra-statutory concession denies any relief for a debt to the extent that the debt is insured. Section 190(3) (restrictions on relief) denies relief only to the extent that an insurance recovery has been received in respect of the debt. Also section 191(2)(f) withdraws relief only to the extent that an insurance recovery has been received in respect of the debt.

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 51: Disposal of know-how: restore an express definition of mineral deposits: sections 192 and 583

This change restores (for income tax purposes) a previous definition of "mineral deposits".

The definition of "mineral deposits" in these sections is in substance the definition that applied for the purposes of the definition of "know-how" in the source legislation for sections 192 and 583 of this Act. That definition applied before certain amendments of Chapter 1 of Part 13 of ICTA were made by CAA.

Section 531 of ICTA makes provision about the tax treatment of certain disposals of know-how. Different provision is made about disposals of know-how that has been used in the course of a trade and other disposals of know-how. The former provision is rewritten in sections 193 and 194 of this Act and the latter in sections 583 to 586.

Know-how is defined for the purposes of section 531 of ICTA as:

> any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Before certain amendments of ICTA were made by CAA, the following definition applied to the expression "mineral deposits" in that definition:

> "mineral deposits" includes any natural deposits capable of being lifted or extracted from the earth and, for this purpose, geothermal energy, whether in the form or aquifers, hot dry rocks or otherwise, shall be treated as a natural deposit.

The history of that definition is as follows. The provisions of section 531 of ICTA derive from section 21 of FA 1968, which included the following definition:

> (7) In this section "know-how" means any industrial information and techniques likely to assist in the manufacture or processing of goods or materials, or in the working of a mine, oil-well or other source of mineral deposits (including the searching for, discovery, or testing of deposits or the winning of access thereto), or in the carrying out of any agricultural, forestry or fishing operations.

Subsection (9) of that section required the above definition to be construed as if it were contained in Part 1 of the Capital Allowances Act 1968, so that the following definition of "mineral deposits" applied:

> "mineral deposits" includes any natural deposits capable of being lifted or extracted from the earth.

That definition was amended by paragraph 2(3) of Schedule 13 to FA 1968, which added the words from "and, for this purpose" onwards.

The relevant provisions were consolidated in 1970 and again in 1988. Section 532 of ICTA originally provided for the definition of "know-how" to be construed as if it were contained in Part 1 of the Capital Allowances Act 1968. A reference to "the 1990 Act" was substituted by the Capital Allowances Act 1990. This attracted the definition of "mineral deposits" which is set out above in the fourth paragraph of this note, and applied throughout that Act.

CAA rewrote provisions about know-how allowances that were previously in Chapter 1 of Part 13 of ICTA. In consequence of the repeal of the Capital Allowances Act 1990, CAA also amended section 532 of ICTA so that it provides for the definition of "know-how" to be construed as if it were contained in the 2001 Act. However, no definition of "mineral deposits" applies for the purposes of CAA as a whole. So the consequential amendment failed to preserve the application of the Capital Allowances Act 1990 definition of "mineral deposits" to the remaining provisions of Chapter 1 of Part 13 of ICTA (including those on which sections 192 and 583 are based).

It is noteworthy that a version of the definition of "mineral deposits" is carried forward in CAA to apply to the rewritten material about know-how allowances. See section 452(3) of that Act.

The failure to preserve the application of the Capital Allowances Act 1990 definition of "mineral deposits" to the remaining provisions of Chapter 1 of Part 13 of ICTA is believed to have resulted from an oversight. The inclusion of a definition of "mineral deposits" in sections 192 and 583 corrects this error.

The definition of "mineral deposits" in sections 192 and 583 of this Act differs from the definition formerly in section 161(2) of the Capital Allowances Act 1990 in that the words "whether in the form of aquifers, hot dry rocks or otherwise" are omitted. The definition of "mineral deposits" in section 452(3) of CAA also omits these words. The omission was made in that Act on the basis that the words are merely illustrative and that leaving them out does not change the legal effect of the definition. They are omitted in this Act for the same

reasons. A fuller discussion of this point can be found in Note 46 in Annex 2 to the Explanatory Notes to CAA.

This change clarifies the law by making it certain that the definition of "mineral deposit" continues to apply for the purposes described above.

This change clarifies the law and removes uncertainty. But it is expected to have no practical effect as it is in line with current practice.

Change 52: Basis periods etc: to allow any reasonable and consistent time basis for apportioning profits or for calculating deductible overlap profit: sections 203, 220, 275 and 871

This change involves giving statutory effect to a concessionary practice for apportioning profits or losses to different periods.

Section 72(1) of ICTA permits the apportionment of profits or losses for the purposes of Schedule D Case I, II or VI. Section 72 of ICTA is applied by section 21A(2) of ICTA for the purpose of calculating the profits of a Schedule A business.

Section 72(2) of ICTA secures that the apportionment must be by reference to days. But, by concession, taxpayers can adopt any other reasonable basis for time apportionment (described in paragraph 71025 of the Business Income Manual).

Section 203 rewrites section 72 of ICTA (so far as trades, professions and vocations are concerned); and section 275 reproduces the effect of applying that section by section 21A(2) of ICTA. Subsection (4) of each section allows the periods to be measured otherwise than by reference to days if it is reasonable to do so and the measure is used consistently. Similarly, section 871 rewrites section 72 of ICTA (in respect of profits formerly charged under Schedule D Case VI which are now listed in section 836B of ICTA), and subsection (5) of that section operates like subsection (4) of sections 203 and 275.

Section 63A(2) of ICTA provides for the calculation and deduction of overlap profit by reference to "days" and the "overlap period" is defined by section 63A(5) of ICTA as the number of days in the period in which the overlap profit arose.

Section 220 preserves that basic approach. But, by concession, taxpayers can adopt any other reasonable measure provided it is used consistently (described in paragraph 71140 of the Business Income Manual). Subsection (4) gives effect to this 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 53: Enterprise allowance: include in trade profits: section 207

This change involves including enterprise allowance in the calculation of trade profits.

The former Enterprise Allowance scheme provided financial assistance for unemployed people starting their own businesses. The payments are now more commonly known as business start-up allowances. These may be in variable amounts including lump sums in certain circumstances.

The original Enterprise Allowance scheme provided only for weekly payments of £40. When the scheme was changed in 1991-92 the special treatment in section 127 of ICTA applied only to business start-up payments of the sort (known as "enterprise allowance") that had

been paid under the original scheme. Any lump sum business start-up payments are not of that sort. So this section does not apply to lump sum payments.

Without section 127 of ICTA the allowances would be taxed as trade profits. With the former prior year basis of assessment some profits of the first year of trading were taxed more than once. As the allowance is usually paid for the first year this might be the case for the allowance. Section 127 of ICTA was introduced to avoid this. It does so by taxing the allowance under Schedule D Case VI instead of Schedule D Case I or II, circumventing the basis period rules.

Even under the current year basis of assessment there may still be an overlap period when trading commences. So section 207(2) of this Act ensures that the allowance is taxed only once, by being included in the profits of only the first of two basis periods.

In some cases this change may lead to a delay in the assessment of the allowances. This is because they will be taken into account in a basis period of the trade rather than in the tax year in which they are received.

It will no longer be possible to set Schedule D Case VI losses against the allowances. But trading losses brought forward and terminal losses may become available against the allowances.

As the allowances will be included in the calculation of trade profits, there is no need to rewrite section 127(3) of ICTA, which treats the allowances in appropriate cases as relevant earnings.

The charge to national insurance contributions is unchanged because contributions are specifically charged on the allowances by section 15(4) of the Social Security Contributions and Benefits Act 1992. This specific charge is no longer needed and is therefore repealed.

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 54: Basis periods: treat accounts regularly prepared to dates near the end of the tax year as if prepared to 5 April subject to a taxpayer's opt out: sections 208, 209 and 210

This change makes automatic, subject to a taxpayer's right to opt out, the treatment under which accounts regularly prepared to dates near the end of the tax year are treated as if prepared to 5 April.

Change 55 gives statutory effect to the non-statutory practice described in paragraph 71170 of the Business Income Manual under which accounts prepared to 31 March (and 1, 2, 3 and 4 April) are treated as prepared to 5 April. That simplifies the operation of the rules by avoiding the creation of very short overlaps of basis periods - and therefore small amounts of overlap profit - during the first years of trading.

Most people with a late accounting date are likely to wish to take advantage of this rule. So section 208(3) makes it automatic unless the taxpayer "elects out".

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 55: Basis periods: to allow accounts prepared to a date near the end of the tax year to be treated as if prepared to 5 April: sections 208, 209, 210 and 220

This change allows accounts regularly prepared to 31 March or 1, 2, 3 or 4 April to be treated as if prepared to 5 April and a change of accounting date to 31 March (or 1, 2, 3 or 4 April) to be treated, for overlap relief purposes, as a change to 5 April.

The source legislation in sections 61 to 63A of ICTA distinguishes between the case where accounts are regularly prepared to 5 April and the case where they are prepared to a different date. In the latter case the rules are more complex and involve periods of overlap of basis periods (and, as a consequence, the creation of overlap profit that must subsequently be relieved) during the first years of trading.

Many taxpayers prepare accounts regularly to 31 March. In practical terms there is little difference between these cases and the 5 April cases but strictly under the source legislation, they nevertheless fall within the more complex "accounting date other than 5 April" rules.

Change 55 allows, for the purposes of the basis period rules, accounts prepared to 31 March to be treated as prepared to 5 April. That simplifies the operation of the basis period rules by avoiding the creation of very short overlaps of basis periods - and therefore of small amounts of overlap profit - during the first years of trading.

But it would be illogical to exclude from this simplification cases where the chosen accounting date would result in overlaps even shorter than those arising from an accounting date of 31 March. So accounts prepared to dates 1 to 4 April are also included.

This change gives statutory effect to the non-statutory practice described in paragraph 71170 of the Business Income Manual and prevents overlaps of less than six days.

A similar problem can arise where there is a change of accounting date. The effect of the source legislation in section 63A of ICTA is that where there is a change of accounting date that is effective for tax purposes and that change is to an accounting date of 5 April, all previous overlap profit is deductible without restriction. But taxpayers who change to a date very close to 5 April would normally be potentially subject to a minor restriction of their overlap relief.

Section 220 provides statutory authority for the non-statutory practice referred to in paragraph 71170 of the Business Income Manual. That practice allows a change of accounting date to 31 March to be treated as though it were a change to 5 April. And that allows all previous overlap profit to be deducted in the year in which such a change takes effect for tax purposes.

Again, it would be illogical to exclude change of accounting date cases where the chosen accounting date fell between 31 March and 5 April. So a change of accounting date to 1, 2, 3 or 4 April is also treated as though it were a change to 5 April.

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 56: Basis periods: to allow accounts regularly prepared to a particular day in the year to be treated as if prepared to a particular date: sections 211, 212 and 213

This change allows accounts regularly prepared to a particular *day* in the year to be treated as if prepared to a particular *date*. This avoids the need to apply complex change of accounting date provisions.

In the source legislation whenever there is a change of accounting date complex rules in sections 62 and 62A of ICTA are triggered. Those rules determine when - or whether - the basis period can align with the new accounting date.

For most taxpayers changes of accounting date are relatively infrequent. But it is sometimes more practical for taxpayers to prepare their accounts to a particular day in the year - a mean date - rather than to a particular date. Examples might include the last Friday in September or the last day of the summer term. Because the resulting accounting date will be different year by year the complex change of accounting date rules would normally apply to such changes.

Change 56 allows taxpayers to prepare their accounts to a mean date without triggering the change of accounting date rules, provided certain conditions are met.

This change gives statutory effect to the extra-statutory practice authorised in paragraph 71175 of the Business Income Manual.

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 57: Overlap profit (calculating a deduction): to allow the taxpayer to disregard 29 February when there is a change of accounting date to a date late in the tax year: section 220

This change, in section 220(6), allows the taxpayer to disregard 29 February in calculating a deduction for overlap profit when there is a change of accounting date to a date falling on 31 March to 5 April inclusive.

It is normally the case that, in any year where overlap relief is due, a taxpayer has the same number of days' overlap relief as there are days between his or her accounting date and 5 April.

As a result, at a change of accounting date to 5 April the overlap profit should be relieved in full under the source legislation in section 63A(1) of ICTA. But when 29 February falls in either the overlap period or the basis period given by section 62(2)(b) of ICTA, section 63A(1) of ICTA does not give the correct result. An adjustment is then necessary on cessation under section 63A(3) of ICTA.

Change 57 gives statutory effect to the practice described in paragraph 71155 of the Business Income Manual. Section 220(6)(a) allows the taxpayer to disregard 29 February in this case and the overlap relief adjustment to be made in full.

Change 55 gives statutory effect to the practice whereby changes of accounting date to dates from 31 March to 4 April inclusive may be treated as if made to 5 April. It would be illogical not to align Change 57 with that Change. So section 220(6)(b) allows taxpayers to disregard 29 February when the change is to one of those earlier dates.

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: Averaging: foreign trades: section 221

This change allows an individual to claim averaging of profits derived from creative work carried on wholly abroad. Section 65(3) of ICTA may in fact allow a claim but the section removes any doubt.

Schedule 4A to ICTA applies to profits derived from creative works that are "chargeable to tax under Case I or II of Schedule D". The policy is to exclude profits that are charged under Schedule D Case VI because they arise from activities that do not amount to a trade, profession or vocation.

It will be rare for a UK resident individual to carry on a "creative" trade wholly outside the United Kingdom. But there is no reason why the profits of such a trade should not be averaged. And it would complicate the Act to make an exception for a foreign trade.

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 59: Averaging: section 221

This change gives statutory effect to ESC A29 (relief for fluctuating profits). It treats the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption as farming for the purposes of averaging.

Averaging applies only to farming, market gardening and "creative activities". Farming is the occupation of land for the purposes of husbandry. Tax law has always drawn a distinction between profits resulting from the taxpayer's occupation of land and profits from an activity to which the occupation is merely incidental in the sense that the activity must be carried out somewhere. This is why the intensive rearing of livestock and fish (so-called "factory farming") is not farming. Such creatures do not live on or draw their sustenance from the soil because they are largely kept in buildings or tanks and so the profits from them do not arise from the occupation of land.

But ESC A29 permits the extension of the rules for averaging to the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption. It does this by extending the definition of farming for these purposes.

Section 362(1) of CAA permits a near-identical extension by defining husbandry to include the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption, in the context of defining "agricultural land". And section 115(2) of the Inheritance Tax Act 1984 permits a similar extension in the context of defining "agricultural property" provided certain conditions are met.

Section 221(3) of this Act ensures that the averaging rules apply to the intensive rearing of livestock or fish without the need to extend the definition of farming itself in section 876.

This change is in taxpayers' favour in principle. But is expected to have no practical effect as it is in line with current practice.

Change 60: Averaging: clarify the rule that a claim cannot be made in commencement or cessation year: section 222

This change ensures that a claim cannot be made in the year in which an individual partner commences or ceases to carry on a qualifying trade in partnership.

Section 96(4)(b) of ICTA provides that no claim is to be made in respect of any tax year "in which the trade is (or by virtue of section 113(1) [of ICTA] is treated as) set up and commenced or permanently discontinued." Section 113 of ICTA applies where there is a complete change in the persons carrying it on. However, it does not apply where there is a partial change, for example, when one partner leaves a firm while the others continue.

Before Self Assessment (when the rule applied only to farmers) the same rule clearly operated for farming carried on by a sole trader and farming carried on by persons in partnership. This is because a claim for averaging could be made only in respect of the profits of a sole trader or of a firm. But under Self Assessment profits are calculated as if the firm were an individual and each partner's share in the profits of the firm is then determined. The rules for determining partners' basis periods are then applied as if they were sole traders.

The intention under Self Assessment is to treat sole traders and individual partners in the same way, so that individual partners cannot make an averaging claim in relation to the year in which they start or cease to carry on a qualifying trade in partnership. It is generally accepted that the legislation achieves this result. But the words of section 96 of ICTA leave some doubt. The references to "his profits from *that trade*" in subsection (1) and to "a year of assessment in which *the trade* is … set up and commenced" in subsection (4)(b) might suggest that these references are to the partnership trade as a whole, rather than to the deemed trade carried on by the individual partner.

Section 222(4) of this Act contains the rule that an averaging claim may not be made in a tax year in which the taxpayer starts or permanently ceases to carry on the qualifying trade. This rule will apply whether the taxpayer is a sole trader or in partnership. So there is no ambiguity in the rule: it is in line with the original intention and with how it is applied in practice.

This change is adverse to some taxpayers in principle. But it is in line with the original legislation before amendment and with the intention of the amended legislation. And it is expected to have no practical effect as it is in line with current practice.

Change 61: Averaging: time limit for a further claim: section 225

This change makes clear that the full 22 month time limit applies to a further claim for averaging.

Section 96(8) of ICTA provides that a claim must be made "…*before* the 31st January next following the year of assessment…". If this precludes a claim being made on 31 January the rule falls one day short of the full 22 month time limit for the making of claims.

This Act expresses time limits consistently. Where possible, the time limit for an election is the first anniversary of the "normal self-assessment filing date" (defined in section 878 of this Act as 31 January following the relevant tax year). So section 225 makes it clear that the full 22 month time limit applies.

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 62: Adjustment income: how an election affects later years: section 239

This change clarifies what happens to the remainder of adjustment income in the years after an election has been made to have the charge increased.

A barrister or advocate may be subject to a charge under Schedule 22 to FA 2002. The charge is spread over ten years in accordance with paragraph 11 of that Schedule. But an election may be made under paragraph 12 of the Schedule to accelerate the charge. In this Act, the spreading rule is in section 238. The election is in section 239.

Example

If there is a charge of £1200 over ten years and an election to have £300 instead of £120 charged in year 4, there is some doubt about the "additional amount" in paragraph 12(4) of Schedule 22 to FA 2002.

- If it is £300, there will be six charges of £90 ([£1200-£300]/10).
- If it is £180, there will be five charges of £102 ([£1200-£180]/10) and a final one of £30.

Policy and logic suggest the first answer but the 2002 legislation seems to suggest the second. Section 239(4) of this Act uses the "additional amount" of £180 to produce six charges of £90.

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 63: Post-cessation receipts: design right: section 253

This change corrects an anomaly in section 104(3) of ICTA. It ensures that a lump sum received by personal representatives for the assignment of design right is not treated as a post-cessation receipt.

The policy is that a lump sum from the disposal of certain rights should not be treated as a post-cessation receipt. That is the rule in section 103(3)(b) and (bb) of ICTA. Paragraph (bb) was inserted by the Copyright, Designs and Patents Act 1988.

Section 104 of ICTA charges sums "not ... otherwise chargeable to tax" (subsection (2)). Section 104(3) of ICTA provides that, in the case of a lump sum from a patent right etc, the section does not charge sums that would have been chargeable to tax under section 103 of ICTA but for the exemption in section 103(3)(b) of ICTA. As there is no reference to the exemption in section 103(3)(bb) of ICTA a lump sum from a design right could in principle be caught by section 104 of ICTA.

This change ensures that the intended exemption applies.

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 64: Post cessation receipts treated as relevant UK earnings for pension purposes: section 256

This change gives statutory effect to the practice of treating certain sums received after a trade, profession or vocation has ceased (post-cessation receipts) as relevant earnings for the purposes of making pension contributions.

Sections 103 and 104 of ICTA charge post-cessation receipts under Schedule D Case VI. This charge is rewritten in Chapter 18 of Part 2 of this Act.

Section 107 of ICTA provides that amounts charged to tax under sections 103 and 104 of ICTA shall be treated as earned income if the profits of the trade, profession or vocation would also have been treated as earned income before the cessation. This treatment is rewritten as section 256 of this Act.

If section 107 of ICTA applies to treat an amount as earned income it is Inland Revenue practice to treat that amount as relevant earnings for the purposes of retirement annuity relief or making contributions under personal pension arrangements (sections 623(2) and 644(2) of ICTA).

FA 2004 introduced a new regime for taxing pensions to take effect in April 2006. The equivalent of relevant earnings in that regime is relevant UK earnings as defined in section 189(2)(b) of FA 2004. Without the change in the law introduced by section 256 the practice described in the previous paragraph would be extended to the new regime. Section 256 anticipates this by providing that post-cessation receipts treated as earned income are also treated as relevant UK earnings for pension purposes.

Retirement annuity relief and personal pension arrangements are dealt with as a transitional measure in paragraph 60 of Schedule 2 to this Act. This is in line with the approach taken to the rewrite of other provisions affected by the new pension regime. The new rules are dealt with in the substantive section and the old rules which apply until 5 April 2006 are dealt with in the transitionals Schedule.

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 65: Statutory insolvency arrangement - Scotland: section 259

This change adapts the definition of "statutory insolvency arrangements" in section 259 to Scotland.

Section 74(1)(j) of ICTA prohibits the deduction in computing the profits of a trade, profession or vocation of any debt other than:

(i) a bad debt

(ii) a debt or part of a debt release by a creditor wholly and exclusively for the purposes of his trade, profession or vocation as part of a relevant arrangement or compromise; and

(iii) a doubtful debt to the extent estimated to be bad.

Section 74(1)(j) of ICTA is rewritten in section 35. Section 35 replaces the term "relevant arrangement or compromise" with "statutory insolvency arrangement".

Section 74(2)(a) of ICTA defines "relevant arrangement or compromise" as a voluntary arrangement under the Insolvency Act 1986 (covering individual voluntary arrangements in

England and Wales) or the Insolvency (Northern Ireland) Order 1989 (covering individual voluntary arrangements in Northern Ireland).

The omission of any reference to Scottish insolvency legislation was an oversight when section 74(2) of ICTA was inserted by section 144(2) of FA 1994. The nearest equivalent in Scotland to the Insolvency Act 1986 and the Insolvency (Northern Ireland) Order 1989 is the Bankruptcy (Scotland) Act 1985 which covers voluntary arrangements in Scotland supervised by the courts or by independent practitioners. So section 259 defines "statutory insolvency arrangement" by reference to the Bankruptcy (Scotland) Act 1985 as well as by reference to the corresponding legislation in England and Wales and in Northern Ireland cited in section 74(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 66: Priority of the charge on trade profits: the "Crown Option" and sections 261, 366 and 575

This change gives priority to the charge on trade profits if an item of income is both a trade receipt and potentially within the receipts of an overseas property business in Part 3, or within a charge to tax in Part 4 or 5 of this Act.

In the source legislation taxable income is allocated to different Schedules. The charges under these Schedules are mutually exclusive.

In addition, a small number of charges (non-schedular charges) are imposed outside the schedular system.

The scope of Schedule D is set out in section 18 of ICTA. The effect of that section (and the relevant case law) is that Schedule D is the residual Schedule. If income meets the conditions to be taxed under Schedule D and the conditions to be taxed under ITEPA 2003 or another Schedule of ICTA it will be taxed under the alternative and not under Schedule D.

But there is no order of priority between Cases I to V of Schedule D. In the event of income falling within more than one of those Cases it has long been accepted that the Inland Revenue has the option to choose under which case the income should be taxed. This "Crown Option" was not legislated until 1996 when section 28A(7B) was inserted into TMA 1970. This was done, not so much to provide explicit statutory authority for the option, but to explain how it should operate under Self Assessment.

In 2001 section 28A(7B) of TMA was replaced by section 9D of TMA. It provides that if a self-assessment return is made and alternative methods are allowed for bringing amounts into charge the Inland Revenue may determine which alternative is used. The decision of the Inland Revenue is final and conclusive.

Section 9D(2) of TMA provides that the cases where the Tax Acts allow for alternative methods for bringing amounts into charge are under either:

- Schedule D Case I or II; or
- Schedule D Case III, IV or V.

The Inland Revenue's guidelines for making the determination are published in paragraph 14035 of the Business Income Manual (BIM 14035). The income will be taxed under Schedule D Case I or II and not under Schedule D Case III, IV or V.

This Act deals with the Crown Option by providing for an order of priority between the Parts if income is capable of being taxed under more than one Part.

Section 261 provides that if income is capable of being taxed under Part 3 of this Act in respect of an overseas property business and under Chapter 2 of Part 2 of this Act it is taxed under Part 2. ICTA taxes the profits arising from an overseas property business under Schedule D Case V so section 261 gives effect to the Crown Option in respect of trades carried on wholly or partly in the United Kingdom (and to section 65A(1)(b) of ICTA in respect of trades carried on wholly abroad).

Section 366(1) gives priority to Chapter 2 of Part 2 of this Act if income falls within both Part 2 and Part 4 of this Act. This gives effect to the Crown Option in respect of income within Part 4 of this Act that is taxed in ICTA under Schedule D Cases III, IV or V. It goes beyond the Crown Option in that it gives Part 2 of this Act priority over income that would be taxed under Schedule F or as a non-schedular charge. It applies the same approach to trades carried on wholly abroad as is applied to trades carried on wholly or partly in the United Kingdom. This is consistent with the law (see section 65(3) of ICTA) and practice that the profits of both types of trade should be calculated on the same basis as far as possible.

In the case of income taxed under Schedule F the statutory authority for this approach is given by section 95(1) of ICTA (applied to trades carried on wholly abroad by section 65(3) of ICTA) .

In the case of non-schedular charges it is unlikely that there would be any overlap for income tax payers. But in theory it is possible that, for example, stock dividends (Chapter 5 of Part 4 of this Act) and gains from contracts for life assurance (Chapter 10 of Part 4 of this Act) may rank as trade receipts. Taxing such income under Part 2 of this Act accords with the policy and practice of taking trade receipts into account in calculating trade profits and not otherwise.

Part 2 of this Act provides for a charge on the profits of professions and vocations as well as a charge on the profits of trades. So section 366(1) goes beyond the ambit of ICTA by giving priority to Part 2 of this Act if the source legislation gives priority to income taxed as a trade receipt or under Schedule D Case I. For example, section 56(2) of ICTA (rewritten as section 551 (transactions in deposits)) excludes income taxed as a trade receipt from the charge under Schedule D Case VI. Paragraph 1(2)(a) of Schedule 5AA to ICTA (rewritten as section 555 (disposals of futures and options involving guaranteed returns)) excludes income taxed under Schedule D Case I or V from the charge under Schedule D Case VI . Taxing such income under Part 2 of this Act accords with the policy of taking receipts into account in calculating Schedule D Case I or II profits, although the point is most unlikely to arise in practice in relation to a profession.

Section 575 gives priority to Part 2 of this Act if income falls both within Chapter 2 of Part 2 (trade receipts) of this Act and Part 5 of this Act. In this case the only possible overlap is with income that could be taxed under Schedule D Cases III and V. So the order of priority gives effect to the Crown Option.

The order of priority in sections 366(1) and 575 allows sections 9D, 12AE(2) and 31(3) of TMA to be repealed.

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: Territorial scope of charge to tax: land in Ireland: section 269

This change concerns income from land in the Republic of Ireland arising to a person whose other foreign income is assessed on the remittance basis.

The change makes it clear that businesses and transactions for generating income from land in the Republic of Ireland form part of an overseas property business of a person to whom the remittance basis applies.

The basic rule is that income arising from property in the Republic of Ireland is assessable on the basis of the amount arising (see section 68(1) of ICTA). This rule applies "notwithstanding anything in section 65 [of ICTA]". Section 65(5) of ICTA provides for the remittance basis to apply to foreign income.

Section 65(4) of ICTA provides that section 65A of ICTA (overseas property businesses) does not apply in relation to persons to whom the remittance basis applies.

It is not clear how the rules in sections 65A and 68(1) of ICTA interact. Section 68(1) of ICTA does not refer to section 65A of ICTA. If it was Parliament's intention that Irish income was to be assessable on the arising basis but not in accordance with section 65A of ICTA, it might be expected that section 68(1) of ICTA would apply notwithstanding sections 65 *and* 65A of ICTA.

So far as Irish income is concerned, the rule in section 65(4) and (5) of ICTA that the income of a person to whom the remittance basis applies is not to be assessed on the arising basis but on the remittance basis is not to be read literally. Section 68(1) of ICTA secures that income arising in the Republic of Ireland is assessed on the arising basis even if it arises to a person to whom the remittance basis applies.

It is likely that Parliament intended the reference to section 65A in section 65(4) to be read in this light. In other words the overseas property business rules were not to apply in relation to the *income* of a person to whom the remittance basis applies that was actually charged on the remittance basis.

Section 269 makes it clear that the overseas property business rules are to be used in calculating a person's income from Irish property even if the remittance basis applies to the other foreign income of that person.

In theory this change may allow a taxpayer to set a loss sustained in letting one Irish property against profits arising from letting another.

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 68: Sums payable instead of rent, or as consideration for the variation or waiver of a term of a lease, for periods of 50 years or less: sections 276, 279 and 281

This change clarifies the application of the lease premium rules to sums paid instead of rent, or for the variation or waiver of a term of a lease, if the period for which the sum is paid, or

the variation or waiver has effect, is 50 years or less but the duration of the lease is more than 50 years.

Section 279 is based on section 34(4) of ICTA. If under the terms of a lease a tenant is to pay a sum instead of rent, section 34(4) of ICTA treats the lease as requiring the payment of a premium for the purposes of section 34 of ICTA.

Section 34(4) of ICTA is intended to prevent a landlord avoiding a charge to income tax on rent by including in the terms of a lease provision for a lump sum to be paid instead of rent.

Section 34(1) of ICTA applies only if the duration of the lease does not exceed 50 years. Section 34(4) of ICTA does not say explicitly that it applies to leases not exceeding 50 years or that it applies irrespective of the duration of the lease. But section 34(4)(a) of ICTA provides that, in computing the profits of the Schedule A business of which section 34(4) of ICTA treats the sum payable instead of rent as a receipt, any period *other than that in relation to which the sum is paid* should be disregarded in arriving at the duration of the lease.

There is more than one way to interpret the relationship between section 34(4)(a) of ICTA and the restriction in section 34(1) of ICTA that the duration of the lease should not exceed 50 years.

Section 34(1) of ICTA could be interpreted as limiting the application of section 34(4) of ICTA to leases with a duration of not more than 50 years. This would allow a landlord to avoid income tax on rent for any period up to 50 years by receiving that rent in the form of a lump sum if it is in respect of a lease for more than 50 years.

This is not the way the legislation has been interpreted and applied in practice over many years. Ever since the legislation was first enacted in FA 1963 the Inland Revenue has interpreted section 34(4) of ICTA as applying to the receipt of a sum instead of rent for a period not exceeding 50 years *regardless* of the duration of the lease. As a result, the person by whom the sum is paid may be treated as paying rent for the purposes of relief under section 37(4) of ICTA in computing the profits of a Schedule A business or under section 87 of ICTA in computing the profits of a trade, profession or vocation.

Section 279(1)(b) follows the Inland Revenue interpretation by applying section 279 if a sum is paid instead of rent for a period of 50 years or less regardless of the duration of the lease. Because this is not explicit in section 34(4) of ICTA it may be a change in the law.

A similar point arises on section 281, based on section 34(5) of ICTA. If a tenant is to pay a sum as consideration for the variation or waiver of any of the terms of a lease, section 34(5) of ICTA treats the lease as requiring the payment of a premium.

Section 34(5) of ICTA is intended to prevent a landlord avoiding a charge to income tax on rent, or on a premium treated as rent under section 34(1) of ICTA, by altering the terms of a lease in return for the payment of a lump sum. For example, a lease on a shop might contain a condition that the property is not to be used for retail trade; the landlord then waives this condition in return for a separate consideration. Without section 34(5) of ICTA, the additional consideration would not be a premium for the purposes of section 34 of ICTA.

As in section 34(4) of ICTA, section 34(5) of ICTA does not say explicitly that it applies to leases not exceeding 50 years or that it applies irrespective of the duration of the lease. But section 34(5)(a) of ICTA provides that in computing the profits of the Schedule A business of which section 34(5) of ICTA treats the sum payable as consideration as a receipt, any period

other than that for which the variation or waiver has effect should be disregarded in arriving at the duration of the lease.

As in section 34(4) of ICTA, there is more than one way to interpret the relationship between section 34(5)(a) of ICTA and the restriction in section 34(1) of ICTA that the duration of the lease should not exceed 50 years.

Section 34(1) of ICTA could be interpreted as limiting the application of section 34(5) of ICTA to leases with a duration of not more than 50 years. This would allow a landlord to avoid income tax on rent for any period up to 50 years by receiving a payment for the waiver or variation of the term of a lease if it is in respect of a lease for more than 50 years.

As in the case of section 34(4)(a) of ICTA, this is not the way the legislation has been interpreted and applied in practice. Ever since the legislation was first enacted in FA 1963 the Inland Revenue has interpreted section 34(5) of ICTA as applying to the receipt of a sum as consideration for the variation or waiver of a term of a lease for a period not exceeding 50 years *regardless* of the duration of the lease. As a result, the person by whom the sum is paid may be treated as paying rent for the purposes of relief under section 37(4) or section 87 of ICTA.

Section 281(1)(c) follows the Inland Revenue interpretation by applying section 281 if a sum is paid for the waiver or variation of the term of a lease for a period of 50 years or less regardless of the duration of the lease. Because this is not explicit in section 34(5) of ICTA, it may be a change in the law.

If, as a result of this change, an amount is brought into account as a receipt in respect of a sum payable under the terms of a lease instead of rent, or as consideration for the variation or waiver of a term of a lease, the tenant may become entitled to relief under sections 287 to 295 if the tenant carries on a property business or under sections 60 to 65 if he or she carries on a trade, profession or vocation.

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 69: Identifying the profits involved where an amount is to be taken into account as a receipt in calculating the profits of a property business: sections 277, 279, 280, 281, 282, 284 and 285

This change relates to the provisions requiring an amount in respect of a premium or other sum payable in connection with a lease to be taken into account as a receipt in calculating the profits of a property business.

Section 34 of ICTA provides that if a premium is payable under the terms subject to which a lease is granted, the landlord is treated as receiving an amount by way of rent. Section 34(4) of ICTA provides that if, under the terms subject to which a lease is granted, a sum becomes payable by the tenant instead of rent or as consideration for the surrender of the lease, the lease is deemed for the purposes of section 34 of ICTA to have required the payment of a premium to the landlord. Section 34(5) of ICTA makes similar provision in the case of a sum payable by the tenant as consideration for the variation or waiver of any of the terms of the lease.

Section 34(7A) of ICTA provides that an amount treated as rent under section 37 of ICTA "shall be taken into account in computing the profits of the Schedule A business in question

for the chargeable period in which it is treated as received". Section 34(1), (4)(b) and (5)(b) of ICTA specify when the rent is deemed to be received.

(A) Under section 34(6) of ICTA, if the premium - or the sum treated as a premium by section 37(4) or (5) of ICTA - is payable to a person *other than* the landlord, that person is:

> taken to have received as income an amount equal to the amount which would otherwise fall to be treated as rent and to be chargeable to tax as if he had received it in consequence of having, on his own account, entered into a transaction falling to be treated as mentioned in paragraph 1(2) of Schedule A.

Paragraph 1(2) of Schedule A in section 15(1) of ICTA provides that certain transactions are to taken to be entered into in the course of a Schedule A business. So the effect of section 34(6) of ICTA is to treat the person to whom the premium or other sum is payable as carrying on a Schedule A business and receiving an amount of income as a receipt of that business.

The receipt must be taken into account in computing the profits of that person's Schedule A business. But there is no provision specifying the period for which the receipt must be taken into account. Section 34(7A) of ICTA does not apply to such receipts as it only applies to amounts treated under section 34 of ICTA as rent.

In practice, premiums or other sums payable to a person other than a landlord are taken into account in computing the profits of the Schedule A business for the same chargeable period as if they had been payable to the landlord and the landlord had been treated as receiving rent. So sections 277(3), 279(3), 280(3) and 281(3) require an amount to be brought into account as a receipt in calculating the profits of a property business for a specified tax year whether the premium or other sum was payable to the landlord or to another person.

This change has no implications for the amount of income liable to tax or who is liable for tax on it. In principle it affects when tax is paid but is expected to have no practical effect as it is in line with current practice.

(B) Section 34(7A) of ICTA provides that an amount treated as rent under section 34 of ICTA is to be taken into account in computing the profits of the Schedule A business for the chargeable period in which it is treated as received.

Section 34(1), (4)(b) and (5)(b) of ICTA specify when the rent is deemed to be received. But it is only necessary to know when the rent is deemed to be received in order to apply the rule in section 34(7A) of ICTA. So in rewriting section 34(1) of ICTA, section 277(4) requires an amount to be brought into account as a receipt in calculating the profits of the property business for the tax year in which the lease is granted. And in the same way, sections 279(4), 280(4) and 281(4) refer to the tax year in which the sum becomes payable.

A similar point arises in sections 35 and 36 of ICTA.

Section 35(2A) of ICTA provides that an amount treated under section 35 of ICTA as income received by the person by whom the lease was assigned:

> (a) is treated as received when the consideration … becomes payable, and
>
> (b) shall be taken into account in computing the profits of the Schedule A business in question for the chargeable period in which it is treated as received.

Similar provision is made by section 36(4A) of ICTA in relation to receipts where the terms subject to which an estate or interest in land is sold provide either that it is to be reconveyed or for the grant of a lease out of the estate or interest in land.

Again, it is only necessary to know when the receipt is received in order to apply the rule in section 34(7A) of ICTA. So in rewriting section 35 of ICTA, section 282(4) requires an amount to be brought into account as a receipt in calculating the profits of the property business for the tax year in which the consideration for the assignment becomes payable. And in the same way, sections 284(4) and 285(5) refer to the profits of the property business for the tax year in which the estate or interest is sold.

This change has no implications in principle or in practice for the amount of tax paid, who pays or when.

Change 70: Lease premiums etc: no receipt in respect of sum payable for variation or waiver of term of lease if sum due to someone other than the landlord or a person connected with landlord: section 281

This change prevents an amount being treated as a receipt of the landlord's property business, where a sum is payable by the tenant as consideration for the variation or waiver of a term of a lease to somebody other than the landlord or a person connected with the landlord.

Section 34(5) of ICTA provides:

> Where, as a consideration for the variation or waiver of any of the terms of a lease, a sum becomes payable by the tenant otherwise than by way of rent, the lease shall be deemed for the purposes of this section to have required the payment of a premium to the landlord (in addition to any other premium) of the amount of that sum …

The effect of this is that the landlord is treated under section 34(1) of ICTA as receiving an amount by way of rent.

Section 34(6) of ICTA provides that if a payment falling within section 34(1), (4) or (5) of ICTA is due to a person other than the landlord, no amount is to be treated as a receipt of any Schedule A business carried on by the landlord. It also provides that the other person is to be:

> taken to have received as income an amount equal to the amount which would otherwise fall to be treated as rent and to be chargeable to tax as if he had received it in consequence of having, on his own account, entered into a transaction falling to be treated as mentioned in paragraph 1(2) of Schedule A.

The effect of this is that the other person is treated as carrying on a Schedule A business and the amount that would have been treated as rent, if the sum had been payable to the landlord, is treated as a receipt of that business.

But section 34(7) of ICTA provides that section 34(6) of ICTA shall not apply in relation to any payment within section 37(5) of ICTA unless it is due to a person who is connected with the landlord. This means that section 34(6) of ICTA does not apply to a payment falling within section 34(5) of ICTA payable to a person who is not the landlord and is not connected with the landlord.

The position for such a payment is governed by section 34(5) of ICTA. Under section 34(5) of ICTA the lease is treated for the purposes of section 34 of ICTA as requiring the payment of a premium to the landlord, regardless of the person to whom it is paid. It follows that the landlord will be treated under section 34(1) of ICTA as receiving an amount by way of rent, even if the sum is payable to somebody who is not connected with the landlord.

The intention appears to be that in such a case nobody should be treated as receiving an amount by way of rent or income. This is how section 34(6) of ICTA is operated in practice. So section 281(1)(b) requires that in order for section 281 to apply the sum payable as

consideration for the variation or waiver of a term of a lease must be due to the landlord or a person connected with the landlord.

If, as a result of this change, no amount is brought into account as a receipt in calculating the profits of the landlord's property business in respect of a sum payable by a tenant as consideration for the variation or waiver of the terms of a lease to a person other than the landlord, or a person connected with the landlord, the tenant will not be entitled to any relief under sections 287 to 295 if the tenant carries on a property business or under sections 60 to 65 if he or she carries on a trade.

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 71: Applying the additional calculation rule to receipts in respect of sums payable for variation or waiver of term of lease: sections 281, 287, 288, 289 and 294

This change applies the provisions of Chapter 4 of Part 3 of this Act for reducing the amount of certain receipts under that Chapter to receipts in respect of sums payable as consideration for the variation or waiver of a term of a lease.

Under section 34(1), (5), (6) and (7) of ICTA if a sum becomes payable by a tenant as consideration for the variation or waiver of any of the terms of a lease, the landlord is treated as receiving a proportion of that sum as rent or, if the sum is payable to a person connected with the landlord that person is treated as receiving the same amount as a receipt of a Schedule A business. (See *Change 70*.)

When certain conditions are met, section 37(1) to (3) of ICTA provides that the amount treated as received under section 34 or 35 of ICTA is to be replaced by a smaller amount calculated under section 37 of ICTA. One of the conditions is that there must be an amount treated as a receipt of a Schedule A business by virtue of section 34 or 35 of ICTA in respect of "the head lease". Another of the conditions is in section 37(2)(b) of ICTA, which provides that the amount to be reduced under section 37 of ICTA must be an amount treated as received under section 34 of ICTA in respect of the grant of a lease out of the headlease or under section 35 of ICTA in respect of the assignment of the headlease.

Section 37(1) to (3) of ICTA does not appear to allow a reduction in an amount treated as received under section 34 of ICTA in respect of a sum payable by the tenant as consideration for the variation or waiver of a term of a lease because such an amount is not received in respect of the "grant" of a lease as required by section 37(2)(b) of ICTA. But relief under section 37(2) and (3) of ICTA is, in practice, allowed in respect of amounts treated as received under section 34 of ICTA in respect of sums paid as consideration for the variation or waiver of a term of a lease.

Section 37(1) to (3) of ICTA is rewritten in sections 287 to 290 in which it is referred to as "the additional calculation rule". So:

- section 281(5) provides that, if the additional calculation rule applies, the amount given by the formula in section 281(4) is to be reduced by the amount calculated in accordance with section 288;
- section 287(1) includes receipts under section 281 in the list of receipts in relation to which the additional calculation rule applies; and

- sections 288(2) (which sets out the additional calculation rule) and 289(2) (which adapts the additional calculation rule where the sublease does not extend to the whole of the leased premises) both refer to section 281.

Section 295 restricts total relief to the amount of the taxed receipt after any deductions under section 61. So if, as a result of this change, a tenant receives relief in respect of a sum payable as consideration for the variation or waiver of a term of a lease, this may reduce the amount of relief available to a subsequent tenant.

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 72: Receipts in respect of sales with right to reconveyance and sale and leaseback transactions: sections 284 and 285

This change introduces a requirement that, for an amount to be treated as a receipt in respect of a sale with a right to a reconveyance or a sale and lease back transaction, the period between the sale and the earliest date of reconveyance or leaseback must be 50 years or less.

Section 36(1) of ICTA provides:

> Where the terms subject to which an estate or interest in land is sold provide that it shall be, or may be required to be, reconveyed at a future date to the vendor or a person connected with him, the following amount shall be deemed to have been received as income by the vendor and to have been received by him in consequence of his having entered into a transaction falling to be treated as mentioned in paragraph 1(2) of Schedule A…

Section 36(1) of ICTA further provides that the amount that the vendor is treated as having received is the amount by which the price at which the estate or interest is sold exceeds the price at which it is to be reconveyed. But if the earliest date at which it would fall to be reconveyed is two years or more after the sale, the amount of the excess is reduced by 1/50th for each complete year (other than the first) in the period between the sale and that date. This means that if the period beginning with the sale and ending with the earliest date on which the estate or interest fall to be reconveyed is 51 years or more, the amount that the vendor is treated as having received is zero. But the vendor will only discover this after carrying out the calculation required by section 36(1) of ICTA.

It is not appropriate to require the vendor to take a zero receipt into account in calculating the profits of a property business. Nor does there appear to be any reason why the period for sale and reconveyance should be 51 years, while sections 34(1) and 35 of ICTA require that the duration of the lease must not exceed 50 years. So in rewriting section 36 of ICTA, section 284(1)(b) requires that in order for section 284 to apply the period between the sale and the earliest date on which the estate or interest in land would fall to be reconveyed must be 50 years or less. This makes it unnecessary for the vendor to calculate the amount and find that it was zero.

A similar point arises in relation to section 285. Section 36(3) of ICTA provides that, where the terms of the sale provide for the grant of a lease directly or indirectly out of the estate or interest to the vendor or a person connected with him, section 36 of ICTA applies as if the grant of the lease were a reconveyance of the estate or interest. Again, the effect of section 36(1) and (3) of ICTA is that the amount treated as received by the vendor will be zero if the period beginning with the sale and ending with the earliest date on which under the terms of the sale the lease would fall to be granted exceeds 51 years.

As in the case of sales with a right to a reconveyance, there does not appear to be any reason why this period should be 51 years, rather than 50 years. So section 285(1)(b) requires that in order for section 285 to apply the period between the sale and the earliest date at which the lease would fall to be granted must be 50 years or less.

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 73: Limiting the reductions in receipts under section 288 and the deductions for expenses under section 292: sections 287, 288, 289, 290, 291, 292 and 295

This change concerns the way section 37(9) of ICTA is rewritten.

Section 37(9) of ICTA provides:

> An amount or part of an amount shall not be deducted under this section more than once from any sum, or from more than one sum, and shall not in any case be so deducted if it has been otherwise allowed as a deduction in computing the income of any person for tax purposes.

The effect that section 37(9) has on the rest of section 37 of ICTA is not entirely clear. There are no references to it in the rest of the section. It is simply added at the end of the section. And the wording of section 37(9) of ICTA does not fit in well with the rest of the section.

It appears that when section 37(9) of ICTA refers to "an amount or part of an amount", it must be referring to the amount, or any part of the amount, chargeable on the superior interest, as defined in section 37(1) of ICTA because it is this amount which determines the extent to which relief is given under section 37(2) and (4) of ICTA.

But the amount or part amount is not, strictly speaking, deducted under section 37 of ICTA at all:

- in the case of a later chargeable amount, section 37(2) and (3) of ICTA substitute a reduced amount for the amount of the later chargeable amount calculated under section 34 or 35 of ICTA; and
- under section 37(4) of ICTA a tenant is treated as paying rent, corresponding to the amount of rent the landlord is treated as receiving under section 34 or 35 of ICTA.

So while the calculation of the reduced amount of the later chargeable amount and the amount of notional rent paid depend on a part of the amount chargeable on the superior interest, no amount is "deducted" under section 37 of ICTA.

In construing section 37(9) of ICTA it is relevant to consider the rationale underlying the rest of section 37 of ICTA.

Under section 34(1) of ICTA, where there is a premium in respect of a lease and a premium in respect of a sublease granted out of that lease, the landlord under the lease and the landlord under the sublease (the tenant under the lease) will both be treated as receiving an additional amount of rent. Part or all of the premium in respect of the sublease will represent value already taxed as income in the hands of the landlord.

The purpose of section 37(2) and (3) of ICTA is to reduce the amount treated as paid under section 34(1) of ICTA in respect of the premium for the sublease by reference to the amount treated as paid under section 34(1) of ICTA in respect of the premium for the lease. It follows from this that the total amount of the reductions should be limited to the amount treated as

received as rent under section 34(1) of ICTA in respect of the premium for the lease. This limit is provided by section 37(9) of ICTA.

The rationale underlying section 37(4) of ICTA is that if an amount is treated under section 34 or 35 of ICTA as rent in the hands of the recipient, the person by whom it is paid (the tenant) should also be treated as paying rent. So it is logical that the amount that the recipient is treated as receiving should be the same as the amount that the tenant is treated as paying. Generally this will be achieved by section 37(4) of ICTA, but there are circumstances in which the amount the tenant is treated as paying under section 37(4) of ICTA could exceed the amount the landlord or other person is treated as receiving under section 34 or 35 of ICTA.

It appears that the purpose of section 37(9) of ICTA is to limit the reductions in later chargeable amounts under section 37(2) and (3) of ICTA, and the amounts the tenant is treated as paying as rent under section 37(4) of ICTA, by reference to the amount chargeable on the superior interest to an amount equal to that amount. So section 295, which is based on section 37(9) of ICTA, is worded as a limit.

Section 37(9) of ICTA is difficult to construe because it does not say how it interrelates with the rest of section 37 of ICTA. Sections 287 to 290 attempt to make the relationship clear. So:

- section 290(1) defines the "unused amount" of the taxed receipt, which under section 37(9) of ICTA is the part of the amount chargeable on the superior interest that has not been "deducted";
- sections 287(5) and 288(3) ensure that there cannot be a reduction by reference to a taxed receipt ("the amount chargeable on the superior interest") in calculating the amount of a receipt if the taxed receipt does not have an unused amount. In the terminology of section 37(9) of ICTA, this would be if the whole of the amount chargeable on the superior interest had already been "deducted"; and
- section 289(4) ensures that the reduction required under section 288 by reference to a taxed receipt cannot exceed the unused amount. In the terminology of section 37(9) of ICTA, this ensures that "deductions" exceeding the amount chargeable on the superior interest cannot be made.

Section 291(4) imposes a similar limit on deductions for expenses under section 292. Sections 291 and 292 are based on section 37(4) of ICTA.

Section 295 restricts total relief to the amount of the taxed receipt. A tenant is entitled to relief only if the taxed receipt by reference to which the relief could be given has an "unused amount". So by reducing the unused amount of the taxed receipt, the relief which each tenant receives by reference to a taxed receipt may reduce the amount of relief to which a later tenant is entitled.

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 74: Deduction for expenditure on energy-saving items: drop the requirement for a claim: section 312

This change removes the requirement for a formal claim to relief for qualifying expenditure on energy-saving items.

Section 31A of ICTA allows a revenue deduction for capital expenditure meeting certain conditions on energy-saving items.

Section 31B(3) of ICTA requires a claim for relief under section 31A of ICTA. This requirement sits uneasily with Self Assessment and the general approach of this Act is not to require a claim for reliefs given as deductions in calculating profits of a trade or property business.

So section 312 drops the requirement to make a claim for relief, with the result that relief will be given by a deduction in the calculation of income in the taxpayer's return. This simplifies the position and makes the administration of the relief consistent with trading and property income deductions generally.

The provisions that govern claims are not the same as the provisions that govern returns. But in practice the change from claim to deduction will have only the following consequences, which both relate to the time available for "claiming" the deduction.

First, the absolute time limit for making a claim is replaced by a time limit that may vary according to the particular circumstances. That may be because the return is issued late or because the taxpayer makes a late return. Accordingly, the Inland Revenue is no longer able to refuse a claim because it is late by reference to an absolute time limit: returns time limits and sanctions will apply and they depend on the date the return was issued and submitted.

Second, the time limit available to make the "claim" will normally reduce. That is because, as a formal claim, the time limit for a claim under section 31B of ICTA is (almost) 70 months from the end of the relevant tax year (section 43(1) of TMA) whereas as a deduction in a return the filing date time limit applies - normally (almost) ten months after the relevant tax year (section 8(1A) of TMA) or, for amendments to returns, 12 months after the filing date (section 9ZA(2) of TMA). However, error or mistake relief claims under section 33 of TMA will be possible if too much tax is paid as a result of omitting to include the deduction in the tax return. Claims under section 33 of TMA must be made within five years of 31 January following the tax year to which the return relates.

This change is adverse to some taxpayers and favourable to others in principle but is not expected to have any practical effect.

Change 75: Meaning of "relevant period" in sections 325 and 326: non-resident companies: section 324

This change defines the "relevant period" by reference to the tax year for non-resident companies liable to income tax in respect of furnished holiday accommodation. That removes any doubt as to how the source legislation applies to such companies.

The provisions in Chapter 6 of Part 3 of this Act define lettings that can qualify for special tax advantages. They are based on section 504 of ICTA. To qualify, certain conditions have to be met during a particular test period – the "relevant period" in section 324.

Section 504(4) of ICTA deals with non-company cases. The test period is defined by reference to the tax year.

Section 504(5) of ICTA deals with company cases. The test period is defined by reference to the accounting period.

Those subsections reflect the different chargeable periods for income tax (the tax year) and corporation tax (the accounting period).

Section 324 is based on section 504(4) of ICTA so the "relevant period" for all persons within this Act is defined by reference to the tax year. But because this Act applies to non-resident companies liable to income tax, that does not replicate directly the source legislation. If the concept of "accounting period" can apply for income tax purposes, the source legislation defines the test period for such companies by reference to their accounting period by virtue of section 504(5) of ICTA.

The change is to define the "relevant period" for non-resident companies that are within the charge to income tax by reference to the tax year. This is appropriate because non-resident companies not within corporation tax are liable to Schedule A income tax on the profits of the tax year and not the profits of an accounting period (sections 11 and 21(2) of ICTA). It brings non-resident companies into line with all other income tax payers in this respect. Doing so reflects the Inland Revenue view of how this legislation is intended to work. And it reflects, as far as can be established, wider views on, and current practice in, interpreting the section.

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 76: Furnished holiday accommodation: permitted longer-term occupation: section 325

This change alters the period during which, in order to qualify for the special tax treatment of the commercial letting of furnished holiday accommodation, the accommodation must not be occupied for more than 31 days at a time.

Section 504(3) of ICTA provides:

> (3) Accommodation shall not be treated as holiday accommodation for the purposes of this section unless–
>
> (a) it is available for commercial letting to the public generally as holiday accommodation for periods which amount, in the aggregate, to not less than 140 days;
>
> (b) the periods for which it is so let amount in the aggregate to at least 70 days; and
>
> (c) for a period comprising at least seven months (which need not be continuous but includes any months in which it is let as mentioned in paragraph (b)) it is not normally in the same occupation for a continuous period exceeding 31 days.

It is not clear whether a "month" for the purposes of paragraph (c) means a calendar month (in the sense of January, February, etc) or any period of one month. It is also not clear whether any breaks in the period of at least seven months can fall at any time or must divide the period into periods of whole months. The better view seems to be that any period of a month during which the accommodation is commercially let to members of the public as holiday accommodation must not overlap with any period during which it is continuously in the same occupation for more than 31 days.

A further uncertainty is whether, for the purposes of paragraph (c), the time that the accommodation is "let as mentioned in paragraph (b)" is 70 days or (which is the better view) all the time that it is commercially let to the public generally as holiday accommodation.

On the latter reading, section 504(3)(c) of ICTA secures that accommodation is not let as holiday accommodation if it is let for more than 31 days continuously (otherwise than because of circumstances that are not normal). Section 325(4) gives effect to this reading.

This reading also reduces to less than five months the total periods during which the accommodation can be in the same occupation for more than 31 days. This can operate capriciously to extend the period of "at least seven months" where the holiday lettings are spaced out throughout the year and not concentrated in a few months.

In section 325(5), the requirement in section 504(3)(c) of ICTA is relaxed so that the periods for which the accommodation is continuously in the same occupation for more than 31 days must not amount to more than 155 days (the aggregate length of the five longest months) during the relevant period (see section 324). This means that the period during which any occupation of the accommodation must be on a short-term basis:

- need not be composed of whole months but can be made up of non-consecutive days; and
- is never extended beyond 155 days.

So, where two or three days of a holiday letting fall in a particular month, the requirement in section 325(5) of this Act (unlike section 504(3)(c) of ICTA) does not restrict what can be done with the accommodation during the rest of the month (provided that the condition is satisfied over the relevant period as a whole).

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 77: Furnished holiday accommodation: period over which lettings are averaged: section 326

This change alters the period during which lettings are averaged for the purpose of treating infrequently let property as qualifying holiday accommodation from the tax year to the relevant period (as defined in section 324).

Subsections (6) to (8) of section 504 of ICTA allow averaging where a taxpayer lets both furnished holiday accommodation and accommodation that would be holiday accommodation if the test in section 504(3)(b) of ICTA were satisfied in relation to it (the "under-used accommodation"). The requirement in section 504(3)(b) of ICTA is that the accommodation is commercially let to members of the public for at least 70 days. Section 504(4) of ICTA says that that requirement must be determined by reference to a period (called the "relevant period" in section 326) which is:

- the tax year; or
- if the accommodation was not let in the year before (or the year after), one year beginning with the first letting (or one year ending with the last letting) in the tax year.

Where the taxpayer elects for averaging, section 504(7) of ICTA treats the under-used accommodation specified in the election as qualifying holiday accommodation if the average of the number of days during the "tax year" for which the furnished holiday accommodation and the under-used accommodation was let is at least 70.

If the relevant period for particular accommodation is not the tax year, the accommodation may have been let for more than 70 days during the "relevant period" but not for more than 70 days during the "tax year". But because the figures averaged in section 504(7) of ICTA

are the numbers of days let during the "tax year", specifying the accommodation in an election could not raise the average number of days of letting during that year above 70.

In rewriting section 504(7) of ICTA, section 326(4) provides that the average is to be taken by reference to days during the "relevant period".

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 78: Deduction of management expenses of owner of mineral rights: omission of condition that expenses are "necessarily" incurred: section 339

This change deals with the omission of the requirement that the allowable expenses of managing mineral rights are necessarily incurred.

Section 121(1) of ICTA makes provision for expenses of management and supervision to be deducted from amounts chargeable to income tax in respect of mineral rents and royalties. The section requires that the expenses are disbursed "wholly, exclusively and necessarily".

Section 121(1) of ICTA is rewritten as section 339. That section does not reproduce the condition that the expenses must be "necessarily" incurred. There is no evidence as to how this test is applied in practice but it is not obvious how it could be enforced. The extensive body of case law on the meaning of expenses being incurred "necessarily" applies to income formerly taxed under Schedule E (now taxed as employment income under ITEPA). That case law establishes that each and every holder of the office or employment would have to incur the expense.

That is not a test that can be sensibly applied to income taxed under Schedule D Case VI. It is most unlikely that the "necessarily" restriction is applied in practice and this section recognises this by omitting "necessarily".

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: Distributions made by UK companies: section 366

This change alters the test for bringing a distribution received from a UK company, or a payment representative of such a distribution, into account in calculating the profits of a trade from one based on the underlying shares to one based on the character of the receipt or payment.

Section 95 of ICTA sets out the circumstances in which a distribution made by a UK company, or a "payment which is representative of" a UK distribution, is brought into account in calculating the profits of a trade.

Section 95 of ICTA operates by determining whether the recipient of a distribution is a dealer in relation to that distribution. This is tested by reference to whether the proceeds of a notional sale by the recipient of the shares in respect of which the distribution is received would be taken into account in calculating the profits of the trade of the recipient.

This approach is a legacy of the origin of section 95 of ICTA. Section 95 of ICTA is derived from section 54 of FA 1982. Section 54 of FA 1982 was concerned with the tax treatment of a dealer from whom a company purchased its own shares. In that context it was logical to focus on the shares rather than on the distribution. But this has the problem not only that the

sale is theoretical but also that the shares may not be held by the dealer when the distribution is received. It is no longer the logical approach now that section 95 of ICTA applies to all distributions received by share dealers.

So section 366(1) has the effect that a distribution received from a UK company, or a payment representative of such a distribution, is dealt with under Chapter 2 of Part 2 of this Act if that distribution or payment is a trade receipt.

The Inland Revenue believe it is highly unlikely that a distribution or payment could be a receipt of a trade unless the proceeds of any sale of the shares giving rise to the distribution would also be treated as a receipt of that trade. But if this is not the case, the change is likely to be favourable to taxpayers as the treatment of trading income is generally more favourable than the treatment of investment income.

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 80: Building society dividends: payment of dividends treated as interest: section 372

This change provides for building society dividends (whether paid gross or net) to be charged to tax as interest and not as dividends.

A building society dividend paid in respect of a shareholding in the society does not strictly constitute interest. However, building society shares are more similar in nature to interest-bearing deposits than to normal company shares and this is reflected in their tax treatment.

Section 477A(9) of ICTA provides that building society dividends paid *without deduction of tax* are regarded as paid by way of interest for the purpose of Schedule D. The implication appears to be that they are accordingly charged to tax as interest.

However, where building society dividends are paid *under deduction of tax*, either by virtue of section 349(3A) or section 477A(1) of ICTA, the source legislation does not specifically charge the dividends to tax as interest. Section 349(3A) of ICTA simply requires that tax be deducted from building society dividends paid on quoted securities. Section 477A(5) of ICTA appears to bring dividends that fall within section 477A(1) of ICTA into Schedule D Case III, but falls short of specifically charging the dividends to tax as interest.

So, apart from dividends paid gross, the source legislation does not specifically charge building society dividends to tax as interest, although in practice that is how dividends paid under deduction of tax are dealt with. In practice, all building society dividends within those sections of ICTA are charged to tax as interest.

Accordingly, section 372(1) provides that "Any dividend paid by a building society is treated as interest for the purposes of this Act" without distinguishing between dividends paid gross or net.

This change has no implications for the amount of tax paid, who pays it or when.

Change 81: Industrial and provident society payments: section 379

This change provides for share interest payable by registered industrial and provident societies to be treated as interest.

Section 486(4) of ICTA provides that share interest is chargeable under Schedule D Case III. The definition of "share interest" in section 486(12) of ICTA is "…any interest, dividend, bonus or other sum….". Section 486(4) of ICTA also provides that loan interest is chargeable under Schedule D Case III, as it would be in any event. As loan interest is true interest, which will be taxed under section 369 of this Act, there is no need to refer to it in this provision. There are three possible ways of dealing with share interest: include a specific tax charge for it, charge it under the same Chapter as interest or treat it as interest.

The rationale behind the source legislation is that this type of payment is much the same as an interest return on an investment. But it is not necessarily true interest and it is not likely to fall within any of the other types of income within Schedule D Case III. The approach adopted is consistent with that taken for other items of income; while these payments are not interest, they are taxed as if they were interest. So section 379(1) provides that such a payment "…is treated as interest for income tax purposes…". This technically goes further than merely taxing it under the same Schedule and Case as interest.

This change has no implications for the amount of tax paid, who pays it or when.

Change 82: Funding bonds: charge to tax as interest: section 380 and paragraph 168 of Schedule 1

This change replaces the charge to tax under Schedule D Case VI, which operates in particular circumstances where funding bonds are issued but it is impracticable to retain any bonds on account of income tax, with a charge on all funding bonds as interest and extends the exemption from income tax for charities to cover the income otherwise within the replaced charge.

Section 582(1) of ICTA provides that where funding bonds are issued to a creditor in respect of any liability to pay interest on certain debts, the issue of the bonds is treated as if it were the payment of an amount of that interest equal to the value of the bonds at the time of issue. Where a person would be required to deduct tax from the payment if it were an actual payment of interest, bonds to a value equal to the tax on the interest are to be retained and tendered in satisfaction of the tax (see section 582(2)(a) of ICTA).

So section 582(1) of ICTA generally treats the issue of funding bonds as a payment of interest and they are taxed accordingly. But there is one situation where funding bonds are charged to tax under Schedule D Case VI, rather than as interest. Section 582(2)(b) of ICTA provides that where it is "impracticable" to retain bonds the recipient is instead chargeable to tax under Schedule D Case VI. As section 582(1) of ICTA treats funding bonds as a payment of interest for all purposes of the Taxes Acts, applying a different charge under Schedule D Case VI in just one situation has no particular logic and adds an unnecessary complication. So the separate charge has not been reproduced. Section 380 ensures that all issues of funding bonds are charged to tax as interest, irrespective of the circumstances in which they are issued.

The substituted section 392 of ICTA in paragraph 168 of Schedule 1 to this Act preserves the possibility of loss relief being claimed as a deduction from this income. (It is not considered that a loss could arise in a transaction where a charge is imposed under section 582 of ICTA.)

Section 505(1)(c)(ii) of ICTA, which allows a charity exemption for income taxed under Schedule D Case III, has been amended so as to refer to all income within section 380 whether formerly Schedule D Case III or Case VI.

This change has no implications for the amount of tax paid, who pays it or when, except that the extension of the exemption for charities' income is in taxpayers' favour in principle and may benefit some in practice, although the numbers affected and the amounts involved are likely to be small.

Change 83: Discounts: charge to tax as interest: section 381

This change provides for discounts taxed in the source legislation under section 18(1)(b) of ICTA and Schedule D Case III (b) to be taxed as interest.

Discounts have been part of the charge to tax under Schedule D Case III since at least 1805. Several tax cases have considered aspects of their tax treatment including the difficulties in determining the nature of a "discount" as compared with "interest". It has emerged from this case law that while the line between the terms can be difficult to identify, they are distinguishable in nature.

Discounts are nevertheless taxed in much the same way as interest. They are charged to tax on the person receiving or entitled to the discount: see section 59(1) of ICTA. Similarly, income tax is computed on the full amount of the income arising within the year of assessment without any deduction: see section 64 of ICTA.

Chapter 2 of Part 4 of this Act includes a specific charge to tax for interest which is extended to include other types of income which, in the source legislation, are treated as interest.

Section 381 provides that discounts, other than discounts in deeply discounted securities within Chapter 8 of Part 4 of this Act, are taxed under Chapter 2 of Part 4 of this Act as interest, so removing the necessity to distinguish between them for the purposes of the charge to income tax. It follows that the separate charge for these discounts is not rewritten in this Act.

This change has no implications for the amount of tax paid, who pays it or when.

Change 84: Dividends etc from UK resident companies: tax credits etc where dividends etc received by companies who pay income tax: sections 397, 399 and 400

This change involves applying sections 231(1) and (3) and 233(1) and (1A) of ICTA as if references to companies did not include companies receiving distributions in a fiduciary or representative capacity.

Section 6(2) of ICTA recognises that income may arise to a company:

- in a beneficial capacity; or
- in a fiduciary or representative capacity.

Broadly speaking, section 6(2) of ICTA prevents income tax applying to income arising to companies in a beneficial capacity. And section 8(2) of ICTA provides that corporation tax applies to profits arising to a company beneficially but excludes profits arising to a company in a fiduciary or representative capacity from corporation tax. The result is that a corporate trust is subject to income tax. The exception to this is that a non-UK resident company's profits are charged to income tax rather than corporation tax, even where it is beneficially entitled to them, except where UK permanent establishment business is involved. (See section 6(2)(a) of ICTA.)

Section 231(1) of ICTA provides that where a company resident in the UK makes a qualifying distribution and the person receiving the distribution is another such company (ie a UK resident company) or a person resident in the UK (not being a company), then the recipient of the distribution is entitled to a tax credit.

Section 231(1) of ICTA makes it clear that a UK resident company is entitled to a tax credit.

Section 231(3) and (3AA) of ICTA describe how the tax credit may be used. It may either be set against an income tax liability under section 3 of ICTA or against the person's income tax liability on total income for the tax year in which the distribution is made.

Section 231(3) of ICTA expressly excludes UK resident companies because it only applies to a person "not being a company resident in the United Kingdom".

It is unnecessary for section 231(3) and (3AA) of ICTA to extend to corporation tax and apply to UK resident companies liable to that tax because such companies do not pay corporation tax on qualifying distributions (see section 208 of ICTA). But, unless it is a mere nominee, a UK resident company receiving a distribution in a fiduciary or representative capacity is charged to income tax on the aggregate of the distribution and the tax credit (see paragraph 2 of Schedule F in section 20(1) and section 835(6)(a) of ICTA). So section 231(3) of ICTA excludes such a company from setting its tax credit against its income tax liability.

In practice, however, the Inland Revenue look at the capacity in which a company is acting and treat a company receiving a distribution in a representative or fiduciary capacity, and hence liable to income tax on it, as if it were an individual receiving it in that capacity. So, in effect, the words "a company resident in the United Kingdom" in section 231(3) of ICTA are taken to refer only to a UK resident company acting in a beneficial capacity. Therefore companies acting in a fiduciary or representative capacity are taken to fall within that section and so may use their tax credits. Section 397(2) gives effect to this by not excluding UK resident companies from claiming.

Similar difficulties arise over the wording of sections 233(1) and (1A) of ICTA.

Section 233(1) of ICTA provides for recipients of distributions to be treated as having paid income tax at the Schedule F ordinary rate on the amount of the distribution. It is expressed to apply if in a tax year the income of any person "not being a company resident in the United Kingdom" includes a distribution, in respect of which that person is not entitled to a tax credit.

So, on a literal interpretation of the phrase "not being a company resident in the United Kingdom" in section 233(1) of ICTA, all UK resident companies whether they are acting in a beneficial or in a fiduciary or representative capacity are excluded. But again because section 233(1) of ICTA is about income tax it does not need to exclude companies subject to corporation tax and it fails to deal with companies receiving distributions in a fiduciary or representative capacity.

In practice, however, the exclusion is only treated as applying to UK resident companies receiving distributions in a beneficial capacity. So a UK resident company acting in a fiduciary or representative capacity and falling within section 233(1) of ICTA is treated as having paid income tax under section 233(1). Sections 399(1) and (2) and 400(1) and (2) rewrite section 233(1) of ICTA and give effect to the practice by not excluding UK resident companies.

Section 233(1A) of ICTA follows on from section 233(1) of ICTA, but deals only with qualifying distributions. It provides that where the income of any person "who is not a company" and is non-UK resident includes a qualifying distribution in respect of which the person is not entitled to a tax credit, so much of the distribution as is comprised in:

(a) income on which the person is treated as having paid income tax at the Schedule F ordinary rate under section 233(1)(a) of ICTA, or

(b) income to which section 686 of ICTA applies (discretionary accumulation and maintenance trusts),

is treated for the purposes of those provisions as if it were grossed up at that rate. And for the purposes of those provisions income tax is treated as having been paid at that rate on it.

Again, strictly a non-UK resident company acting in a fiduciary or representative capacity does not fall within section 233(1A) of ICTA as it is a company. It can only fall within section 233(1) of ICTA (and so would not be subject to grossing-up). But, in practice, the same approach is followed for companies receiving the distribution in a fiduciary or representative capacity as with sections 231(1) of ICTA and 233(1) of ICTA. So section 233(1A) of ICTA is taken to apply to all non-residents, whether individuals or companies receiving the distributions in such a capacity. Section 399(3) and (4) follow this approach in rewriting section 233(1A) of ICTA without any exclusion for such companies.

In principle, this change is in taxpayers' favour so far as it relates to sections 231(3) and 233(1) of ICTA and is adverse to some taxpayers so far as it relates to section 233(1A) of ICTA. But it is expected to have no practical effect as it is in line with current practice.

Change 85: Stock dividends from UK resident companies: the net amount of stock dividends: section 412

This change relates to the simplification of the rules concerning the net amount of stock dividends.

Under section 249(4) of ICTA an individual is taxed on "income of an amount which, if reduced by an amount equal to income tax on that income at the Schedule F ordinary rate …, would be equal to the appropriate amount in cash". The expression "appropriate amount in cash" is defined in section 251(2) to (4) of ICTA. This covers a variety of possible situations.

Where the stock dividend is simply chosen in lieu of an ordinary cash dividend (that is, the stock dividend falls within section 249(1)(a) of ICTA), "the appropriate amount in cash" is the amount of the alternative cash dividend, unless that is substantially different from the share capital's market value. If it is substantially different (whether more or less), "the appropriate amount in cash" is that market value (see section 251(2)(a)(i) and (b) of ICTA). Statement of Practice A8 explains that the Inland Revenue generally regard a difference of 15% of the market value as substantial, but are normally prepared to allow a difference of 17%.

Where the stock dividend is bonus share capital (that is, the stock dividend falls within section 249(1)(b) of ICTA), the situation is more complicated.

If there is a related cash dividend (a separate cash dividend, payable in respect of a different class of shares in the company, the amount of which determines, or is determined by, the quantity of share capital issued as stock dividend), "the appropriate amount in cash" is the

amount of that related cash dividend, unless that is substantially different from the share capital's market value. If it is substantially different (whether more or less), "the appropriate amount in cash" is that market value (see section 251(2)(a)(ii) and (b) of ICTA).

For these purposes, however, if there is also an accompanying cash dividend (a cash dividend in respect of the *same* shares as the stock dividend) the amount of the related cash dividend is treated as reduced by the amount of the accompanying cash dividend (see section 251(4) of ICTA).

If there is no related cash dividend, "the appropriate amount in cash" is the share capital's market value (see section 251(2)(b) of ICTA).

The provisions in ICTA are pretty complex, particularly where the stock dividend is bonus share capital. But, leaving aside the reduction under section 251(4) of ICTA, the general effect is to tax the cash dividend alternative or something not substantially different from the market value of the share capital.

Therefore in rewriting these provisions the rules which apply where the amount of the alternative cash dividend is not used have been modified so that, for a stock dividend taken in lieu of an ordinary cash dividend, it is clearly stated in section 412(2) that in the case of an issue of share capital in lieu of a cash dividend where the difference between the cash dividend alternative and the market value of the share capital exceeds 15% of that market value, the market value is taken instead. In addition, the rule in section 251(2)(a)(ii) and (4) of ICTA is omitted so that under section 412(3) for a stock dividend which is bonus share capital, the net amount will always be the share capital's market value.

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 86: Deeply discounted securities: deemed acquisitions at market value where deemed disposals on conversion of securities or transfer by personal representatives to legatees: section 441

This change provides that in the case of two sorts of disposals that are treated as made for amounts equal to market value, conversions of relevant discounted securities into other such securities and transfers by personal representatives to legatees, the corresponding acquisitions are treated as acquisitions for the same amounts.

Paragraph 1 of Schedule 13 to FA 1996 charges profits realised from the discount on a relevant discounted security and provides that the profit is realised when a person transfers such securities or becomes entitled to a payment on their redemption.

In four cases Schedule 13 to FA 1996 provides for a transfer of a relevant discounted security to be treated as made at market value and for the corresponding acquisition of the security to be treated as made at that value. They are transfers made on the death of a holder, transfers made otherwise than by a bargain at arm's length, transfers between connected persons and transfers for a consideration which is not wholly in money or money's worth. (See paragraphs 4(2), 8(2) and 9(2) of that Schedule.)

Paragraph 6(7) of Schedule 13 to FA 1996 also provides that where personal representatives transfer relevant discounted securities to legatees the personal representatives are treated as obtaining an amount equal to the securities' market value, and under paragraph 5 of Schedule 13 to FA 1996 where such securities are converted into shares or other securities the

conversion is to constitute the redemption of the securities and "to involve a payment" on the redemption of an amount equal to the market value of the shares or securities. But no specific provision is made about the price that the legatees are treated as paying for the securities, nor the acquisition cost of any relevant discounted securities obtained as the result of a conversion of such securities. In practice, however, in both these cases the market value of the securities is taken as being an amount paid in respect of the acquisition of the security, and so is taken into account in calculating the profit or loss on a subsequent disposal of the securities.

Section 441 fills these gaps by providing that a person acquiring these securities on any of the transfers that are treated as occurring at market value or on the conversion of such securities into other such securities is treated as doing so by the payment of their market value.

In the case of the acquisition by legatees the only alternative for acquisition cost if the gap is not filled appears to be that the legatees acquire the securities for no cost. In that case the change would always be favourable to the taxpayer. In the case of the acquisition on conversion there are perhaps two possible alternatives if the gap is not filled. These are that the securities are acquired for no cost or acquired for the acquisition cost of the securities which are converted. If the securities are treated as acquired for no cost the effect is favourable to the taxpayer. If the original acquisition cost of the converted securities is used the effect would usually be favourable, but may not be in rare cases.

This change is favourable to most taxpayers in principle but may be adverse in rare cases. But it is expected to have no practical effect as it is in line with current practice.

Change 87: Strips of government securities: acquisitions and disposals: section 445

This change alters the time at which strips of government securities held at 5 April that are deemed to be transferred at market value on that day are re-acquired. The reacquisition is deemed to be immediate, rather than to occur on 6 April.

Paragraph 14(4) of Schedule 13 to FA 1996 provides that a person holding a strip of a government security on 5 April in any tax year is deemed to have transferred it on that day. (Strips are defined in paragraph 15(1) of Schedule 13 to FA 1996, and the definition is rewritten in section 444 of this Act.) The rule in paragraph 14(4) of Schedule 13 to FA 1996 only applies if no other disposal occurs on 5 April and ensures that anyone holding a strip is taxed, year by year, on the increasing value of the strip. The purpose of paragraph 14(4) of Schedule 13 to FA 1996 was to prevent strips becoming a tax avoidance vehicle, since otherwise investors might choose to invest in strips of securities, rather than in the securities themselves, so as to defer their tax liabilities instead of being taxed on interest from the securities year by year.

Under paragraph 14(4)(c) of Schedule 13 to FA 1996, the strip which is deemed to be transferred on 5 April is deemed to be reacquired on the next day (6 April), for its value on the day of the transfer (5 April).

There does not appear to be any reason for this delay of one day. It is simpler to provide that the strip is treated as disposed of and immediately reacquired and doing so removes the scope for confusion in the source legislation caused by the reacquisition on 6 April being deemed to be at the value of the strip on 5 April. It also removes the scope for confusion where there is an actual disposal on 6 April. Therefore, in rewriting paragraph 14(4)(c) of Schedule 13 to FA 1996, section 445(3) provides for strips that are treated as disposed of on 5 April at

market value to be treated as having been immediately reacquired for the same amount, rather than being reacquired on the following day for that amount. Paragraph 80 of Schedule 2 to this Act preserves the position in the source legislation for strips held on 5 April 2005, so that they are deemed to have been reacquired on 6 April 2005 at market value on that day.

The change has no implications for the amount of tax paid, who pays it or when.

Change 88: Gains from contracts for life insurance etc: individuals who are not resident in the United Kingdom in the tax year not liable for tax: sections 465 and 539

This change gives statutory effect to part of Part 1 of ESC B53.

Section 547(1)(a) of ICTA provides that gains under Chapter 2 of Part 13 of ICTA are deemed to form part of an individual's total income for the tax year in which the chargeable event giving rise to the gain occurred if any of the following conditions are met. They are:

- that the rights under the policy or contract in question are vested in the individual as beneficial owner;
- that the rights under the policy or contract are held on trusts created by the individual; or
- that the rights are held as security for a debt owed by the individual.

Section 547(1)(a) of ICTA applies wherever the individual is resident. (Section 549 of ICTA (corresponding deficiency relief) applies similarly.) But Part 1 of ESC B53 provides that the Inland Revenue will not pursue liability to tax on a gain that is treated as income of an individual who is not resident in the UK at any time during the tax year in which the gain is chargeable.

Section 465 gives statutory effect to this part of the concession by providing that an individual is only liable for tax under Chapter 9 of Part 4 of this Act, which rewrites Chapter 2 of Part 13 of ICTA, if the individual is UK resident in the tax year in which the chargeable gain arises.

Under section 549 of ICTA certain deficiencies are allowable as deductions if, had such an excess as is mentioned in section 541(1)(a) or 543(1)(a) of ICTA arisen, it would have been treated as a gain and would form part of the individual's total income for the final year of the policy in question. In rewriting this relief for deficiencies, section 539 provides for the relief to apply also where the gain would form part of the individual's total income apart from the condition in section 465 requiring UK residence, so that a non-UK resident individual continues to be eligible for the relief despite the new condition. But in some circumstances the effect of the condition in section 465 may be to reduce the amount of relief to which an individual is entitled. This will happen if an individual was not liable at all for earlier gains because of the operation of the condition, and so they did not form part of the individual's total income as required by section 541(4)(b) of this Act (calculation of deficiencies).

This change is broadly in taxpayers' favour in principle. But it is expected to have little practical effect as it is in line with current practice. It may reduce the amount of relief for deficiencies. But the numbers affected and the amounts involved are likely to be small.

Change 89: Gains from contracts for life insurance etc: disregard of alteration of terms of old life insurance policies where insurer stops collecting premiums: sections 488 and 489

This change gives statutory effect to part of ESC A96.

Alterations in the terms of a life insurance policy may simply have the effect of varying the terms of the policy or they may result in the replacement of the policy. The result of varying the terms or replacing the policy may be that a charge to tax will arise on later events, such as the surrender or maturity of the policy, which would not otherwise have arisen. For example, this could occur because after the alteration the policy is no longer a qualifying policy, as defined in Schedule 15 to ICTA. (Qualifying policies are normally outside the chargeable event gains regime in Chapter 2 of Part 13 of ICTA.) It could also occur because the alteration causes a policy which was entirely outside the chargeable event regime or particular provisions of it to be brought within it. For instance, this could happen where the policy commenced before 20 March 1968 (the date of introduction of the chargeable event gains regime).

ESC A96 is concerned with a particular sort of alteration in terms of policies. It is sometimes uneconomical for insurers to collect premiums on old policies because of the small sums involved. If they agree to stop collecting such premiums, that may be an alteration in the terms of the policies. But ESC A96 provides that, for the purposes of the chargeable event gains regime in Chapter 2 of Part 13 of ICTA, an alteration in the terms of a life insurance policy should be ignored if it results from a decision by an insurer to stop collecting premiums on a number of policies of the same description because it is no longer economically viable to do so. ESC A96 only applies where the policy was issued at least twenty years before the alteration and the alteration is not itself a chargeable event. (ESC A96 also provides for such alterations to be ignored for the purposes of Schedule 15 to ICTA (qualifying policies).)

Sections 488 and 489 give statutory effect to the concession so far as they provide that such alterations are ignored for the purposes of determining whether a chargeable event has occurred in relation to a policy or contract.

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 90: Gains from contracts for life insurance etc: allowing the deduction of gains previously charged on related policies to be made in calculating later gains: section 491(5)

This change enables gains charged on an earlier chargeable event in respect of a policy of life insurance to be deducted in calculating the gains from a later chargeable event in respect of a related policy.

Section 541 of ICTA provides the rules for computing chargeable event gains on policies of life insurance and is expressed in section 541(1) of ICTA to apply to "any policy of life insurance", which is referred to later as "the policy".

Section 541(1) of ICTA provides that premiums previously paid under the policy are deductible in calculating chargeable event gains. Section 541(5)(b) of ICTA provides that in relation to premiums references to "the policy" include references to "any related policy, that

is to say, to any policy in relation to which the policy is a new policy within the meaning of paragraph 17 of Schedule 15 to ICTA, and any policy in relation to which that policy is such a policy, and so on". (Under Schedule 15 to ICTA a "new policy" is created when one policy is issued in substitution for or on the maturity of another policy by way of an option conferred by the other policy.) So section 541(5)(b) of ICTA ensures that premiums paid in respect of one policy are allowed as a deduction in computing the gain on the second or later policy to which the first policy is related.

Section 541(1) of ICTA also allows the amount treated as a gain on the happening of previous chargeable events in relation to a policy to be deducted in calculating the chargeable event gains in respect of the policy. But section 541(5)(b) of ICTA only deals with the deduction of premiums in respect of related policies and does not make any corresponding provision about such gains on the happening of previous chargeable events in respect of related policies. This appears to have been an oversight and, in practice, gains in respect of related policies are deducted from a final gain on a second or later policy.

Section 491 gives effect to this practice by providing in subsection (2) that "PG" (defined as any gains on a previous calculation event in relation to the policy or contract) are to be deducted in calculating the gains, and then providing in subsection (5) that the reference to the policy in the definition of "PG" includes related policies, as defined in subsection (6).

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 91: Gains from contracts for life insurance etc: disregard of trivial inducement benefits: section 497

This change gives statutory effect to part of ESC B42 under which small non-monetary inducements to enter into insurance contracts are disregarded for the purposes of Chapter 2 of Part 13 of ICTA.

Gifts may be offered by insurers to attract insurance business. These may take a variety of forms, including small consumer goods, store vouchers and discounts offered by travel agents etc.

Under section 541(1) of ICTA on the happening of a chargeable event the amount or value of any relevant capital payments in respect of a life policy may be brought into the computation of the chargeable gain. Such payments are defined in section 541(5)(a) of ICTA so as to include, broadly, any sum or other benefit of a capital nature. This could include the value of gifts. Similar provisions apply in the case of life annuity contracts and capital redemption policies (see sections 543(1) and (3) and 545(3) of ICTA).

ESC B42 prevents non-monetary gifts, not exceeding £30 in value in aggregate, that are made as an incentive in connection with an insurance from being brought into the calculation of the chargeable gains. (It also prevents such gifts from being taken into account in determining if a policy is a qualifying policy within Schedule 15 to ICTA.)

Section 497 gives statutory effect to the concession so far as it prevents such gifts being brought into the computation of a gain. Section 497(3) also provides that the £30 limit may be increased by an order made by the Treasury.

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 92: Gains from contracts for life insurance etc: removal of requirement for calculation under section 546(1) of ICTA to be made annually: section 498

This change replaces the requirement that the calculation under section 546(1) of ICTA should be made annually with a requirement that it should be made only where relevant partial surrenders and assignments of rights under insurance policies and contracts have occurred.

Under sections 540(1)(a)(v), 542(1)(c), 545(1)(d) and 546C(7)(a) of ICTA, a chargeable event is treated as occurring at the end of a policy year where the calculation mentioned in section 546(1) of ICTA produces an "excess". In broad terms, the calculation compares the proceeds of a part surrender or part assignment of rights in the policy or contract that has occurred in the policy year with a portion of the premiums or other consideration paid under it to date.

Section 546(1) of ICTA requires that calculation to be performed "as at the end of each year" (that is, successive 12 month periods beginning with the making of the insurance or contract: see section 546(4) of ICTA). But unless an assignment for money or money's worth or a surrender has occurred during the policy year, the calculation cannot show a gain, and so will be otiose for the purposes of Chapter 2 of Part 13 of ICTA.

The requirement to carry out that calculation is rewritten primarily in section 498, which is expressed only to apply if there has been an assignment for money or money's worth or a surrender of a part of or share in the rights under a policy or contract in an insurance year. ("Insurance year" is defined in section 499 which mirrors section 546(4) of ICTA.)

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 93: Gains from contracts for life insurance etc: treating taking a capital sum under a contract for a life annuity as a surrender of a part of the rights under the contract for all purposes: section 500

This change involves treating the taking of a capital sum under a contract for a life annuity as a surrender of part of the rights under the contract for all purposes of Chapter 2 of Part 13 of ICTA, and not just for sections 542 and 543 of ICTA.

Sections 542 and 543 of ICTA deal respectively with chargeable events in respect of life annuity contracts and the computation of gains in respect of such contracts. Under section 542(2) of ICTA, where a contract provides for the payment of a capital sum as an alternative to annuity payments, the taking of the capital sum is treated as a surrender in whole or part of the rights under the contract. Section 542(2) of ICTA is expressed as applying for the purposes of sections 542 and 543 of ICTA. But, in fact, it is section 546 of ICTA which deals with the calculations which have to be made to see if a gain has arisen on part surrenders or assignments, although section 542(1)(c) of ICTA refers to such calculations under section 546 of ICTA and lists an excess in such a calculation as a chargeable event for such contracts. Section 546(1) of ICTA is expressed to apply for the purposes of section 542 of ICTA. But the result is that it is not entirely clear whether the taking of a capital sum in these circumstances is a surrender for the purposes of section 546 of ICTA or the alternative regime for taxing excesses under section 546 of ICTA that now applies under sections 546B to 546D of ICTA.

In practice, the taking of a capital sum is treated as a surrender in whole or part of the rights under the contract for the purposes of the calculations under sections 546 and 546B to 546D of ICTA. Section 500(b) clarifies the position by providing that the taking of a capital sum is treated as a partial surrender for the purposes of the whole of Chapter 9 of Part 4 of this Act (which corresponds to Chapter 2 of Part 13 of ICTA). So it reflects current practice.

This change provides a clarification of the law. But it is expected to have no practical effect as it is in line with current practice.

Change 94: Gains from contracts for life insurance etc: enactment of regulations about personal portfolio bonds in primary legislation: sections 515 to 526

This change replaces regulations about personal portfolio bonds made by the Treasury under section 553C of ICTA with provisions in primary legislation, and cuts down the power in section 553C of ICTA as a result.

Section 553C of ICTA confers a wide power on the Treasury to use regulations to impose a yearly charge to tax in relation to personal portfolio bonds. It permits the regulations to make provision about matters such as the method by which the charge to tax is imposed and its administration. The section defines "personal portfolio bond", but the regulations can in effect make certain modifications to that definition. In particular they can prescribe property and indexes which may be selected without a policy or contract being a personal portfolio bond.

The regulations under section 553C of ICTA are rewritten in Chapter 9 of Part 4 of this Act, so far as they apply in relation to income tax. Section 516 defines "personal portfolio bond", for example, and sections 518 to 521 make provision about the kinds of index or property which may be selected without a policy or contract being a personal portfolio bond. Sections 522 to 524 set out the method for calculating the charge to tax on personal portfolio bonds. The regulations continue to apply in relation to corporation tax.

Section 526 contains a power to make regulations about certain matters in relation to the personal portfolio bond provisions in Chapter 9 of Part 4 of this Act. The power is more limited than the power in section 553C of ICTA. This reflects the fact that provision about personal portfolio bonds has now been made in the regulations and in this Act.

The only matter that can be dealt with in regulations under section 526 is the administration of the charge to tax on personal portfolio bonds. Any other changes to the personal portfolio provisions in this Act need to be made in primary legislation.

This matter can be dealt with in the regulations themselves or by modifications to Chapter 9 of Part 4 of this Act or Chapter 2 of Part 13 of ICTA. Chapter 2 of Part 13 of ICTA includes certain administrative provisions which apply in relation to income tax. So section 526 includes a power to amend those provisions as they apply to personal portfolio bonds.

The power in section 526 for regulations to be made which amend primary legislation reflects the power under section 553C of ICTA to amend the regulations about personal portfolio bonds, and to exclude or apply (with or without modifications) other provisions of Chapter 2 of Part 13 of ICTA in relation to personal portfolio bonds.

This change has no implications for the amount of income liable to tax, who pays it, or when. It affects only the method by which the provisions on personal portfolio bonds may be amended in the future.

Change 95: Gains from contracts for life insurance etc: reductions for sums chargeable to tax apart from section 547(1) of ICTA: section 527

This clarifies the meaning of the exception from the charge to tax under section 547(1) of ICTA given by section 547(2) of ICTA for any amount chargeable to tax apart from section 547(1) of ICTA.

Section 547 of ICTA deals with the method of charging chargeable event gains to tax. This differs according to the person who is interested in the policy. For example, under section 547(1) of ICTA where the rights in a policy or contract are held by an individual as beneficial owner the gain forms part of the individual's total income. However, section 547(2) of ICTA states "Nothing in subsection (1) shall apply to any amount which is chargeable to tax apart from that subsection.".

In practice, the words "amount which is chargeable to tax" in section 547(2) of ICTA are taken to mean the amount of the receipts and credits taken into account for the purposes of ascertaining the overall taxable profit under another provision, rather than the actual amount that is charged to tax under another provision, which in the case of a trader, for instance, will be the net profits of the trade.

Section 527 which rewrites section 547(2) of ICTA makes it clear that the amount chargeable to tax under Chapter 9 of Part 4 of this Act is reduced by the amount of the receipt or other credit item that is taken into account in calculating the amount on which income tax is charged otherwise than under Chapter 9 of Part 4 or the amount on which corporation tax is charged.

This change provides a clarification of the law. But it is expected to have no practical effect as it is in line with current practice.

Change 96: Gains from contracts for life insurance etc: reduction in gains where non-UK resident trustees hold policy: section 529

This adopts the conditions for trustees' residence in section 110 of FA 1989 for the purposes of the disapplication of the rule in section 553(3) of ICTA about reduction of gains chargeable under Chapter 2 of Part 13 of ICTA where the policy was held by non-UK resident trustees.

Section 553(3) of ICTA provides that in the case of new non-resident policies and new offshore capital redemption policies (as defined in section 553(10) of ICTA) the gain that would otherwise arise under section 541 or 546C(7)(b) of ICTA is reduced to the proportion of it that corresponds with the proportion of the period during which the policy has been in force that the policyholder was resident in the United Kingdom.

Under section 553(5) of ICTA if, when the gain arises or at any time during that period, the policy is or was held by a trustee resident outside the United Kingdom or by two or more trustees *any of whom* is or was so resident, the reduction under section 553(3) of ICTA is only made if:

(a) the insurance was made before 20 March 1985; and

(b) on 19 March 1985 the policy was held by a trustee who was so resident or, as the case may be, by two or more trustees any of whom was so resident.

However, the residence of a body of trustees is now generally determined by section 110 of FA 1989, so that if at least one of them is and at least one of them is not UK resident, they are all treated as UK resident or not UK resident according to the rule in section 110(1) of FA 1989, regardless of their individual status. Under section 110(6) of FA 1989, that section only applies for the tax year 1989-90 and subsequent years, so it would not apply to determine the trustees' residence for section 553(5) of ICTA before that time.

Section 529(1) rewrites section 553(5) of ICTA for insurances made on or after 20 March 1985. Section 529 (1)(b) disapplies section 528 (the rewritten section 553(3) of ICTA) if, when the gain arises or at any time during the policy period, the policy is or was held by non-UK resident trustees. So the trustees are looked at as a group, rather than individually. Section 529(2) applies section 110 of FA 1989 whenever the policy period starts. Therefore the same test for the trustees' residence will apply throughout.

This change provides a clarification of the law. But it is expected to have no practical effect as it is in line with current practice.

Change 97: Gains from contracts for life insurance etc: clarification of entitlement to credit for income tax at the lower rate in the case of certain foreign life insurance policies: section 531(5)

This change clarifies the interpretation of section 553A(3) of ICTA, making it clear that an individual who is chargeable on gains from certain foreign life insurance policies is treated as having paid income tax at the lower rate under section 547(5) of ICTA.

Under section 547(1)(a) of ICTA a gain treated as arising on a chargeable event may be treated as part of an individual's total income. Section 547(5) of ICTA provides that the individual is treated as having paid income tax at the lower rate on the amount so treated. This is subject to some complex exceptions which deny the relief to certain foreign contracts and policies.

Section 547(6) of ICTA denies the benefit of section 547(5) of ICTA to certain life annuity contracts except where section 547(6A) and (7) of ICTA apply. (The exception in section 547(6A) of ICTA is not relevant here.) Section 547(7) of ICTA disapplies section 547(5) of ICTA for gains in connection with policies issued by a friendly society in the course of tax exempt life or endowment business, except so far as calculating top slicing relief under section 550 of ICTA is concerned.

Section 553 of ICTA makes provision about certain foreign policies. Section 553(6) of ICTA denies the benefit of section 547(5) of ICTA to new non-resident policies and new offshore capital redemption policies subject to similar exceptions to those that apply to section 547(6) of ICTA. (The exception in section 553(6A) of ICTA corresponds to that in section 547(6A) of ICTA and is not relevant here.) Section 553(7) of ICTA disapplies section 553(6) of ICTA where a new non-resident policy meets the conditions in paragraph 24(3) of Schedule 15 to ICTA (policies which are part of the insurer's UK taxed business).

Section 553A of ICTA makes provision about a further class of "foreign policy" (policies issued as part of the overseas life assurance business of a UK insurer). Section 553A(1) of ICTA provides that these are treated as if they were new non-resident policies, and so they would come within the terms of section 553(7) of ICTA if they met the conditions in paragraph 24(3) of Schedule 15 to ICTA. But section 553A(3) of ICTA provides that section 553(7) of ICTA does not apply to gains arising on new non-resident policies.

However, the intention was that section 553A(3) of ICTA should only apply to policies treated as new non-resident policies under section 553A(1) of ICTA and in practice that is how it is interpreted. Otherwise, section 553(7) of ICTA would be otiose.

Section 553(7) of ICTA is rewritten in section 531 so that it continues to apply to foreign policies of life insurance (see section 531(3)), other than those which meet the conditions in section 531(5) and (6). Section 531(5) refers to policies within paragraph (a) of the definition of a "foreign policy of life insurance" in section 476(3) of this Act. Policies that are foreign policies by virtue of section 553A of ICTA are covered by paragraph (b) of that definition and so they are excluded.

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: Gains from contracts for life insurance etc: removal of requirement for claims for top slicing relief: section 535(1)

This change removes the requirement that a claim must be made for relief to be given under section 550 of ICTA in respect of tax on gains under Chapter 2 of Part 13 of ICTA.

Although a gain that is chargeable under Chapter 2 of Part 13 of ICTA will accrue over the life of an insurance, the whole of the gain will usually fall to be charged in one tax year. Higher rate tax liability may therefore arise when there would have been no such liability had the gain been spread throughout the period of the insurance. To compensate for the effect of assessing a gain in a single year, section 550 of ICTA provides for relief to be given. The relief only applies where there is a charge to higher rate tax and it is the chargeable event gain itself which brings the taxpayer into the higher rate field.

Section 550(1) of ICTA provides that the relief is given on the making of a claim to the Board of Inland Revenue. In practice, however, relief under section 550 of ICTA is given automatically, just as relief for deficiencies under section 549 of ICTA is given, and the requirement for a claim for relief is ignored.

Therefore in rewriting section 550 of ICTA, section 535(1) provides that a person is entitled to relief in the relevant circumstances, but does not require that a claim be made before the relief is given.

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 99: Gains from contracts for life insurance etc: definition of "insurance company": section 545(1)

This change introduces a definition of "insurance company" for the purposes of the chargeable event gains regime in Chapter 2 of Part 13 of ICTA.

Although Chapter 2 of Part 13 of ICTA contains several references to insurance companies, it does not define "insurance company". This is inconsistent with more recent legislation using the term "insurance company" which does provide a definition. See, for instance, section 333B(9) of ICTA (insurance element of individual savings accounts), which was inserted by FA 1998 and amended by the Financial Services and Markets Act 2000 (Consequential Amendments) (Taxes) Order 2001 (SI 2000/3629). In practice, the definition in section 333B(9) of ICTA is the one used for the purposes of Chapter 2 of Part 13 of ICTA too.

Accordingly, that definition has been adopted in section 545(1) for the purposes of the whole of Chapter 9 of Part 4 of this Act.

This change provides a clarification of the law. But it is expected to have no practical effect as it is in line with current practice.

Change 100: Gains from contracts for life insurance etc: definition of "market value": section 545(1)

This change involves defining "market value" for the purposes of the provisions which relate to gains from contracts for life insurance etc.

Section 541(3) of ICTA provides that where an assignment of the rights under a policy of life insurance takes place between connected persons, it is deemed to have been made for a consideration equal to the market value of the rights assigned. Section 543(2) of ICTA applies the same rule to an assignment of the rights conferred by a contract for a life annuity between connected persons. "Market value" is not defined for either purpose.

The definition of "market value" in section 545(1) is by reference to section 272 of TCGA but it also mentions section 273 of that Act. Section 272(1) of TCGA defines the "market value" of assets as the price which those assets might reasonably be expected to fetch on a sale in the open market. The remainder of section 272, and section 273, of TCGA provide some further guidance about the operation of the rule in different contexts.

The definition of "market value" reflects the ordinary common sense meaning of that term, and so how that term as it relates to Chapter 2 of Part 13 of ICTA would otherwise be understood.

The intention behind sections 541(3) and 543(2) of ICTA is that the consideration that would have been payable on an arm's length transaction is brought into account. The definition of "market value" makes this clear.

Similarly, where it is necessary for the purposes of Chapter 2 of Part 13 of ICTA to value property other than cash transferred to an insurance company in satisfaction of a premium, the price the property would achieve on an open market sale will be used. Again the definition will clarify that this is the approach taken in Chapter 9 of Part 4 of this Act.

This change provides a clarification of the law. But it is expected to have no practical effect as it is in line with current practice.

Change 101: Disposals of futures and options involving guaranteed returns: foreign non-trading income: section 555

This change provides for profits and gains, other than trading profits, that arise from disposals of futures and options involving guaranteed returns and fall within Schedule D Case V to be charged to tax under Chapter 12 of Part 4 of this Act (which rewrites Schedule 5AA to ICTA: disposals of futures and options involving guaranteed returns).

Paragraph 1(2) of Schedule 5AA to ICTA excludes from the charge under that Schedule "so much of any profits or gains arising to a person from a transaction as are charged to tax in his case under Case I or Case V of Schedule D". It appears that the intention in mentioning Schedule D Case V was to exclude foreign trade profits, rather than all income that falls into Schedule D Case V.

Following the decision in Cooper v Stubbs (1925), 10 TC 29 CA, profits of the kind charged by Schedule 5AA to ICTA would fall into Schedule D Case VI if they were from a source in the United Kingdom and not trading profits. So if such profits arose from a foreign possession other than a trade, they would be chargeable under Schedule D Case V. However, income from such dealing is extremely unlikely to arise outside the United Kingdom in the hands of a United Kingdom resident.

Section 128(1) of ICTA exempts from any charge to tax under Schedule D "any gain arising to a person in the course of dealing in commodity or financial futures or in qualifying options, which is not chargeable to tax in accordance with Schedule 5AA to ICTA and apart from [that section] would constitute profits or gains chargeable to tax under Schedule D *otherwise than as the profits of a trade*".

The result of a person's gains of this kind being exempted by section 128 is that the person's outstanding obligations under any futures contract entered into in the course of the dealing in question and any qualifying option granted or acquired in the course of it are regarded under section 143(1) of TCGA as chargeable assets, so that gains on their disposal fall within that Act.

Therefore if all gains from disposals of futures and options involving guaranteed returns that are foreign income within Schedule D Case V, other than those that constitute trade profits, are excluded from the charge under Schedule 5AA to ICTA by paragraph 1(2) of that Schedule, they are exempted from income tax, only to be treated as capital gains. There is no obvious reason why income of this sort should have been treated in this way. So it appears that paragraph 1(2) of Schedule 5AA to ICTA should have excluded from the charge under that Schedule only profits or gains charged to tax under Schedule D Case I or Case V "as the profits of a trade", so as to correspond with the wording of section 128(1) of ICTA.

Schedule 5AA to ICTA is rewritten in Chapter 12 of Part 4 of this Act and the charge in section 555 does not exclude foreign profits and gains from disposals. The former residual charge under Schedule D Case V on foreign profits and gains from disposals that are not trading profits is rewritten in Chapter 8 of Part 5 of this Act. Since the charge in section 687 of that Chapter only applies to income not otherwise charged to income tax, it will not apply to foreign profits charged under Chapter 12 of Part 4. So they will fall solely within that Chapter. The exemption under section 128 of ICTA is rewritten in section 779 but will not apply to these foreign profits, since it only applies to income within Chapter 8 of Part 5 of this Act.

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: Guaranteed returns on futures and options: associated companies: section 561

This change relates to the omission of references to associated companies in paragraph 5(3) and (4) of Schedule 5AA to ICTA.

Schedule 5AA to ICTA (guaranteed returns on transactions in futures and options) originally applied for both income tax and corporation tax purposes. Paragraph 5 of Schedule 5AA explains the meaning of references in the Schedule to the return from one or more disposals. Under paragraph 5(1)(a) these are references to the return on investment represented by the total net profits and gains arising from the disposal or disposals.

Paragraph 5(2) of Schedule 5AA provides that where profits and gains are realised on more than one disposal by associated persons those profits or gains are treated as realised by the same person. Paragraph 5(3) then explains when persons are associated for the purposes of paragraph 5(2). The definition includes persons who are or have been associated companies (see paragraph 5(3)(b) and (3)(c)), and "associated company" is defined in paragraph 5(4) by reference to section 416 of ICTA.

FA 2002 amended Schedule 5AA to ICTA so that it does not apply for corporation tax purposes with effect for accounting periods beginning after 30 September 2002. It repealed most references in the Schedule to companies. Although Schedule 5AA continues to apply to companies liable to income tax, companies are only so liable if they are acting in a fiduciary or representative capacity or are non-resident. The extension of the definition of associated person to include associated companies was not originally intended to refer to companies liable to income tax (although it could do so) and appears to have been overlooked when Schedule 5AA was amended in 2002. The provisions about when persons are associated for this purpose in section 561(3) to (6) does not include association by companies.

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 103: Charge on income treated as arising from foreign holdings: foreign dividend coupons: section 570

This change clarifies two points in rewriting section 18(3B) of ICTA. First, that a "bank in the United Kingdom" means a bank's office in the United Kingdom, whether the bank is resident in the United Kingdom or abroad. Second, that a "dealer in coupons in the United Kingdom" means a coupon dealer carrying on business in the United Kingdom, whether the dealer is resident in the United Kingdom or abroad.

Section 18(3B) of ICTA provides that a charge under Schedule D Cases IV or V arises on the sale or other realisation of coupons for foreign dividends by a "…bank in the United Kingdom…" which pays over the proceeds or carries them to an account. This is interpreted by the Inland Revenue to mean the office in the United Kingdom of a bank, whether that bank is incorporated in the United Kingdom or abroad. Similarly, a sale of such coupons to a "…dealer in coupons in the United Kingdom…" is taken to mean a coupon dealer carrying on business in the United Kingdom, whether resident in the United Kingdom or abroad.

Section 570 is based principally on section 18(3) and (3B) of ICTA. It treats income as arising from foreign holdings where a dividend coupon attached to the holding is (a) sold or otherwise realised by a bank in the United Kingdom, or (b) sold to a coupon dealer in the United Kingdom by someone other than a bank or coupon dealer. So subsection (3) of the section refers to "…a bank's office in the United Kingdom…" and subsection (4) refers to a person "…dealing in coupons in the United Kingdom…" in rewriting section 18(3B) of ICTA.

Where section 18(3B) of ICTA does not apply then section 730 of ICTA may apply to tax the coupon sales to income tax under Schedule D Case VI. An alternative interpretation to "in the United Kingdom" may, depending on circumstances, take a sale of coupons out of one provision and into another. Whether more tax is paid as a result of being taxed under section 570 of this Act or section 730 of ICTA depends on the taxpayer's own circumstances.

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 104: Death of a seller of patent rights: time for serving notice: sections 593 and 862

This change relates to the correction of an omission to revise, in connection with the Self Assessment reforms, the time limit for serving a notice under section 525(2) of ICTA.

Section 525(2) of ICTA sets a period within which the personal representatives of a seller of patent rights who has died may claim a reduction in the tax payable out of the estate. The claim must be made "not later than 30 days after notice has been served on them" of the charge falling to be made under section 525(1) of ICTA.

The system of Self Assessment for personal tax applied from the tax year 1996-97 onwards. Schedule 21 to FA 1996 contained amendments of provisions setting time limits for claims, elections etc to align them with the time limits for certain actions under the Self Assessment system, such as the filing of tax returns. The normal time limit for filing a personal return containing a self-assessment is 31 January following the tax year to which the return relates.

When a person dies, his personal representatives are responsible for making any Self Assessment return for the year of death and agreeing and settling all tax liabilities up to and including the year of death. It therefore makes sense to align the time limit in section 525(2) of ICTA with the normal Self Assessment time limit.

Schedule 21 to FA 1996 did not amend the time limit in section 525(2) of ICTA. This omission has been corrected by revising the time limit in the rewritten legislation.

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 105: Settlements: approved pension arrangements: section 627 and paragraph 132 of Schedule 2

This change provides for pension arrangements prescribed by regulations made under the Welfare Reform and Pensions Act 1999 and the Welfare and Reform and Pensions (Northern Ireland) Order 1999 to fall within the definition of a "relevant pension scheme", benefits of which are not treated as income of the settlor. This is in place of a pension arrangement of any description which may be prescribed by regulations made by the Secretary of State under section 660A(11)(c) of ICTA (and section 660A(11)(g) for 2005-06).

Section 660A(1) of ICTA treats as income of the settlor income arising under a settlement from property in which the settlor retains an interest. But Section 660A(9)(c) of ICTA provides that a benefit under a relevant pension scheme will not be treated as the settlor's income. Section 660A(11) of ICTA defines a relevant pension scheme. This includes (subsection (11)(c)) "a pension scheme of any description which may be prescribed by regulations made by the Secretary of State".

The exclusion from the settlements charge for benefits from certain pension schemes was introduced into the settlements legislation by paragraph 26 of Schedule 13 to FA 2000 as section 660A(11). Section 660A(11)(g) of ICTA included within the approved arrangements pensions prescribed by regulations made by the Secretary of State. Paragraph 28 of Schedule 35 to FA 2004 amended these provisions for the tax year 2006-07 onwards but retained the

exemption for pensions prescribed by regulations previously in section 660A(11)(g) of ICTA. The purpose of section 660A(11)(g) of ICTA was to provide the powers for regulations to be made by the Secretary of State. The wording of paragraph 26 of Schedule 13 to FA 2000 was borrowed almost in its entirety from section 11(2) of the Welfare Reform and Pensions Act 1999. But, in error, section 83 of that Act, which provides the supporting legislation for such regulations, was not legislated in FA 2000.

As a result, the powers in section 660A(11)(g) of ICTA and, following FA 2004, subsection 11(c) are inadequate to make regulations. However the intention was that regulations made under section 660A(11)(g) of ICTA (and hence also, for the tax year 2006-07 onwards, section 660A(11)(c) of ICTA) should be the same as those made under section 11(2)(h) of the Welfare Reform and Pensions Act (currently the Occupational and Personal Pension Schemes (Bankruptcy) (No 2) Regulations SI 2002/836) and in practice the pension arrangements in these regulations are accepted under section 600A(11)(g) of ICTA.

Rather than rewrite in Chapter 5 of Part 5 of this Act the powers in section 83 of the Welfare Reform and Pensions Act, it is considered simpler to include directly the arrangements within the regulations made under that Act. A reference to the equivalent legislation for Northern Ireland (Article 12(2)(h) of the Welfare and Reform and Pensions (Northern Ireland) Order 1999) has also been included. The relevant regulations here are in SI 1999/3417 (N.I.11).

The reference in section 660A(11)(g) (and (11)(c)) of ICTA to "Secretary of State" is not rewritten as it is, as a result of this change, unnecessary.

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 106: Beneficiaries' income from estates in administration: set off of excess of allowable estate deductions in the final tax year of the administration period: beneficiaries with absolute interests: section 660

This change provides for any amounts that are allowable against the aggregate income of the estate in calculating the residuary income of the estate in the tax year in which the administration period ends, but cannot be so allowed because they exceed that income, to be set off against the amount in respect of which the beneficiary with an absolute interest is taxable or, if there is more than such beneficiary, for a just and reasonable part to be set off.

Section 697(1A) of ICTA provides that where the deductions for any year exceed the aggregate income of the estate, the excess shall be carried forward and treated as an allowable deduction in the following year. Clearly, this is not possible in the tax year in which the administration period ends. In practice, however, excess deductions may be set off against any residuary income of the estate which has not been paid out. (This is often necessary since personal representatives may incur a high proportion of expense on the estate towards the end of the administration period, for example, because of the billing of legal or accountancy fees at the end.)

In rewriting section 697(1A) of ICTA, section 660(3) of this Act reflects that practice by providing for a person's basic amount of estate income for that year (that is, the person's share of the residuary income of the estate that has not yet been paid out) to be reduced by the excess deductions. If there is more than one absolute interest in the residue of the estate at the end of the administration period a just and reasonable part of the excess is subtracted.

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 107: Beneficiaries' income from estates in administration: exclusion of income from specific dispositions and income from contingent interests from the aggregate income of the estate: sections 664 and 666

This change excludes income from specific dispositions and income from contingent interests from the aggregate income of an estate (which is used to compute the residuary income of an estate and hence affects the amount of estate income that is chargeable to tax where a person has an absolute interest in the estate) and from the deductions made in determining the residuary income of the estate.

The aggregate income of the estate is defined in section 701(8) of ICTA as:

> the aggregate income from all sources (for the tax year in question) of the personal representatives of the deceased as such, treated as consisting of –
>
> (a) any such income which is chargeable to United Kingdom income tax by deduction or otherwise, such income being computed at the amount on which tax falls to be borne for that year; and
>
> (b) any such income which would have been so chargeable if it had arisen in the United Kingdom to a person resident and ordinarily resident there, such income being computed at the full amount thereof actually arising during the year, less such deductions as would have been allowable if it had been charged to United Kingdom income tax;
>
> but excluding any income from the property devolving on the personal representatives otherwise than as assets for the payment of the debts of the deceased.

Property that is the subject of a specific disposition is available for the payment of the deceased's debts and so is not excluded. However, under section 697(1)(b) of ICTA "the amount of any of the aggregate income of the estate for [a tax year] to which a person has on or after assent become entitled by virtue of a specific disposition either for a vested interest during the administration period or for a vested or contingent interest on the completion of the administration" is deductible from the aggregate income of the estate for that year in calculating the amount of the residuary income of an estate for that year. The Scottish version of this provision omits the words "on or after assent" and the words following "specific disposition": see section 702(b) of ICTA. But the inclusion of the words "on or after assent" for the rest of the United Kingdom means that much of the income of the specific disposition will form part of the aggregate income. The result is that the measure of the income taken to be available to residuary beneficiaries is inflated.

In practice, the Inland Revenue allow all income from specific dispositions to be deducted from the aggregate income of the estate in calculating the residuary income of the estate. But it is considered simpler for it merely to be excluded from what counts as the aggregate income and not to be deducted from it. Accordingly, the definition of "the aggregate income of the estate" in section 664 contains an exclusion for all income from specific dispositions to which a person is or may become entitled at subsection (5)(a). In consequence, the deduction for this income in section 697(1)(b) of ICTA and its adaptation for Scotland in section 702(b) of ICTA are not rewritten.

Since tax is treated as having been paid at the basic rate on this income, any reduction in the income taken to be available to beneficiaries as a result of this change will result in beneficiaries who pay tax at rates above the basic rate paying less tax, but those not liable to

income tax, or liable to tax only at rates below the basic rate, may not be able to reclaim so much tax.

This change is adverse to some taxpayers and is favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 108: Beneficiaries' income from estates in administration: removal of the requirement for interest to be annual and a charge on residue to be deductible in calculating the residuary income of the estate: section 666

This change removes the requirements for interest to be annual and a charge on residue in order to be deductible from the aggregate income of the estate in calculating the residuary income of the estate.

The deductions that are allowable in ascertaining the amount of the residuary income of an estate for a tax year are set out in section 697(1)(a) and (b) of ICTA. Section 697(1)(a) of ICTA refers to "the amount of any annual interest, annuity or other annual payment [for the year] which is a charge on residue …". There is a definition of "charges on residue" in section 701(6) of ICTA which is adapted for Scotland in section 702(d) of ICTA.

So far as the requirement for the interest to be annual is concerned, historically tax legislation has distinguished between short interest (which was not usually deductible) and annual or yearly interest (which was usually deductible). FA 1969 abolished the general relief for interest paid by taxpayers. However, specific provision was made for relief to continue to be allowed in respect of interest on borrowings for certain purposes. Annual or yearly interest continued to be significant as there was a requirement that tax was deducted from certain payments of yearly interest. But under the law as it applies before the commencement of this Act, interest, whether short or annual, may be deducted as an expense in computing the profit or loss of a trade for tax purposes if incurred wholly and exclusively for business purposes. (This is subject to certain restrictions on the deduction of annual interest paid to a person not resident in the United Kingdom and there is still a requirement to deduct tax in certain circumstances in relation to annual interest under section 349(2) of ICTA. For example, where the payment is to a person whose usual place of abode is outside the United Kingdom.)

So far as deductions in calculating residuary income of an estate are concerned, there is no reason, in principle, why short interest paid by the personal representatives should not be deductible. The historic distinction between short interest and annual interest no longer applies in tax legislation generally so it is difficult to justify here.

The other requirement in section 697(1)(a) of ICTA is that the payment of annual interest must be a charge on residue. "Charges on residue" are defined in section 701(6) of ICTA as certain specified liabilities properly payable out of the estate, as well as interest payable in respect of them. The definition is wide enough to include all interest ever likely to be paid by personal representatives, so the requirement that the payment is a charge on residue is otiose for interest.

Therefore, section 666(2)(a) of this Act, which rewrites section 697(1)(a) of ICTA, omits the requirements for interest to be annual and a charge on residue before it can be deducted from the aggregate income of the estate to calculate the residuary income of the estate. As a consequence, all interest paid by the personal representatives will be deductible, except for interest on unpaid inheritance tax which is expressly disallowed by section 233(3) of the Inheritance Tax Act 1984.

Since tax is treated as having been paid at the basic rate on this income, any reduction in the income taken to be available to beneficiaries as a result of this change will have the result that beneficiaries who pay tax at rates above the basic rate will pay less tax, but those not liable to income tax, or liable to tax only at rates below the basic rate, may not be able to reclaim so much tax.

This change is adverse to some taxpayers and is favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.

Change 109: Beneficiaries' income from estates in administration: how reduction in share of residuary income of estate under section 697(2) and (3) of ICTA operates for successive absolute interests: section 671

This change relates to the reduction in the share of the residuary income of the estate required where the amounts actually paid during or payable at the end of the administration period in respect of an absolute interest are less than the share of the residuary income for all tax years and clarifies how the reduction is to be made in cases where the absolute interest has been held successively.

Under section 697(2) of ICTA on the completion of the administration of an estate in which a person has an absolute interest, a comparison is made between the aggregate benefits received in respect of that interest and the aggregate for all years of the residuary income of the person having that interest. If the aggregate of the benefits is less than the aggregate of the residuary income, the amount of the shortfall is to be applied in reducing the person's residuary income for the tax year in which the administration is completed. If that does not exhaust the amount of the shortfall, the remainder is used to reduce the previous tax year's residuary income, and so on for previous tax years. (Section 697(2) of ICTA is rewritten in section 668 of this Act.)

Section 697(4) of ICTA provides that if a different person had an absolute interest in the residue at any time in the administration period "the aggregates mentioned in [section 697(2) of ICTA] shall be computed in relation to those interests taken together, and the residuary income of that other person also shall be subject to reduction under [section 697(2) of ICTA]". This is too vague to indicate how the reduction is to be made under section 697(2) of ICTA where there is more than one person with a share of the residuary income of the estate available to be reduced.

One possibility would be for the reduction to be apportioned in some way between the absolute interest holders. But it is not at all obvious how such an apportionment would work because section 697(2) of ICTA requires the excess for the final tax year of the administration period to be used to reduce the last absolute interest holder's residuary income in the previous tax year. So it is not apparent whether that would have to be done before any other person's reduction was made. The other holder or holders of the interest may have held it several tax years before the final year.

Section 671(5) and (6) of this Act provide for the reduction to be made in these circumstances. Section 671(6) provides that the last absolute interest holder's share of the residuary income should be reduced first. If there is still an excess of residuary income over the gross amount of all sums paid during or payable at the end of the administration period after going through all the years that the final holder had the interest, the excess is then applied to the residuary income of the previous holder for the last tax year that that person

had the interest and then to earlier tax years (and earlier absolute interest holders as appropriate) working backwards.

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 110: Beneficiaries' income from estates in administration: requirement for apportionments where the parts of the residuary estate in which successive interests subsist do not wholly correspond: section 676

This change introduces a requirement for just and reasonable apportionments to be made in cases involving successive interests in the residuary estate where the part of the residuary estate in which a succeeding interest subsists does not wholly correspond with the part in which the preceding interest subsisted.

The taxation of successive interests in the residue of an estate is dealt with in section 698 of ICTA. Section 701(11) of ICTA provides that where different parts of the estate are the subject of different residuary dispositions, Part 16 of ICTA has effect in relation to each of those parts with the substitution for references to the estate of references to that part of the estate. (This is rewritten as a general rule for the interpretation of Chapter 6 of Part 5 of this Act in section 649(4)). But there is no provision for situations where the residuary estate in which a later holder acquires an interest was not all subject to the interest held by a previous holder or is only a part of the residuary estate in which a previous holder held an interest.

Section 676 of this Act provides that in such cases such apportionments as are just and reasonable are to be made.

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 111: Beneficiaries' income from estates in administration: omission of section 695(6) of ICTA: section 678

This change relates to the omission of section 695(6) of ICTA, which requires that where relief is given to a person with a limited or discretionary interest in a foreign estate for United Kingdom income tax borne by the income of the estate, the person's total income should include an amount corresponding to the relief.

Section 695(5) of ICTA enables a beneficiary of a foreign estate who is entitled to a limited interest in the residue of the estate and is charged to tax for a tax year in respect of income from the estate to claim relief if any of the aggregate income of the estate has borne United Kingdom income tax. Section 698(3)(b) of ICTA applies this also to beneficiaries who are charged in respect of income paid from the estate under a discretion.

Section 695(6) of ICTA (which is also applied by section 698(3)(b) of ICTA) provides that where the relief is given "such part of the amount in respect of which [the beneficiary] has been charged to income tax as corresponds to the proportion mentioned in [section 697(5) of ICTA] shall, for the purposes of computing his total income, be deemed to represent income of such amount as would after deduction of income tax be equal to that part of the amount charged". (The proportion referred to is the proportion that the amount of the beneficiary's income that has borne United Kingdom income tax, less the tax, bears to the amount of the aggregate income of the estate, less United Kingdom income tax.) The meaning of this provision, which originated while surtax was still charged, is now obscure, and it is

particularly difficult to see how it could operate in the context of Self Assessment. Consequently, in practice it tends to be ignored. Therefore it is not being rewritten in this 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 112: Exempt income: savings certificates: unauthorised purchases involving multiple certificates: sections 692(2) and 693(5)

This change enables multiple savings certificates to be regarded as authorised in part where an unauthorised number of certificates has been purchased, and so confers exemption on the income from the part that is so regarded.

The Treasury limit the number of savings certificates of any particular issue that a person is permitted to purchase. The limits are stated in the prospectus for each issue.

The income from savings certificates is exempt from income tax under section 46 of ICTA. However, the exemption only applies to certificates purchased within the permitted limits. Section 46(3) of ICTA provides that the exemption does not apply to savings "... certificates ... purchased ... in excess of the amount which a person is for the time being authorised to purchase ...". It is not entirely clear how this would work in the case of multiple certificates. (These are certificates which represent a number of individual unit certificates.)

For example, if the maximum number of certificates permitted is 100, X holds 80, and then purchases a multiple certificate of 50, section 46(3) of ICTA appears to prevent the exemption from applying to the second multiple certificate. However, in practice, the second certificate is treated as 50 individual certificates, so that 20 would be treated as authorised and 30 as unauthorised.

Sections 692(2) and 693(5) of this Act reflect this practice by providing that certificates are authorised "so far as" their acquisition was not prohibited by regulations made by the Treasury limiting a person's holding or, in the case of Ulster Savings Certificates, such regulations made by the Department of Finance and Personnel.

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: Exempt income: Ulster Savings Certificates: section 693

This change gives statutory effect to ESC A34 (certificates encashed after death of registered holder).

Income from Ulster Savings Certificates (USCs) is exempt from income tax if the conditions in section 46(3) and (4) of ICTA are met.

Under section 46(3) of ICTA the exemption does not apply to certificates purchased in excess of the maximum number prescribed by the Department of Finance and Personnel in Northern Ireland. Under section 46(4) of ICTA the holder must be resident and ordinarily resident in Northern Ireland:

- either when the certificates are repaid; or
- where the holder purchased the certificates, at the time of purchase.

So, if the holder did not purchase the certificates, but, say, inherited them, the exemption would apply only if the holder satisfied the residence condition at the time of repayment.

ESC A34 therefore extends the exemption so if the deceased holder of the USCs was resident and domiciled in Northern Ireland at the time the certificates were purchased, but the personal representative, or the beneficiary who inherited the USCs was not, the exemption is still available. It provides:

> Accumulated interest on Ulster savings certificates held by persons resident and domiciled in Northern Ireland is exempt from income tax (TA 1988 s 46). Where repayment is made after the death of the holder, exemption is allowed if the deceased was resident and domiciled in Northern Ireland at the time of purchase.

Until 1981, the residence condition for the exemption was that the holder had to be "resident and domiciled" in Northern Ireland (see section 96 of ICTA 1970), although in practice this was interpreted as "resident and ordinarily resident". The wording of the legislation was amended by section 34 of FA 1981 to bring it into line with the practice. The ESC was introduced in 1958 and has not been amended, so it is still phrased in terms of the pre-1981 legislation, although, in practice, it is now operated in line with the post-1981 wording, so that the reference in the ESC to "domiciled" is read as "ordinarily resident".

Section 693(4) of this Act gives statutory effect to the 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 114: Individual investment plans: non-resident insurance companies: sections 697 and 698(6)

This change extends the provisions in section 333A of ICTA to cover non-resident insurance companies and omits section 333B(4) of ICTA (so far as income tax is concerned).

Sections 333 to 333B of ICTA contain powers for the Treasury to make regulations providing for the income of individuals from investments held in certain types of investment plan to be exempt from income tax. Section 333A of ICTA provides that the regulations may include certain requirements to be fulfilled by a "European institution" or a "relevant authorised person" if it is to be a "plan manager".

Section 333B(4) of ICTA provides for regulations to be made about non-resident insurance companies appointing United Kingdom tax representatives. So far as income tax is concerned, this provision does much the same for non-resident insurance companies as section 333A of ICTA does for European institutions. This duplication is unnecessary: it was never intended that non-resident insurance companies should be subject to substantially different requirements from European institutions. Indeed, some non-resident insurance companies may be European institutions, which increases the scope for confusion.

So, in rewriting these provisions, section 333A of ICTA has been extended to cover non-resident insurance companies and section 333B(4) of ICTA has been omitted, so far as income tax is concerned. Section 697(2)(c) provides that "foreign institution" includes "…an insurance company which is non-UK resident".

This has four effects.

- The provisions rewritten from section 333A of ICTA will apply only to non-resident insurance companies which are plan managers, whereas section 333B(4) of ICTA applies for all non-resident insurance companies.
- The more specific language of section 333A of ICTA is substituted for the general formula in section 333B(4)(a) of ICTA, see sections 697 and 698.
- The scope of the provision is restricted to the "prescribed duties" (rewritten as "specified" duties, see section 697(1)) referred to in section 333A(2), (3) and (4), whereas section 333B(4) of ICTA applies to any duties.
- The powers which may be conferred and the liabilities which may be imposed are restricted to those covered by section 333A(10) of ICTA, rather than those covered by section 333B(4)(b) of ICTA (see section 698(6)).

This change has no implications for the amount of tax paid, who pays it or when.

Change 115: Exemptions: venture capital trust dividends: conditions for shares where share reorganisations have occurred: section 712

This change treats shares acquired as a result of a company reorganisation as satisfying the condition requiring them to have been acquired for genuine commercial reasons.

In order to qualify for the income tax exemption for distributions from venture capital trusts ("VCTs") the shares in respect of which the distributions are made must satisfy certain conditions. The conditions are set out in paragraph 7(3) of Schedule 15B to ICTA. These include that:

- the shares were acquired "for bona fide commercial purposes and not as part of a scheme or arrangement the main purpose of which, or one of the main purposes of which, is the avoidance of tax" (paragraph 7(3) (a)(ia)); and
- they are not "shares acquired in excess of the permitted maximum for any year of assessment" (paragraph 7(3)(a)(ii)).

The first of those conditions was added by section 70 of FA 1999, and only has effect for shares acquired after 8 March 1999.

Paragraph 8(3) and (4) of Schedule 15B to ICTA apply where shares in VCTs are acquired in circumstances in which they are required by TCGA to be treated as the same assets as other shares. This covers the situation where there has been a reorganisation, for example, a bonus issue of shares or an issue of shares falling within sections 135 and 136 of TCGA. Under paragraph 8(3) and (4) of Schedule 15B to ICTA new shares acquired as a result of the reorganisation etc. are treated as being acquired within the permitted maximum i.e. as meeting the condition in paragraph 7(3)(a)(ii) of Schedule 15B to ICTA if the old shares were within the permitted maximum. However, no reference is made to the first of the conditions mentioned above i.e. the bona fide commercial purposes test.

For the issue of new shares to fall within sections 135 and 136 of TCGA, section 137(1) of TCGA must be satisfied. Section 137(1) of TCGA will only be satisfied if *the share reorganisation was effected* for bona fide commercial reasons and not as part of a scheme or arrangement the main purpose (or one of the main purposes) of which is the avoidance of tax

liability. So, in practice, the Inland Revenue treat such new shares as having been *acquired* for bona fide commercial purposes as so meeting both conditions mentioned above.

Section 712 of this Act applies the same rules about new shares meeting the genuine commercial purposes condition as are applied about the permitted maximum condition.

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: Interest from FOTRA securities held on trust: section 715

This change gives statutory effect to a practice relating to interest arising from FOTRA securities held on trust.

FOTRA exemptions apply where gilt-edged securities are in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom. The source legislation, principally section 154 of FA 1996, is rewritten in Chapter 6 of Part 6 of this Act. The beneficial ownership test lies within the definition of "FOTRA security": as it is part of the exemption condition of the securities. (See, in particular, section 22 of F(No 2)A 1931).

Although in the case of bare trusts and trusts with an interest in possession, it is fairly clear where the beneficial ownership lies, in the case of discretionary or accumulation trusts it can be difficult to apply the beneficial ownership test. In some types of trust the beneficial ownership of an asset is, in effect, in suspense. In others, while it may be clear where the beneficial ownership lies, it may belong to a different person from the person entitled to the income.

In practice, where interest from FOTRA securities held in trust arises to trustees and none of the beneficiaries of the trust is ordinarily resident in the United Kingdom, the beneficial ownership test is regarded as met whatever kind of trust is involved and no account is taken of whether the trustees themselves are resident or ordinarily resident. So if all the potential beneficiaries of a discretionary or accumulation trust (that is, those who have the right, at the discretion of the trustees, to benefit from the trust income or accumulated income) are not ordinarily resident in the United Kingdom, the FOTRA beneficial ownership test is treated as having been met.

Section 715 of this Act gives effect to this practice. So, for the purposes of determining whether interest arising from a FOTRA security held in trust is exempt from income tax under section 714 of this Act, it is to be assumed that the security is in the beneficial ownership of a person who is not ordinarily resident if none of the beneficiaries of the trust is resident when the interest arises. (See section 715(1) and (2)). Section 715(3) defines "beneficiaries of the trust" widely so as to cover all potential income beneficiaries of discretionary and accumulation trusts. Section 715(4) brings in beneficiaries receiving accumulated income.

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: Exempt income: purchased life annuity payments: claim for exemption of capital element of purchased life annuity: section 717(3)

This change relates to the rewriting in this Act (and so as primary legislation) of the requirement in regulation 4 of the Income Tax (Purchased Life Annuities) Regulations 1956 SI 1956/1230 for a claim to be made to obtain the benefit of section 656(1) of ICTA.

Case law has established that the whole of an annuity payment received by an annuitant is chargeable to income tax. (See, for example, the judgment of the Lord President (Inglis) in Coltness Iron Co v Black (1881), 1 TC 287 CS, which was cited with approval by Lord Wilberforce in CIR v Church Commissioners for England (1976), 50 TC 516 HL[2].) However, section 656(1) of ICTA provides for a part of an annuity payment made under a purchased life annuity to be treated as capital (the "capital element"). The effect is that, so far as it consists of the capital element, the annuity payment is exempt from income tax.

To obtain the benefit of section 656(1) of ICTA, an annuitant has to make a claim under regulation 4 of the Income Tax (Purchased Life Annuities) Regulations 1956 SI 1956/1230. Section 658(4) of ICTA provides that the regulations may "make provision for the time limit for making any claim for relief from or repayment of tax". But that is the only specific reference to a claim in the primary legislation. So that it is clear to a reader of the exemption that it is subject to a claim, the implied requirement for a claim in regulation 4 is rewritten in section 717(3) of this Act. Accordingly, the power in section 658(3) of ICTA to make regulations about this is not rewritten. As a result, the requirement for a claim cannot be revoked or amended by regulations.

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 118: Exempt income: purchased life annuity payments: method of calculating exempt part of purchased life annuity: section 719

This change alters the method of calculating the exempt part of an annuity payment where both the term of the annuity and the amount of the annuity payment depend on some contingency other than the duration of human life, and gives statutory effect to ESC A46.

Section 656(1) of ICTA provides for a part of an annuity payment made under a purchased life annuity to be treated as capital (the "capital element"). The effect is that, so far as it consists of the capital element, the annuity payment is exempt from income tax.

The way in which that exempt part is calculated varies according to the type of annuity involved, but the legislation is very jumbled and does not distinguish the different types very clearly.

By definition (see section 657(1) of ICTA) the term of a purchased life annuity is always dependent on the duration of a human life. The amount of the annuity payment might also be dependent on the duration of a human life. And the term or the amount (or both) might also be dependent on some other contingency (a "non-life contingency").

There are two basic approaches to the calculation of how much of any annuity payment is exempt. Which approach applies is, in general, determined by whether or not the amount of

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the annuity payment depends on some non-life contingency. Where the amount does depend on a non-life contingency, a constant sum is exempt (assuming the period covered by each payment is the same) - see section 656(2) of ICTA. But where the amount of the payment does not depend on a non-life contingency, a constant proportion of each payment is exempt - see section 656(3)(a) to (c) of ICTA.

Where not only the amount of the annuity payment but also the term of the annuity (in addition to depending on the duration of human life) depends on a non-life contingency, section 656(3)(b) and (e) of ICTA provide for the exempt part of each payment to be computed as a constant proportion. "[T]hat proportion shall be such as may be just, having regard to subsection (2) above and to the contingencies affecting the annuity."

As section 656(2) of ICTA recognises, actuarial techniques do not provide any mechanism for calculating the (exempt) capital element as a constant proportion of an annuity where the amount of the annuity is dependent on a non-life contingency. So the calculation envisaged by section 656(3)(b) and (e) of ICTA is not possible. Actuarial techniques do, however, provide a route to calculating a capital element as a constant monetary sum. It is possible, therefore, where both the amount and the term depend on a non-life contingency, to calculate the (exempt) capital element as a constant monetary sum (rather than as a constant proportion). Accordingly, section 719(4) provides for the constant sum method to apply in this case.

If the exempt capital element is so calculated, it is then possible for the amount of the exempt part to exceed the amount of a particular annuity payment. (See *Change 119* in Annex 1.) To cover that situation the carry forward of excess exempt amounts allowed by ESC A46 has been extended to annuities of this sort. The result is that the excess may be carried forward and added to the exempt part of the next payment. (See section 719(5).)

This change is adverse to some taxpayers and favourable to others in principle. If the amount of the annuity payment increases at a rate greater than that assumed for the purpose of calculating the capital element, the constant proportion approach favours the taxpayer. If the rate of increase falls below that predicted, the constant sum approach is to the taxpayer's advantage. In practice, it is expected to have no effect because this type of annuity has not been met in practice and remains no more than a hypothetical possibility.

Change 119: Exempt income: purchased life annuity payments: carry forward of excess exempt capital element in purchased life annuity payment: section 719 and paragraph 144 of Schedule 2

This change gives statutory effect to ESC A46.

Section 656(1) of ICTA provides for a part of an annuity payment made under a purchased life annuity to be treated as capital (the "capital element"). The effect is that, so far as it consists of the capital element, the annuity payment is exempt from income tax.

The way in which that exempt part is calculated varies according to the type of annuity involved, but the legislation is very jumbled and does not distinguish the different types very clearly.

By definition (see section 657(1) of ICTA) the term of a purchased life annuity is always dependent on the duration of a human life. The amount of the annuity payment might also be

dependent on the duration of a human life. And the term or the amount (or both) might also be dependent on some other contingency (a "non-life contingency").

There are two basic approaches to the calculation of how much of any annuity payment is exempt. Which approach applies is, in general, determined by whether or not the amount of the annuity payment depends on some non-life contingency. Where the amount does depend on a non-life contingency a constant sum is exempt (assuming the period covered by each payment is the same) - see section 656(2) of ICTA. But where the amount of the payment does not depend on a non-life contingency a constant proportion of each payment is exempt - see section 656(3)(a) to (c) of ICTA.

An example of an annuity where the amount depends on a non-life contingency is an index-linked annuity where the amount of the annuity fluctuates with movements in the Retail Prices Index. Initially the return under this type of annuity is low and the gross annuity may fall short of the amount of the constant exempt sum. With inflation the amount of the annuity payments is likely to rise and in due course to overtake the amount of the exempt sum.

ESC A46 deals with the situation where the amount of the annuity payment is less than the amount computed as exempt under the constant sum method in section 656(2) of ICTA. It allows any excess of the exempt amount over the gross annuity to be carried forward and increase the exempt part of the next payment. Section 719(5) of this Act gives statutory effect to the concession and Part 9 of Schedule 2 to this Act enables such excesses that were not absorbed by annuity payments made before tax year 2004-05 because they were too small, to be carried forward by increasing the exempt amount of the first payment made after 5 April 2005.

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 120: Exempt income: purchased life annuity payments: determining the age of the person during whose life a purchased life annuity is payable: sections 720(4) and 721(4)

This change alters in certain circumstances the age to be taken for the person during whose life a purchased life annuity is payable for the purposes of calculating the amount of the annuity that is exempt.

Section 656(1) of ICTA provides for a part of an annuity payment made under a purchased life annuity to be treated as capital (the "capital element"). The effect is that, so far as it consists of the capital element, the annuity payment is exempt from income tax.

The way in which that exempt part is calculated varies according to the type of annuity involved, but the legislation is very jumbled and does not distinguish the different types very clearly.

By definition (see section 657(1) of ICTA) the term of a purchased life annuity is always dependent on the duration of a human life. The amount of the annuity payment might also be dependent on the duration of a human life. And the term or the amount (or both) might also be dependent on some other contingency (a "non-life contingency").

There are two basic approaches to the calculation of how much of any annuity payment is exempt. Which approach applies is, in general, determined by whether or not the amount of the annuity payment depends on some non-life contingency. Where the amount does depend

on a non-life contingency, a constant sum is exempt (assuming the period covered by each payment is the same) - see section 656(2) of ICTA. This is determined by reference to the purchase price of the annuity and its expected term. Under section 656(2)(a)(ii) of ICTA the term is determined as at the date when the first annuity payment begins to accrue "by reference to prescribed tables of mortality".

But where the amount of the payment does not depend on a non-life contingency a constant proportion of each payment is exempt. (See section 656(3)(a) to (c) of ICTA.) Under section 656(4)(c) of ICTA the proportion used is the proportion that the total amount or value of the consideration for the grant of the annuity bears to the actuarial value of the annuity. That is determined as at the date on which the first payment begins to accrue "by reference to the prescribed tables of mortality".

Section 656(7) of ICTA provides that in using the prescribed tables of mortality to determine the expected term of an annuity or the actuarial value of the annuity payments:

> the age, as at the date when the first of the annuity payments begins to accrue, of a person during whose life the annuity is payable shall be taken to be the number of years of his age at his last birthday preceding that date.

So the age of the person during whose life the annuity is payable is determined by reference to his or her last birthday before the date of the calculation. Accordingly, where the calculation is to be made on the individual's actual birthday, it is still his or her age on his or her *previous* birthday that is taken even though he or she is, in any ordinary sense, a full year older.

Actuarial practice recognises the annuitant's age in years and fractions of years. For simplicity of calculation the purchased life annuity legislation only recognises full years, but it is not consistent with actuarial practice that it should attribute to an individual an age that he or she attained a year and a day previously. Inland Revenue practice follows actuarial practice in this respect, and so bases the calculation on the age attained on the date of the calculation if that date is the individual's birthday. Under both approaches for calculating how much of any annuity payment is exempt, the constant sum approach and the constant proportion approach, this practice produces a higher figure for the exempt element than the legislation. Sections 720(4)(b) and 721(4)(c) of this Act rewrite this 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 121: Exempt income: personal injury damages: omission of statutory references and inclusion of damages for death: sections 731 and 751 and paragraph 148 of Schedule 2

This change relates to the omission, from the provisions exempting interest on personal injury damages and damages paid as periodical payments from income tax, of references to the specific statutory provisions under which the damages are awarded, and the inclusion of damages for death.

Section 329(1) of ICTA exempts interest on damages for personal injury from income tax and section 329AA of ICTA exempts personal injury damages paid in the form of periodical payments.

Section 329AA(1) of ICTA (as amended by section 100(2) of the Courts Act 2003) exempts periodical payments (as defined in section 329AA(1A) of ICTA) from income tax. Under

section 329AA(1A)(b) of ICTA "periodical payments" includes payments made under an agreement so far as it settles a claim or action for damages in respect of personal injury (including an agreement as varied).

Section 329AA(6) of ICTA provides that such a claim or action includes claims or actions brought under various statutory provisions. In fact, it was never intended to limit the scope of the exemption by referring to these specific provisions. So, in rewriting this exemption, section 731 of this Act omits these references. However, the omission of the specific references to the Fatal Accidents Act 1976 and the Fatal Accidents (Northern Ireland) Order 1977 has made it necessary to refer specifically to damages for death, because without the references to that Act and Order it would not be clear that such damages are included in damages for personal injuries.

Similarly, section 329(1) of ICTA exempts interest on damages in respect of personal injuries or in respect of a person's death included in a sum for which judgment is given by virtue of the provisions referred to in section 329(2) of ICTA. In rewriting this exemption, section 751 of this Act omits these references and merely refers to interest on damages for personal injury or death included in a sum awarded by a court, without referring to the provisions under which the award may be made.

Since these references have been omitted, it is necessary specifically to exclude interest relating to the period between the making and satisfaction of an award, as such interest is awarded under the Judgments Act 1838, which is not listed in section 329(2) of ICTA.

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 122: Exempt income: personal injury damages: exemption of persons receiving payments on behalf of injured persons: section 734

This change relates to the extension of the provisions exempting personal injury damages paid as periodical payments from income tax, to include payments to a person receiving payments on behalf of an individual entitled to the payments.

Section 329AA(4) of ICTA provides that certain payments paid by trustees to, or for the benefit of, an injured person who is entitled to damages are exempt from income tax. However, that section does not provide that the person receiving the payment on behalf of the person so entitled is exempt from income tax. But, in practice, the person receiving damages on behalf of another is not taxed.

In rewriting section 329AA(4) of ICTA, section 734(2)(b) of this Act extends the persons entitled to the exemption to a person who receives a payment on behalf of the injured person.

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 123: Exempt income: health and employment insurance payments: extension to insurance against loss of office: sections 736(2) and 737(2)(b)

This change extends the risks against which insurance policies may provide if payments under them are to be exempt to loss of office.

Sections 580A and 580B of ICTA exempt payments under insurance policies providing cover against risks to health or employment from income tax where they meet specified conditions.

Under section 580A(3)(b) of ICTA the risk of loss of employment is described as "a risk that circumstances will arise as a result of which the insured will cease to be employed or will cease to carry on any trade, profession or vocation carried on by him". Under section 580A(4)(b) of ICTA the related period during which payments may continue is described as "any period during which the insured is, in circumstances insured against by the relevant part of the policy, either unemployed or not carrying on a trade, profession or vocation".

In practice, although section 580A(3)(b) of ICTA refers to loss of employment and not loss of office, the Inland Revenue does not distinguish between employees and office holders in deciding whether there is a qualifying risk relating to employment. So, taken together with the reference to trades, professions and vocations in section 580A(3)(b) of ICTA, the risk that a person will no longer be in receipt of income as a result of a loss of work of any sort is included. Accordingly, in rewriting that section in section 736(2), the risk that circumstances will arise as a result of which the insured will cease to hold an office has been included.

Similarly, in rewriting section 580A(4)(b) of ICTA in section 737(2)(b), a period during which the insured, in circumstances insured against by the relevant part of the policy, does not hold an office is expressly included.

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 124: Exempt income: health and employment insurance payments: meaning of "the insured": section 742

This change extends the meaning of "the insured" in certain provisions relating to the exemption of payments made under insurance policies insuring against health or employment risks.

Sections 580A and 580B of ICTA exempt payments under insurance policies providing cover against risks to health or employment from income tax where they meet specified conditions. The legislation uses the expression "the insured" in several places, without any definition. In certain provisions, "the insured" is extended by section 580A(9) of ICTA to include the insured's spouse, and any other person with whom they have joint, insured liabilities.

Section 742 extends the definition further so that a child of the insured is covered if the child is under 21. This means that payments from insurance policies taken out in respect of children's health or employment are included in the exemption so long as the general conditions for the exemption are met. These include the condition under section 580A(6) of ICTA that the premiums must not have qualified for tax relief by being deductible in calculating the insured's income from any source or be deductible from that income. So, following the extension of the meaning of "the insured" to include the insured's children, if premiums were so deductible as respects the child's income, the exemption would not be available for payments made under the policy. However, that is extremely unlikely to be the case.

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: Exempt income: interest on damages for personal injury: awards by foreign courts: section 751(1)

This change gives statutory effect to ESC A30 (interest on damages for personal injuries (foreign court awards)).

Section 329(1) of ICTA exempts interest on damages for personal injury from income tax by reference to judgements given by virtue of the statutory provisions specified in section 329(2) of ICTA. These are provisions that have effect in the various parts of the United Kingdom.

However, ESC A30 provides that the exemption under section 329 of ICTA is extended to interest on damages awarded in corresponding circumstances by a foreign court if the interest is exempt from tax in the country in which the award is made.

Section 751(1)(c) gives effect to the 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 126: Interest under employees' share schemes: participants in the scheme: section 752

This change extends the exemption from tax to interest received from any participant in an employees' share scheme (and not just from company employees and salaried directors).

The origin of section 688 of ICTA is paragraph 9 of Schedule 4 to FA 1970. In 1970 the exception from the prohibition on financial assistance for employees' share schemes was in terms of the employees of the company (section 54(1) of the Companies Act 1948). It was specifically provided that "employees" included directors holding a salaried employment or office in the company.

The current exception (section 153(4)(b) of the Companies Act 1985) refers to "the provision by a company, in good faith in the interest of the company, of financial assistance for the purposes of an employees' share scheme". Section 743 of the Companies Act 1985 explains what is meant by an "employees' share scheme". Such a scheme may, among other things, encourage the holding of shares by former employees and the spouses and children of employees and former employees.

Consequently, although former employees and spouses and children can benefit from schemes that are set up to comply with section 153(4)(b) of the Companies Act 1985, any payments of interest by them do not benefit from the exemption in section 688 of ICTA.

Section 752 extends the exemption to interest received by trustees from any participant in the scheme.

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 127: Interest under employees' share schemes: foreign source interest: section 752

This change extends the exemption from tax to foreign interest.

Section 688 of ICTA exempts trustees from income tax under Schedule D Case III. If a UK resident company advanced money to UK resident trustees for the purposes of an employees' share scheme, the trustees might receive interest from non-UK resident employees. In such

circumstances the foreign interest would be charged under Schedule D Case V. Accordingly, the trustees would not benefit from the exemption in section 688 of ICTA.

Section 752 provides that no liability to income tax arises under Chapter 2 of Part 4 of this Act in respect of the interest. The income charged by that Chapter includes foreign income that was formerly charged under Schedule D Case V.

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 128: Rent-a-room relief: income other than trading or property income: sections 785, 786, 794 and 798.

This change prevents the receipt of certain Schedule D Case VI income from disqualifying taxpayers from rent-a-room relief (as well as allowing the relief on that income).

Under paragraph 2(1) of Schedule 10 to F(No 2)A 1992 relief is available only if all "relevant sums" deriving from letting accommodation in the taxpayer's home would otherwise be chargeable under Schedule A or Schedule D Case I.

"Relevant sums" includes sums accruing in respect of meals, cleaning, laundry and goods and services of a similar nature provided in connection with the use of furnished accommodation (paragraphs 2(2) and 8 of Schedule 10 to F(No 2)A 1992). If a taxpayer lets a room and the income is charged under Schedule A, any incidental income for (say) occasional laundry services or meals would normally be chargeable under Schedule D Case VI. The receipt of that income would therefore disqualify the taxpayer from the relief.

This was not the case when F(No 2)A 1992 was enacted. Paragraph 2(1) of Schedule 10 to F(No 2)A 1992 originally referred to Schedule D Cases I and VI. At that time, income from letting furnished accommodation was charged under Schedule D Case VI unless the taxpayer elected for it to be charged under Schedule A (or unless the letting arrangements amounted to a trade as, for example, in the case of a bed and breakfast business).

In amending section 15 of ICTA, FA 1995 brought all lettings of furnished accommodation within the Schedule A charge. FA 1995 replaced the reference to Schedule D Case VI in paragraph 2(1) of Schedule 10 to F(No 2)A 1992 with a reference to Schedule A.

The definition of "rent-a-room receipts" in section 786(1) includes, by virtue of paragraph (d), receipts that would otherwise be chargeable under Chapter 8 of Part 5 of this Act (income not otherwise charged (the successor to Schedule D Case VI for this kind of receipt)). Consequently, those receipts no longer disqualify the taxpayer from the relief. Rent-a-room relief is also available on the 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 129: Rent-a-room relief: making the United Kingdom location condition explicit and a potential disqualification from the relief: sections 785 and 786

This change makes it explicit that rent-a-room relief applies only to United Kingdom property and removes a bar to the relief that can arise in respect of a let United Kingdom residence if, exceptionally, an individual also lets an overseas residence.

Paragraph 2(1) of Schedule 10 to F(No 2)A 1992 provides that an individual qualifies for relief for a tax year if all sums which accrue to the individual for the year from letting a room in a qualifying residence, or from providing associated goods or services, would otherwise be chargeable under Schedule A or Schedule D Case I.

Paragraph 4 of Schedule 10 to F(No 2)A 1992 provides that a residence is an individual's "qualifying residence", in respect of a tax year, if at some time during the period specified in that paragraph it is the individual's only or main residence. In rewriting that provision, section 786(1)(a) makes it explicit that the residence must be in the United Kingdom.

For an individual who has only a single qualifying residence in respect of a tax year the requirement is implicit in paragraph 2(1) of Schedule 10 to F(No 2)A 1992. If the residence is overseas the individual could not qualify for rent-a-room relief because any income from letting a room in the residence would be chargeable to tax under Schedule D Case V (as profits of an overseas property business or, exceptionally, income of a foreign trade).

That contrasts with the case of an individual who in a tax year lets a room in a qualifying United Kingdom residence *and* in a qualifying overseas residence. This case arises only if the individual's only or main residence changes during the period specified in paragraph 4 of Schedule 10 to F(No 2)A 1992.

Under paragraph 2(1) of Schedule 10 to F(No 2)A 1992, any income from letting a room in the overseas residence which is chargeable under Schedule D Case V would disqualify the individual from any rent-a-room relief at all (and which would otherwise have been available on income from the United Kingdom residence).

Relief will continue not to be available on income from an overseas residence. But the income relating to the overseas residence will no longer disqualify the individual from obtaining rent-a-room relief on income from the United Kingdom residence at the time of the change of residence.

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 130: Rent-a-room relief: removing anomaly from qualifications for relief: sections 788 and 795

This change counts any relevant balancing charge in the "total rent-a-room amount" for the purpose of establishing entitlement to the alternative method of calculation.

Under the source legislation a taxpayer with rent below the individual's limit but whose rent-a-room income and any relevant balancing charges together exceed the limit is not eligible for either form of rent-a-room relief.

Paragraph 9(4) of Schedule 10 to F(No 2)A 1992 prevents that taxpayer from qualifying for exemption. ("Relevant balancing charges" are balancing charges which would otherwise be made under CAA in respect of any plant or machinery used in any trade or Schedule A business from which the rent-a-room income is derived.)

But neither does the taxpayer qualify for the alternative method of calculation under paragraph 11 of Schedule 10 to F(No 2)A 1992 because the rent-a-room income alone does not exceed the limit (as required by sub-paragraph (1)(b)).

Section 795 provides that, if the other conditions are satisfied, the alternative method of calculating profits (the successor to paragraph 11 of Schedule 10 to F(No 2)A 1992) is available if the "total rent-a-room amount" exceeds the individual's limit. The "total rent-a-room amount" is defined in section 788 to include any relevant balancing charges.

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.

hange 131: Foreign income: special rules: meaning of "relevant foreign income": treatment of certain payments made by industrial and provident societies arising from a source outside the UK: section 830

This change allows foreign source loan interest, dividends and bonuses or other sums payable by a registered industrial and provident society to benefit from provisions available to income taxed under Schedule D Cases IV and V.

Under section 486(4) of ICTA any share or loan interest paid by a registered industrial and provident society is charged to tax under Schedule D Case III wherever it arises. Under section 66 of FA 1988 a society registered under the Industrial and Provident Societies Acts will be resident in the United Kingdom through incorporation. A society may, however, be non-resident where it also satisfies a residence test in the territory of a treaty partner of the United Kingdom and the treaty awards residence to that other territory. Section 249 of FA 1994 will then apply to treat the society as non-resident. Theoretically therefore share or loan interest paid by a registered society may arise outside the United Kingdom but be charged under Schedule D Case III. In consequence such income cannot, under the source legislation, benefit from treatment specific to Schedule D Cases IV and V.

It is unlikely that share or loan interest would arise to an industrial and provident society from a non-UK source. But it is believed that in principle it ought to benefit from the treatment available to interest within Schedule D Cases IV and V. Section 830 defines "relevant foreign income" as income arising from a source outside the United Kingdom which is charged under certain provisions which are listed. So, section 379 is not excluded from the list of provisions in section 830(2) under which a charge on relevant foreign income could arise. (See the reference to Chapter 2 of Part 4 of this Act in subsection (2)(e)).

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 132: Foreign income: special rules: relevant foreign income charged on remittance basis: conditions for claim: sections 831 and 857(1)

This change makes a minor alteration to the rules in section 65(4) of ICTA (remittance basis) to remove the citizenship condition so that any person who is not ordinarily resident in the United Kingdom is entitled to make a claim.

Section 18(3) of ICTA charges tax on income of a person resident in the United Kingdom which arises from securities (Schedule D Case IV) or possessions (Schedule D Case V) outside the United Kingdom. Section 65 of ICTA contains the rules for calculating the amount of income within Schedule D Cases IV and V that is chargeable to tax. Tax is charged on the amount of the income arising in the tax year unless the person chargeable under section 59 of ICTA meets one of the conditions set out in section 65(4) of ICTA and makes a claim. If one of those conditions is met and a claim is made, tax is charged on the

amount of the income received in the United Kingdom. The first condition is that the person is domiciled outside the United Kingdom. The second condition is that the person is both not ordinarily resident and a citizen of the Commonwealth or the Republic of Ireland.

The restriction of the second condition to citizens of certain countries is thought to have little practical effect. Citizens of other countries who are resident, but not ordinarily resident, in the United Kingdom are very unlikely to have their domicile in the United Kingdom. And, if they are not domiciled in the United Kingdom, they will meet the first condition, regardless of where they are ordinarily resident. In addition, restricting the second condition to citizens of certain countries might be argued to involve discrimination.

Therefore, in order to simplify the second condition and to ensure equality of treatment for all citizens who are not ordinarily resident in the United Kingdom, section 831(4) rewrites the second condition without the reference to citizenship of certain countries.

This change affects not only section 831 but also those provisions that refer to meeting the conditions in that section. See, in particular, section 857 and the definition of when the remittance basis applies to a person in section 878(2). Section 857 (partners to whom the remittance basis applies) is based on section 112(1A) of ICTA which repeats the conditions found in section 65(4) of ICTA. The definition of when the remittance basis applies to a person is required for various sections in Part 3 of this Act relating to overseas property income. See in particular sections 269(3) and (4), 357 and 358.

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 133: Foreign income: special rules: relevant foreign income charged on remittance basis: amalgamation of rules for Schedule D Cases IV and V: section 832

This change relates to the amalgamation of the rules which apply to income assessed under the remittance basis where income is taxed under either Schedule D Case IV or Case V.

Section 65(5) of ICTA contains the rules for calculating the quantum of income within Schedule D Cases IV and V that is chargeable to tax under the remittance basis. There are separate rules for Schedule D Case IV income (see section 65(5)(a) of ICTA) and Schedule D Case V income (see section 65(5)(b) of ICTA).

The rule for Case IV income is as follows:

> Tax shall be computed in the case of tax chargeable under Case IV, on the full amount, so far as the same can be computed, of the sums received in the United Kingdom in the year of assessment, without any deduction or abatement

And for Case V income:

> Tax shall be computed in the case of tax chargeable under Case V, on the full amount of the actual sums received in the United Kingdom in the year of assessment from remittances payable in the United Kingdom or from property imported, or from money or value arising from property not imported, or from money or value so received on credit or on account in respect of any such remittances, property, money or value brought or to be brought into the United Kingdom, without any deduction or abatement other than is allowed under the provisions of the Income Tax Acts in respect of profits charged under Case I of Schedule D.

These separate rules date from the Income Tax Act of 1803. Schedule D Case IV covers income from securities and Schedule D Case V income from possessions. The Case IV rule is more succinct, possibly because the rule did not need to cover so many eventualities as the rule applying to income from possessions, which covered income from more diverse sources.

The leading case of Thomson v Moyse (1960), 39 TC 291 HL established that the Case IV rule charging to tax "sums received in the United Kingdom" included all the examples of "sums received" listed under the Case V rule. There was some disagreement as to whether the Case V rule was narrower in its scope. This turned on whether or not the list of examples given in the rule was intended as a complete list of possibilities or merely examples of how sums might be received.

Although there was not a complete consensus of views, even those who did not think that the Case V rule was as wide in its scope as the Case IV rule agreed that the examples given for the Case V rule appeared to cover every conceivable way sums might be received in the UK.

In practice, the Inland Revenue treat the scope of the two rules as the same. There have been no cases since Thomson v Moyse where the point has been raised again.

Therefore no distinction between Schedule D Case IV and Case V type income is made in this Act and the two rules concerning the remittance basis have been merged to cover all Schedule Case IV and Case V income (in this Act "relevant foreign income" as defined in section 830). No list of how sums might be received has been included, because of the impracticality of producing a finite list, and the amount of detail required for a list of mere examples.

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 134: Foreign income: special rules: relevant foreign income charged on remittance basis: allowable deductions under section 65(5)(b) of ICTA: section 832

This change extends the rule in section 65(5)(b) of ICTA allowing deductions from remittances in respect of trade profits to profits of professions or vocations exercised outside the United Kingdom.

Section 65(5) of ICTA contains the rules for calculating the quantum of income within Schedule D Case IV and V that is chargeable to tax under the remittance basis. There are separate rules for Schedule D Case IV (section 65(5)(a) of ICTA) and Schedule D Case V (section 65(5)(b) of ICTA) income.

The rules for Schedule D Case V income are as follows:

> Tax shall be computed in the case of tax chargeable under Case V, on the full amount of the actual sums received in the United Kingdom in the year of assessment from remittances payable in the United Kingdom or from property imported, or from money or value arising from property not imported, or from money or value so received on credit or on account in respect of any such remittances, property, money or value brought or to be brought into the United Kingdom, *without any deduction or abatement other than is allowed under the provisions of the Income Tax Acts in respect of profits charged under Case I of Schedule D.*

The italicised words at the end are interpreted as meaning that where the income remitted is the equivalent of income within Schedule D Case I (i.e. profits arising from a trade), then the same deductions are available. The deductions are not available to all types of income remitted. But section 832(3) and (4) extend this rule so that the same deductions may be made from remittances of income in respect of professions or vocations exercised outside the United Kingdom as are made from income in respect of professions or vocations exercised in the United Kingdom.

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: Foreign income: special rules: relief for unremittable income and delayed remittances: conditions for granting relief: sections 835 and 841

This change broadens one condition and removes another condition for claims for relief in respect of unremittable income under section 584 or 585 of ICTA.

Section 584 of ICTA provides for relief for taxpayers taxed on income arising outside the United Kingdom, where the income cannot be remitted to the United Kingdom and certain conditions are met. Section 584(1)(a) and (2)(b) of ICTA refer 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 foreign currency in the overseas territory "notwithstanding any reasonable endeavours on his part".

Section 585 of ICTA applies to taxpayers on the remittance basis (see section 65(4) of ICTA). It provides that relief from tax on income taxed under Schedule D Case IV or V may be claimed if the conditions set out in subsection (1)(a) to (c) are met.

- Subsection (1)(a) requires the taxpayer to have been unable to transfer the income to the United Kingdom.
- Subsection (1)(b) 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 foreign currency in that territory.

Subsection (1)(c) requires the inability to transfer to have been not due to any want of "reasonable endeavours" on the part of the taxpayer.

(A) This concerns the condition contained in sections 584(1)(a) and 585(1)(b) of ICTA requiring 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).

Sections 835(3)(c) and 841(3)(c) remove the possibility of that narrow interpretation being taken. They require an inability to transfer because of the impossibility of obtaining in the territory currency "that could be transferred to the United Kingdom". The reference to that currency being foreign has been dropped as misleading: if local currency can be obtained that cannot be transferred to the United Kingdom, the case is likely to fall within section 835(3)(a) or (b) or 841(3)(a) or (b), but there is no point in excluding it from paragraph (c).

(B) The condition contained in section 585(1)(c) of ICTA and the similar words about "reasonable endeavours" in section 584(2) of ICTA are not rewritten in this Act. They are regarded as adding little to the requirements of sections 584(1)(a) and 585(1)(a) and (b) of ICTA. If, by reasonable endeavours, the taxpayer could transfer the income to the United Kingdom, the test in section 584(1)(a) of ICTA of his being prevented from transferring it

and the similar tests in section 585(1)(a) of ICTA about being unable to transfer the income or remit the proceeds of transfer must not be met, and there would then be no inability to transfer *because of* local law, government action or the impossibility of obtaining foreign currency as required under section 585(1)(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 136: Foreign income: special rules: delayed remittances: remittances in respect of which a claim may be made: section 835

This change enables a claim for relief to be made in respect of some (as opposed to all) of a taxpayer's delayed remittances where the taxpayer is taxed on the remittance basis.

Relief is available under section 585 of ICTA to taxpayers who are taxed on the remittance basis for income which cannot be remitted to the United Kingdom, if the conditions in section 585(1) of ICTA are met.

Section 585 of ICTA does not expressly refer to the possibility that a claim for relief may be made in respect of some (as opposed to all) of the income from a source which meets those conditions. But in practice the Inland Revenue would allow such a partial claim.

Section 835(1) gives effect to this practice by providing that a claim may be made "in respect of any of the income which meets [the relevant conditions]" without requiring that the claim must be made in respect of all the 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 137: Foreign income: special rules: deductions: omission of requirement for income not to be received in the United Kingdom: section 838

This change involves rewriting the part of section 65(1) of ICTA that permits deductions for expenses incurred outside the United Kingdom to be allowed in calculating the amount of foreign income chargeable to tax with the omission of the condition that the income in question must not be received in the United Kingdom.

Under section 65(1)(a) of ICTA certain deductions may be made from income within Schedule D Case IV and V that is taxed on the arising basis (with the exception of income arising from a trade carried on wholly abroad). The deductions are only permitted to be made where the income concerned is not received in the United Kingdom. (See the words preceding paragraph (a) of section 65(1) of ICTA.)

It is thought that this rather curious condition was included as an attempt to put taxpayers who found themselves within the arising basis rather than the remittance basis (following the restrictions placed on the remittance basis in FA 1914) on a similar footing to those who could still take advantage of the remittance basis. In fact, no deductions are available to those taxed on the remittance basis (except in the case of trading income). Moreover, in practice, for taxpayers within the arising basis, the Inland Revenue make no distinction between income received and not received in the United Kingdom: deductions available under section 65(1)(a) of ICTA are given whether or not the income in question is received in the United Kingdom. (See Change 138 for further details about the nature of these deductions.)

In rewriting the circumstances in which these deductions are allowed, this restriction has been omitted. (It is necessary, however, and has been retained for the deduction allowed for annuities under section 65(1)(b) of ICTA which is rewritten in section 839: see subsection (5)(a) of that section.)

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 138: Foreign income: special rules: specifying deductions available: section 838

This change concerns specifying the type of deductions available under section 65(1)(a) of ICTA for income within Schedule D Cases IV and V and extending the availability of these deductions to profits of foreign trades.

Section 65(1)(a) of ICTA allows certain deductions in computing the charge to income tax under Schedule D Cases IV and V where the income is taxed under the arising basis. Section 65(1)(a) of ICTA is drafted in very vague terms, referring to "the same deductions and allowances as if it [the income] had been so received [in the United Kingdom]". In this context, the word "received" is thought to be a reference to income taxed on the remittance basis.

In practice, the Inland Revenue treat these words as referring to expenses incurred in the "management and collection" of the income and the expenses allowed are confined to expenses incurred outside the United Kingdom. (See paragraph 1669 of the Inland Revenue's Inspector's Manual (IM 1669).) This interpretation is in accordance with the decision in Atkin v McDonald's Trustees (1894), 3 TC 306 (Court of Exchequer, Scotland, First Division) which involved income assessed on the remittance basis. In that case it was held that expenses incurred in the United Kingdom could not be deducted from the remitted income. So it follows that if deductions under section 65(1)(a) of ICTA are to mirror the position a taxpayer might find himself or herself in under the remittance basis, the section 65(1)(a) of ICTA expenses are confined to expenses incurred outside the United Kingdom.

Section 838 uses the words "collection or payment" rather than "management and collection" because the use of the word "management" might imply that the costs of managing a portfolio of investments should be allowed, but that is not so. The deductions that are allowed are those solely concerned with the costs of handling the income. There is nothing in the legislation that confines those costs to costs involved in sending the money to the United Kingdom, so no such restriction has been imposed.

Section 65(3) of ICTA provides that section 65(1)(a) of ICTA does not apply to income arising from a trade, profession or vocation carried on wholly outside the United Kingdom ("a foreign trade"). But, in practice, the Inland Revenue treat section 65(1)(a) of ICTA as conferring a deduction for certain extra expenses of a foreign trade that result from the income arising outside the United Kingdom, although in fact it is unlikely that there are any expenses within section 65(1)(a) of ICTA that would not be allowable in arriving at the profits of a foreign trade. Such trades are thus treated in the same way as overseas property businesses, since section 65A(5) of ICTA does not disapply section 65(1)(a) of ICTA.

In rewriting section 65(1)(a) of ICTA, section 838 does not exclude income from a foreign trade. So the costs attributable to the collection or payment of income from a foreign trade are deductible.

This change is adverse to some taxpayers and favourable to others in principle but in practice is expected to have only favourable effects and those small, and in few cases, because the incidence of these costs is rare.

Change 139: Pensions charged on the arising basis (sections 575, 613 and 635 of ITEPA): relief for arrears of foreign pensions: section 840 and paragraph 152 of Schedule 2

This change gives statutory effect to ESC A55 (arrears of foreign pensions). In doing this the Act makes a number of changes to the approach in the concession.

Sections 575, 613 and 635 of ITEPA determine the amount of taxable pension income for foreign pensions, foreign annuities and foreign voluntary annual payments respectively. The amount is found by applying the rules of Schedule D Case V. Section 65(1) of ICTA computes income under Schedule D Case V on the full amount of the income arising in the year of assessment (unless the remittance basis applies – see section 65(4) of ICTA). Section 68 of ICTA has provisions equivalent to section 65(1) of ICTA (but not to section 65(4) of ICTA), in respect of such income from the Republic of Ireland.

When a pension, annuity or voluntary annual payment (or an increase in such a pension etc) is granted retrospectively, arrears paid in respect of an earlier year or years arise for the purposes of sections 65(1) and 68 of ICTA in the year they become due rather than in an earlier year or years. The person receiving the arrears may be liable at a higher rate of tax in the year the income arises than the rate that would have applied had the arrears arisen in the earlier year.

Under ESC A55 the Inland Revenue recalculates the tax for the year in which the arrears arise for the purposes of section 65(1) of ICTA as if the arrears had arisen in the earlier year or years. If the recalculation is advantageous to the taxpayer, the tax charged is abated. The recalculation takes into account the 10% deduction under sections 65(2) or 68(5) of ICTA where appropriate. The abatement is applied without a claim.

Section 840 gives effect to the concession, but with some adaptations, taking the parallel relief for income charged under the remittance basis in section 836 (relief for delayed remittances: back dated pensions) as its model. So, rather than the tax for the year in which the arrears arise being abated, the arrears are treated as income of each relevant earlier year. The tax charge for each earlier year will increase, but the reduction of the charge in the year in which the arrears otherwise arise will compensate (and normally exceed the aggregate of the increases). Section 840(2) also requires a claim by the person liable for tax on the arrears, instead of action being initiated by the Inland Revenue. The administrative provisions of section 837 (claims for relief on delayed remittances) are applied so as to cater for these factors in the change of approach. It provides a time limit for claims, machinery for adjusting tax for earlier years and administration of the relief when a claimant dies.

This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is broadly in line with current practice.

Change 140: Foreign income: special rules: unremittable income: time limit for claims for relief: section 842(5)

This change alters the time limit for claims to relief in respect of unremittable income arising outside the United Kingdom so that the limit is tied to the tax year for which the income would otherwise be chargeable, rather than to the tax year in which the income arises.

Under section 584(6)(a) of ICTA a claim must be made "on or before the first anniversary of the 31 January next following the year of assessment in which the income arises". The year in which the income arises, however, might not be the year for which the income is chargeable, and the normal time limit for claims is by reference to the year for which the income is chargeable. So in such a case the limit under section 584(6)(a) of ICTA would differ from the normal time limit for claims.

In rewriting section 584(6)(a) of ICTA in section 842(5), the time limit for claims has been expressed by reference to the tax year for which the income would be chargeable if no claim were made, so aligning the limit for this kind of claim with the normal time limits for claims.

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 141: Foreign income: special rules: unremittable income: withdrawal of relief: ECGD payments received: section 843

This involves the withdrawal of relief in respect of unremittable income on the making of an Export Credit Guarantee Scheme payment in respect of the income.

Section 584 of ICTA provides a relief from income tax where a person's income arising outside the United Kingdom is charged on the basis of the income arising in the tax year, but cannot be transferred to the United Kingdom because of circumstances outside the person's control ("unremittable income"). Section 584(2) of ICTA provides that if such a person makes a claim in respect of overseas income which:

- is unremittable; and
- he or she will continue to be prevented from transferring to the United Kingdom, notwithstanding any reasonable endeavours on his or her part,

the amount of the income is to be left out of account in charging income from that source.

However, under section 584(2A) of ICTA if on any date "paragraph (a) or (b) of subsection (2) above ceases to apply" the income is treated as arising on the date of the change and is charged to tax for the tax year in which that date falls.

Section 584(5) of ICTA modifies the operation of the relief where a payment is made under the Export Credit Guarantee Scheme in respect of the unremittable income. Section 584(5) of ICTA provides that "…to the extent of the payment, the income shall be treated as income to which paragraphs (a) and (b) of subsection (2) above do not apply (and accordingly cannot cease to apply)". This makes it clear that no claim can be made, but not whether relief already given may be withdrawn or, if it may, whether the charge to withdraw the relief is to be made for the tax year in which the income first arose, or the year in which the ECGD payment is made.

This lack of clarity appears to be an unintentional result of amendments made by paragraph 33 of Schedule 20 to FA 1996, which substituted the present subsections (2) and (2A) of section 584 of ICTA for the original subsection (2) and amended subsection (5) in consequence. Those amendments, which were part of the changes made to facilitate Self Assessment for income tax, built on the changes already made by F(No 2)A 1987 for the introduction of "Pay and File" for corporation tax. Before the FA 1996 changes section 584(2) of ICTA was much longer and provided not only that account would not be taken of the income to the extent that the claimant showed "to the satisfaction of the Board that conditions [corresponding to those in paragraphs (a) and (b) in the present subsection (2)]" were satisfied with respect to it, but also that "on the Board ceasing to be satisfied that those conditions are satisfied" such assessments etc were to be made as were necessary to take account of the income and of any tax payable in the overseas territory in respect of it "according to their value at the date when in the opinion of the Board those conditions cease to be satisfied with respect to it".

The original section 584(5) of ICTA provided that to the extent of the Export Credit Guarantee Scheme payment the income should be treated as income "with respect to which the conditions mentioned in subsection (2) above are not satisfied (and accordingly cannot cease to be satisfied)". So it plainly had the effect that not only could no claim be made, but the Board would be bound to be satisfied that the income had ceased to be unremittable – or perhaps had never been unremittable – and so it could be assessed. It was never very clear what date was to be used for the value of the income and the foreign tax. But presumably the only date that could be used was the date when the Board had to cease to be satisfied, that is the date of the payment.

There is no good reason for the treatment of income which is no longer unremittable to vary according to whether circumstances have changed or an ECGD payment has been made. So this apparent change in the effect of section 584(5) of ICTA appears to have been completely unintentional. In practice, the income is taxed in the tax year in which the ECGD payment is made. Therefore section 843(4) and (5), which rewrite section 584(5) of ICTA, provide for the income to be taxed in that tax year, and accordingly for the income and any tax payable in respect of it in the place where it arises to be taken into account for income tax purposes at that date.

This change is adverse to some taxpayers in principle. But it is in line with the original legislation before amendment and with the intention of the amended legislation. And it is expected to have no practical effect as it is in line with current practice.

Change 142: Relevant foreign income: unremittable income: appeals to the Special Commissioners: Chapter 4 of Part 8 and paragraph 153 of Schedule 2

This change involves the omission from this Act of any provision rewriting the requirement under section 584(9) of ICTA that appeals concerning questions about relief for unremittable income should be heard by the Special Commissioners.

Section 584(9) of ICTA provides that appeals involving any question as to the operation of that section (relief for unremittable overseas income) must be made to the Special Commissioners and not to the General Commissioners. This is a departure from the normal rules in sections 31B to 31D of TMA under which in most cases a taxpayer may have an

appeal heard by the General Commissioners or make an election under section 31D of TMA for the appeal to be heard by the Special Commissioners.

This Act does not include any requirement about appeals involving any question as to the operation of Chapter 4 of Part 8 of the Act, which rewrites section 584 of ICTA. So the normal rules in sections 31B to 31D of TMA will apply to such appeals without restriction.

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 143: Partnerships: allocation of firm's profits between partners: section 850

This change legislates the practice in paragraph 72245 of the Inland Revenue's Business Income Manual.

Section 111(3) of ICTA provides that a partner's share of the profits or losses of a trade carried on in partnership is to be determined "according to the interests of the partners". It offers no guidance on how this is to be done.

Some partnership agreements provide for an initial allocation of profits (often in the form of a salary or interest on capital) to some partners before the balance is allocated on the basis of a percentage share in the profits.

For instance, three partners may agree to allocate profits of 250,000 as follows:

Partner	**A**	**B**	**C**	**Total**
Salary	50,000	50,000		100,000
Balance (30/30/40)	45,000	45,000	60,000	150,000
Total	95,000	95,000	60,000	250,000

But, if the profits were only 90,000, the position would be:

Partner	**A**	**B**	**C**	**Total**
Salary	50,000	50,000		100,000
Balance (30/30/40)	(3,000)	(3,000)	(4,000)	(10,000)
Total	47,000	47,000	(4,000)	90,000

Section 111(3) of ICTA deals in this case with an allocation of the trade *profits*. So the answer for partner C cannot be a loss. The Inland Revenue practice, supported by decisions by the Special Commissioners, is to re-allocate C's "loss" to the other partners, so that in the example both A and B are allocated 45,000 of the trade profits. C's share is nil.

A similar position can arise if the result for the firm is a loss. A share of that loss under section 111(3) of ICTA cannot be a profit.

Section 850(2) and (3) of this Act set out how a profit is to be allocated between partners, so that no partner's share is a loss. Subsections (4) and (5) set out the corresponding rule for the case where the overall result is a loss.

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 144: Partnerships: carrying on by partner of notional business: section 854

This change makes clear how the basis period rules apply to a non-trade business carried on in partnership.

If a person carries on a business (but not a trade) in partnership, section 111(10) of ICTA provides that subsections (1) to (3) of that section apply as they apply to a trade carried on in partnership. But those subsections do not import the special basis period rules in sections 60 to 63A of ICTA. So the income of the firm is assessed on the basis of the income arising or profits accruing in the tax year.

The position changes if the firm also carries on a trade. Then each partner's share of the trading profits is assessed, in accordance with the rules in sections 60 to 63A of ICTA, on the profits of basis periods which may differ from tax years. A consequence of that treatment is that section 111(7) and (8) of ICTA apply to the non-trading income of the firm. So the non-trading income may also be assessed on the income of basis periods which differ from tax years.

There is a potential problem if a non-trading firm starts to trade. Section 111(8)(b) of ICTA seems to require the basis periods for the non-trading income to be re-determined for all years since the partner joined the firm. That would pose considerable practical difficulties in the absence of rules about how to make the adjustments to assessments for earlier years.

Section 854(2)(b) of this Act makes it clear that the partner's "notional business" (comprising a share of the non-trading income) does not start until the firm starts to trade: there is no question of looking back to the time when the partner joined the firm.

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 145: Partnerships: resident partners and double taxation agreements: section 858

This change enacts the Inland Revenue practice of giving a narrow interpretation to the word "affect" in section 112(4) of ICTA.

The business profits article of the United Kingdom/Jersey double taxation agreement exempts the profits of a Jersey firm from United Kingdom tax. In the case of Padmore v CIR (1989), 62 TC 352 CA[3], the Court of Appeal decided that the exemption covered the share of the profits arising to a United Kingdom resident partner. The rules in section 112(4) and (5) of ICTA were enacted in 1987 to remove the exemption.

It was intended, in the case of income tax, that the 1987 legislation should do no more than remove the exemption claimed in the Padmore case. The words used in section 112(4) of ICTA are "shall not affect any liability to tax". On the face of it, these words could deny the partner any relief, including tax credit relief, under a double taxation treaty.

Section 858(2) of this Act makes it clear that it is only the partner's chargeability to tax that is preserved, overriding any provision to the contrary in a double taxation treaty. No other effect of the treaty is overridden.

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[3] STC [1989] 493

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 146: Exception of certain business gifts from the disallowance of expenditure on business entertainment and gifts in calculating the profits of non-trade and non-property businesses: section 867

This change extends an exception made in calculating profits, in the case of a business which is a trade or property business, to non-trade and non-property businesses.

Section 577 of ICTA (business entertaining expenses) prohibits the deduction of business entertaining expenditure in calculating profits chargeable to tax under Schedule D (section 18 of ICTA). Profits chargeable to tax under Schedule D include not only profits of a trade, profession or vocation, whether chargeable under Case I or II or Case V of that Schedule, but profits chargeable under other Cases of that Schedule. Section 21A(2) of ICTA applies section 577 of ICTA to the computation of income under Schedule A (section 15 of ICTA).

Section 577(8) of ICTA extends the restriction of deductible expenses under that section to the provision of gifts.

There are a number of exceptions from the restriction under section 577(1) or (8) to ICTA. Subsection (9) makes an exception for gifts to "expenditure incurred in making a gift to a body of persons or trust established for charitable purposes only" and two named bodies are treated as such a body of persons for this purpose. This exception was inserted by section 54 of FA 1980 in the predecessor of section 577 of ICTA, to give statutory form to an extra-statutory concession for donations by businesses to local charities. The scope of the former concession was broadened by the inserted exception, but the exception was restricted to "computing profits under Case I and II of Schedule D".

The exception provided by section 577(9) of ICTA does not therefore apply to business other than trades, professions and vocations or property businesses.

Section 577 of ICTA is rewritten, in respect of such trades and property businesses, in sections 45 to 47 in Part 2 of this Act. This section borrows from those sections to provide the extension of the rules, including exceptions, to non-trade businesses and non-property businesses.

It was not Inland Revenue policy, despite the drafting used in section 577(9) of ICTA, to make a distinction in the application of the exception between trades and property businesses and other businesses. Section 867 extends the benefit of the exception in principle to those other businesses.

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 147: General calculation rules: apportionment of profits: section 871

This modifies the application of section 72 of ICTA so that it applies to certain income within Schedule D Cases IV and V as well as Case VI.

Section 72(1) of ICTA permits the apportionment of profits or losses for the purposes of Schedule D Cases I, II or VI where accounts have been made up for a period which is not coterminous with the tax year (for income tax) or an accounting period (for corporation tax).

Section 72 of ICTA is applied by section 21A of ICTA for the purpose of calculating the profits of a Schedule A business.

Although section 72 of ICTA is expressed to apply in the case of profits or gains chargeable under Schedule D Cases I, II and VI only, it applies also to income chargeable to tax under Schedule D Cases IV and V which is derived by a person (whether solely or in partnership) from a trade profession or vocation. Section 65(3) of ICTA applies the rules applicable to Schedule D Cases I and II in computing such Schedule D Case IV or V income. Section 203 (apportionment etc. of profits to basis periods) applies the income tax rule in section 72 of ICTA to all trades, professions and vocations, whether within Schedule D Cases I or II or Cases IV or V.

Section 871 applies the income tax rule in section 72 of ICTA for the purpose of calculating income charged under provisions listed in section 836B of ICTA (inserted by paragraph 340 of Schedule 1 to this Act). Subsection (2) disapplies section 836B(4)(a) of ICTA, which excludes relevant foreign income from income within the tables in that section. This ensures that section 871 extends to income within Schedule D Case IV or V as well as income within Case VI.

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 148: Definition of "caravan" given by section 875 relevant to sections 20, 266, 308, 787 and 809

This change provides a single definition of "caravan" relevant to a number of sections and based on section 29(1) of the Caravan Sites and Control of Development Act 1960 and section 13(1) of the Caravan Sites Act 1968.

The change is relevant to sections 20, 266, 308, 787 and 809.

For the purposes of paragraph 3 of Schedule A (see section 15(1) of ICTA) "caravan" has the meaning given by section 29(1) of the 1960 Act. Paragraph 3 is re-written in section 266. The same definition is attracted by paragraph 4 of Schedule A (re-written in section 308).

Subsection (1) of section 875 reproduces the effect of section 29(1) of the 1960 Act; and subsection (2) reproduces the effect of section 13(1) of the 1968 Act. The section does not, however, reproduce the effect of section 13(2) of the 1968 Act (which provides that a structure mentioned in section 13(1) (a twin-unit caravan) is not a caravan if its dimensions exceed specified limits). Neither the 1960 Act nor the 1968 Act extend to Northern Ireland. However, the Caravans Act (Northern Ireland) 1963 contains the same definition for Northern Ireland as is contained in section 29(1) of the 1960 Act.

It is not clear whether the 1968 Act modifications apply for the purposes of paragraphs 3 and 4 of Schedule A. First, it is likely that Parliament intended that only one definition of "caravan" was to apply throughout the United Kingdom. But the 1968 Act does not extend to Northern Ireland. As the substance of the definitions in the 1960 Act (which applies to Great Britain) and in the Northern Ireland Act of 1963 are the same, a reference to the definition in the 1960 Act would be enough to secure a uniform definition.

Second, paragraph 3(2) of Schedule A provides that "caravan" has the meaning "given by" section 29(1) of the 1960 Act. Section 13 of the 1968 Act modifies the operation of Part 1 of the 1960 Act (rather than the section 29(1) definition). Because the definitions in section

29(1) apply "in" Part 1 of the 1960 Act it is therefore not certain whether the modifications made by the 1968 Act have been attracted.

Section 875 resolves these doubts by reproducing only section 13(1) of the 1968 Act. Consequently it does not matter whether a twin-unit caravan can be lawfully moved on a highway when assembled. For the purposes of Schedule A (as re-written in this Act) it is also immaterial if the twin-unit caravan exceeds the dimensions specified in section 13(2) of the 1968 Act. Schedule A treatment seems more appropriate the bigger the structure.

The definition of "caravan" in section 875 is also relevant to sections 787 and 809. "Caravan" is not defined in the definition of "residence" in paragraph 7 of Schedule 10 to F(No 2)A 1992 (rent-a-room relief) or in paragraph 7(3) of Schedule 36 to FA 2003 (foster-care relief). Accordingly, "caravan" has its ordinary meaning in those provisions. The definition of "caravan" in section 875 is wider than the ordinary meaning: for example, it includes structures that can be moved only by being put on trailers.

In relation to section 787 (which re-writes paragraph 7 of Schedule 10 to F(No 2)A 1992), a structure covered by the extended definition of "caravan" may be covered by the reference to a building or part of a building. But if not, the effect of moving from the ordinary meaning of "caravan" to the definition in section 875 is to widen the range of residences in relation to which rent-a-room relief is available.

In relation to section 809 (which re-writes paragraph 7(3) of Schedule 36 to FA 2003) the definition of "residence" used in section 787 applies. Consequently, the point made in relation to section 787 is also relevant. In referring to "the" residence, paragraph 7(3) of Schedule 36 to FA 2003 assumes that the accommodation which is actually provided by the foster carer for the child is caught. That would include accommodation comprising a structure covered by the extended definition of "caravan". Therefore the application of the extended meaning of "caravan" has no effect in relation to foster-care relief.

The changes are 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 149: References to "the Inland Revenue": section 878

This change converts references in the source legislation to an inspector or to the Board of Inland Revenue into references to any officer of the Board.

(A) References to an inspector The legislation rewritten in this Act contains a substantial number of references to an "inspector" (which means an inspector of taxes: see section 832(1) of ICTA). Except in the cases where that legislation refers to the making of claims and elections to the inspector, this Act replaces such references with references to "the Inland Revenue". This expression is defined by section 878(1) to mean any officer of the Board of Inland Revenue. For the purposes of this Act "the Board of Inland Revenue" means the Commissioners of Inland Revenue appointed under section 1 of the Inland Revenue Regulation Act 1890: see section 878(1).

As a result, the provisions affected will expressly authorise or require things to be done by or in relation to an officer of the Board instead of by or in relation to an inspector. This is consistent with the internal reorganisation of the Inland Revenue which took place in the mid-1990s and resulted in the merger of the previously separate networks of collection and tax offices and less rigid specialisation in relation to particular functions.

This represents only a minor change in the law because a similar result could in many cases be achieved by a different means under section 1(2B) of TMA, which was inserted by FA 1990. Under that provision a person who is not an inspector may for particular purposes exercise functions conferred on inspectors if, in accordance with the Board's administrative practices, he or she has been authorised to act as an inspector for those purposes.

In the cases where the legislation rewritten in this Act refers to the making of a claim or election to the inspector, the Act does not expressly provide for such a claim or election to be made to an officer of the Board. It does not specify to whom the claim or election must be made.

If the claim or election could be made by being included in a return to an officer of the Board, section 42(2) of TMA will apply to require it to be made in such a return. Otherwise paragraph 2(1) of Schedule 1A to TMA will apply to require the claim or election to be made to an officer of the Board.

This does not represent a change to the position before the passing of this Act. Section 42(2) of TMA and paragraph 2(1) of Schedule 1A to that Act also apply where the source legislation refers to the making of a claim or election to the inspector. They operate to require the claim or election to be made to an officer of the Board.

(B) References to the Board of Inland Revenue The source legislation also contains a number of references to "the Board" (which means the Commissioners of Inland Revenue: see section 832(1) of ICTA). Except where it is dealing with claims and elections, or where in practice the Board has not devolved the function concerned, this Act replaces such references with references to "the Inland Revenue". As mentioned above, this expression is in turn defined by section 878(1) to mean any officer of the Board of Inland Revenue.

Where the source legislation provides for a claim or election to be made to the Board, this Act does not expressly state to whom such a claim or election is to be made. Section 42(2) of TMA, or paragraph 2(1) of Schedule 1A to that Act, will apply to require the claim or election to be made to an officer of the Board. In such cases the requirement to make the claim or election to the Board is still replaced by a requirement to make the claim or election to an officer of the Board, as a result of the application of the TMA.

This last change has a further consequence. If a claim to the Board is made in a return, section 46C of TMA provides that an appeal concerning the claim will be heard by the Special Commissioners. If such a claim is made otherwise than in a return, paragraph 10 of Schedule 1A to that Act has the same effect.

Neither section 46C of TMA nor paragraph 10 of Schedule 1A to that Act will apply to the equivalent claim under this Act, which will be made to an officer of the Board. An appeal concerning such a claim will be heard by the General Commissioners instead, by virtue of section 31B of TMA (claims in returns) or paragraph 11(1) of Schedule 1A to that Act (other claims).

The claimant will still have the right under section 31D(1) of TMA (claims in returns) or paragraph 11(2) of Schedule 1A to that Act (other claims) to elect for the appeal to be heard by the Special Commissioners, although the General Commissioners may in certain circumstances disregard that election.

The result of the changes mentioned in this section is that the provisions affected will authorise or require things to be done by or in relation to an officer of the Board instead of by or in relation to the Board itself. However, as with the conversion of references to an inspector, this reflects the current organisation of the Inland Revenue.

Under section 4A of the Inland Revenue Regulation Act 1890 (which was introduced by FA 1969) any function conferred on the Board by or under any enactment, including any future enactment, may be exercised by any officer of the Board acting on their authority. All of the functions under the provisions affected by the conversion of references to the Board, which are in the main concerned with administrative processes, have in fact been devolved to officers of the Board, and the Board itself is no longer directly involved in their exercise.

Each of the provisions affected by the conversion of references to the inspector or to the Board is identified in the Table of Origins by a cross-reference to this change.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so in principle and occasionally in practice).

Change 150: Definition of "houseboat" given by section 878 relevant to sections 787 and 809

This change provides a single definition of "houseboat", relevant to sections 787 and 809.

For the purposes of paragraph 3 of Schedule A (see section 15(1) of ICTA) "houseboat" is defined as a boat or similar structure designed or adapted for use as a place of human habitation. Paragraph 3 is re-written in section 266. The same definition is attracted by paragraph 4 of Schedule A (re-written in section 308).

But "houseboat" is not defined in the definition of "residence" in paragraph 7 of Schedule 10 to F(No 2)A 1992 (rent-a-room relief) or in paragraph 7(3) of Schedule 36 to FA 2003 (foster-care relief). Accordingly, "houseboat" has its ordinary meaning in those provisions. The definition of "houseboat" in section 878 is wider than the ordinary meaning: for example, it includes structures which are similar to boats (but are not boats).

In relation to section 787 (which re-writes paragraph 7 of Schedule 10 to F(No 2)A 1992), a structure covered by the extended definition of "houseboat" may be covered by the reference to a building or part of a building. But if not, the effect of moving from the ordinary meaning of "houseboat" to the definition in section 878 is to widen the range of residences in relation to which rent-a-room relief is available.

In relation to section 809 (which re-writes paragraph 7(3) of Schedule 36 to FA 2003) the definition of "residence" used in section 787 applies. Consequently, the point made in relation to section 787 is also relevant. In referring to "the" residence, paragraph 7(3) of Schedule 36 to FA 2003 assumes that the accommodation which is actually provided by the foster carer for the child is caught. That would include accommodation comprising a structure covered by the extended definition of "houseboat". Therefore the application of the extended meaning of "houseboat" has no effect in relation to foster-care relief.

The 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 151: Definition of "personal representatives" and replacement of the expression "executors or administrators" with "personal representatives": section 878

This change involves replacing the expressions "personal representatives" and "executors and administrators", where they are used in the source legislation without definition, with a defined term, "personal representatives". It also involves applying that new definition in relation to provisions in the source legislation which use the expression "personal representatives" as defined in section 701(4) of ICTA.

The term "personal representatives" is used without definition in the following provisions of the legislation on which this Act is based:

- section 103(3)(b) and (bb) of ICTA (which disapply the charge to tax on receipts after the discontinuance of a trade, profession or vocation in relation to consideration paid to the personal representatives of an author for the assignment of copyright, and consideration paid to the personal representatives of a designer for the assignment of a design right) (see section 253);
- section 108 of ICTA (which allows personal representatives to elect for tax chargeable on sums received after discontinuance to be charged as if they were received on the date of discontinuance) (see section 257);
- section 113(7) of ICTA (by which a change in the personal representatives of a person is not to be treated for the purposes of that section as a change in the persons carrying on a trade, profession or vocation carried on by the personal representatives as such) (see sections 258 and 361);
- section 525(2) of ICTA (which allows the personal representatives of a person on whom a charge to tax falls or would fall to be made by reason of the person's sale of patent rights to require the tax payable to be reduced) (see sections 593 and 862);
- paragraphs 4(2), 6(7) and (8) of Schedule 13 to FA 1996 (by which the vesting of a relevant discounted security in personal representatives on a person's death, and the transfer of such a security by personal representatives to a legatee, is to be treated as a transfer of the security for its market value) (see sections 437 and 440); and
- paragraph 14 of Schedule 22 to FA 2002 (which makes provision about the liability of personal representatives to an adjustment charge arising from a change of basis in computing the profits of a trade, profession or vocation) (see section 240).

The expression "executors or administrators" is used, also without definition, in the following provisions of the legislation on which this Act is based (using "personal representatives" in place of that expression):

- section 584(7) of ICTA (relief for unremittable overseas income) (see section 843); and
- section 585(8) of ICTA (relief on delayed remittances) (see section 837).

The definition of "personal representatives" in section 701(4) of ICTA applies to the following provisions of the legislation on which this Act is based:

- section 249(5) of ICTA (by which stock dividend income is deemed in certain circumstances to be part of the aggregate income of the estate of a deceased person) (see sections 410 and 664);
- section 421(2) of ICTA (by which the amount charged to tax in respect of the release of a loan made to a participator in a close company falls in certain circumstances to be treated as part of the aggregate income of the estate of a deceased person) (see sections 419 and 664);
- section 347A(3) of ICTA (which makes provision about annual payments made by personal representatives) (see sections 727 and 730);
- section 547(1) of ICTA (by which the amount of a gain treated as arising on the happening of a chargeable event in relation to a contract for life insurance etc is deemed in certain circumstances to be part of the aggregate income of the estate of a deceased person) (see sections 466 and 664);
- sections 547(7A) and 547A(3) of ICTA (which make provision for and in connection with the liability of personal representatives to tax on a gain treated as arising on the happening of a chargeable event in relation to a contract for life insurance etc) (see sections 466 and 470);
- section 697(1) of ICTA (which makes provision for the determination of the amount of the residuary income of an estate for a year) (see section 666);
- section 698(1) and (3) of ICTA (which make provision for the personal representatives of a deceased person to be deemed to have an absolute or limited interest in relation to the estate of another deceased person) (see section 650);
- section 701(8), (9) and (12) of ICTA (which define various concepts for the purposes of Part 16 of that Act) (see sections 651, 664 and 681); and
- paragraph 7(3) of Schedule 5AA to ICTA (which makes provision about the application in relation to personal representatives of provisions about the taxation of profits and gains from disposals of futures and options involving guaranteed returns) (see section 568).

The definition of "personal representatives" in section 701(4) of ICTA provides that:

> "personal representatives" means, in relation to the estate of a deceased person, his personal representatives as defined in relation to England and Wales by section 55 of the Administration of Estates Act 1925 and persons having in relation to the deceased under the law of another country any functions corresponding to the functions for administration purposes under the law of England and Wales of personal representatives as so defined; and references to "personal representatives as such" shall be construed as references to personal representatives in their capacity as having such functions.

The new definition in section 878 of this Act provides that:

> "personal representatives", in relation to a person who has died, means—
>
> (a) in the United Kingdom, persons responsible for administering the estate of the deceased, and
>
> (b) in a country or territory outside the United Kingdom, those persons having functions under its law equivalent to those of administering the estate of the deceased.

This follows section 721(1) of ITEPA. It is also similar to the definition of "personal representatives" in section 229(1) of ICTA. This definition (which does not apply to any of the provisions listed above) provides that:

> "personal representatives" means persons responsible for administering the estate of a deceased person.

So the main difference between the definition in section 701(4) of ICTA and the definition in section 878 is that the former applies the definition in section 55 of the Administration of Estates Act 1925. Subsection (1)(xi) of that section 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.

It is also worth noting the definition of "personal representatives" in section 111(3) of FA 1989. This definition (which does not apply to any of the provisions listed above) provides that:

> (3) 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 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 first question is whether there is any difference in coverage between the definition in section 701(4) of ICTA on the one hand, and the first limb of the section 878 definition on the other.

The definition in section 55 of the Administration of Estates Act 1925 (and that in section 45(1) of the Administration of Estates Act (Northern Ireland) 1955 mentioned in the definition in section 111(3) of FA 1989) 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 the "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 the "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 he is known as an executor nominate, or by the court, in which case he 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, he 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 701(4) of ICTA (or section 111(3) of FA 1989) are the persons responsible for administering the person's estate. The first limb of the section 878 definition therefore seems to catch the same persons as does section 701(4) of ICTA (and section 111(3) of FA 1989) in relation to each part of the United Kingdom, but does so more directly and succinctly.

Then there are the provisions in the source legislation which use the expression "personal representatives" or the expression "executors and administrators" without definition. It follows from what is said above that the application of the first limb of the section 878 definition in relation to these provisions as rewritten in this Act reflects the ordinary common sense meaning of those terms in each part of the United Kingdom.

So far as the second limb of the section 878 definition is concerned, if the first limb covers the same ground as section 701(4) of ICTA, it follows that the application of that first limb to countries and territories outside the United Kingdom must have the same effect as the application of section 701(4) to such countries and territories.

That leaves the question of whether there is any change involved in applying the section 878 definition to provisions in the source legislation which use the expressions "personal representatives" and "executors and administrators" 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" or "executors or administrators" 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" or "executors or administrators" in the 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 like section 108 of ICTA. These confirm that, on a person's death, the rights and liabilities which are or would otherwise have been conferred on him are conferred on his personal representatives or his executors and administrators. Sections 584(7) and 585(8) of ICTA and paragraph 14 of Schedule 22 to FA 2002 also fall into this category.

In this context it is clear that the references to "personal representatives" (or "executors or administrators") 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 to deal with the deceased's tax affairs as he or she would have if he or she were still alive, and are subject to the same tax liabilities.

The second category covers those provisions which only apply because a person has died, so that his or her property is being administered by his or her personal representatives. See, for example, section 103(3)(b) and (bb) of ICTA. This says that the fact that someone who was previously carrying on a trade has died does not mean that certain sums received by his or her personal representatives are to be treated as post-cessation receipts of the trade. Sections 113(7) and 525(2) of ICTA and paragraphs 4(2) and 6(7) and (8) of Schedule 13 to FA 1996 also fall into this category.

In these 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 that gap. 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.

This change has no implications for the amount of tax paid, who pays it or when.

Change 152: Intellectual property receipts which are earned income for the purposes of the Income Tax Acts: paragraph 338 of Schedule 1 (section 833 of ICTA)

This change concerns certain capital receipts from intellectual property which fall within the definition of "earned income" for the purposes of the Income Tax Acts.

Section 529(1) of ICTA provides that "income from patent rights" arising to an individual is in certain circumstances to be treated as earned income. The circumstances are where the patent was granted for an invention devised by the individual, whether alone or jointly. If any part of the patent rights has previously belonged to someone else, only the part of the income which is not attributable to the rights owned by the other person counts as earned income (section 529(2) of ICTA).

There is no definition of "income from patent rights" in Chapter 1 of Part 13 of ICTA. Section 533(1) of ICTA defines "patent rights" as the right to do or authorise the doing of anything which would, but for that right, be an infringement of a patent. The section also contains a definition of "income from patents" covering:

- any royalty or other sum paid in respect of the user of a patent;
- any amount on which tax is payable under section 524 (taxation of receipts from sale of patent rights) or 525 (taxation of such receipts on death, winding up or partnership change) of ICTA; and
- any amount on which tax is payable under section 472(5) of or paragraph 100 to Schedule 3 to CAA 2001 (balancing charges).

In practice, all the kinds of income mentioned in this definition of "income from patents" are treated as if they were "income from patent rights" for the purposes of section 529(1) of ICTA. It is not thought that there is any other kind of income which is covered by the reference in that section to "income from patent rights".

It benefits taxpayers for the amounts mentioned in the definition of "income from patents" to be treated as earned income for the purposes of the Income Tax Acts.

Earned income is excluded from the rule in section 282A of ICTA that, in a case where the property from which income arises is jointly owned by a husband and wife, it is to be treated as income to which they are entitled in equal shares.

Income treated as earned income by virtue of section 529 of ICTA also falls within the definitions of "relevant earnings" which apply for the purposes of Chapters 3 (retirement annuities) and 4 (personal pension schemes) of Part 14 of that Act (see sections 623 and 644 of ICTA respectively).

The amendment to section 833 of ICTA in paragraph 338 of Schedule 1 to this Act rewrites section 529 of ICTA as subsections (5B) to (5E) of section 833 of that Act. These subsections form part of the main definition of "earned income" for the purposes of the Income Tax Acts.

Section 833(5B) of ICTA provides for "patent income" to be earned income in certain circumstances, mirroring the circumstances specified in section 529(1) of ICTA. The definition of "patent income" in section 833(5D) of ICTA follows the definition of "income from patents" in section 533(1) of ICTA (except that it is drafted by reference to the intellectual property provisions in this Act rather than in ICTA).

So section 833 of ICTA, as amended, confirms that the kinds of income referred to in the definition of "income from patents" in section 533(1) of ICTA are all to be treated as "earned income" for the purposes of the Income Tax Acts.

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 153: Deduction for employers' national insurance contributions paid by an employee: paragraph 594 of Schedule 1

This change gives a deduction as part of an employee's travel expenses for national insurance contributions paid in respect of a person employed by the employee.

Section 617(3) of ICTA contains a general prohibition on the deduction for tax purposes of any social security contribution. But subsection (4) sets out certain exceptions to the general prohibition. One of the exceptions concerns a deduction from taxable earnings for employers' national insurance contributions paid by an employee.

Before section 617 of ICTA was amended by ITEPA the exception was expressed in terms of a deduction available under section 198 of ICTA. That section covered most of the expenses for which an employee could have a deduction. In ITEPA the rules for expenses were split between the "general rule" in section 336 and the rule for "travel expenses" in sections 337 to 342.

The consequential amendment of section 617 of ICTA by paragraph 87(3) of Schedule 6 to ITEPA allows a deduction for employers' national insurance contributions only if they are within the general rule in section 336 of ITEPA. It is possible for an employee to incur travel expenses in the form of an employee's wages (for instance, those of a chauffeur). In that case, a deduction should be available for employers' national insurance contributions under sections 337 to 342 of ITEPA.

This Act moves the employment income part of the rule in section 617 of ICTA into ITEPA, where it becomes section 360A. Subsection (2) of the new section makes it clear that a

deduction may be made for employers' national insurance contributions in accordance with the general rule in section 336 of ITEPA or in accordance with the rules for travel expenses in sections 337 to 342 of ITEPA. This restores the law to what it was before the ITEPA amendment to section 617 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 154: Certain pension income from the Republic of Ireland: basis of calculation: paragraphs 606 to 609 of Schedule 1(sections 575, 613, 631 and 635 of ITEPA)

This gives a 10% deduction in calculating the amount of certain pension income arising in the Republic of Ireland regardless of whether it is the income of a person who could make a claim for the remittance basis.

Section 68 of ICTA provides the basis for calculating the amount of income chargeable under Schedule D Cases IV and V where that income arises in the Republic of Ireland. It provides rules which are in part equivalent to those provided by section 65 of ICTA where such income arises in any other country outside the United Kingdom. The basis provided by section 68 of ICTA (disregarding some obsolete material on averaging) is the amount of income arising in the tax year. Section 68 of ICTA does not include an equivalent of the remittance basis, which is made available by section 65 of ICTA to those who fall within the terms of section 65(4) of ICTA.

Sections 65 and 68 of ICTA are applied by sections 575, 613, 631 and 635 of ITEPA to the pension income charged as a result of those sections. Section 68(5) of ICTA provides that, in calculating the amount of any income which arises in the Republic of Ireland from a pension, a deduction of 10% of the amount of the pension income may be allowed. This is equivalent to the deduction provided by section 65(2) of ICTA for other foreign pension income charged on the arising basis. However, section 68(5) of ICTA adds a condition which denies the deduction where the pension income is "the income of a person falling within section 65(4)", that is a person who has claimed the remittance basis for his non-Irish income.

In practice, the Inland Revenue do not apply that condition. Accordingly, in the amendments made by paragraphs 606 to 609 of Schedule 1 to this Act to the provisions in sections 575, 613, 631 and 635 of ITEPA that contain the basis for the calculation of the pension income charged under that Act as a result of those sections, no distinction is drawn between income charged on the basis of the amount arising in the Republic of Ireland and income charged on the basis of the amount arising in any other country outside the United Kingdom. The 10% deduction is made a part of the basis of calculation for all the income.

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 155: Employment-related annuities: taxable pension income: annuities arising in the Republic of Ireland: paragraph 607 of Schedule 1 (section 613 of ITEPA 2003)

This ensures that 10% can be deducted when calculating the taxable amount of certain annuities arising in the Republic of Ireland.

Section 613(2) of ITEPA applies the rules applicable to income within Schedule D Case V to calculate the amount chargeable as taxable pension income in respect of foreign annuities

within Chapter 10 of Part 9 of that Act. Section 613(3) of ITEPA lists relevant rules, and includes both sections 65 and 68 of ICTA.

The 10% deduction for pensions provided by section 65(2) of ICTA was extended by section 613(4) of ITEPA to annuities within Chapter 10 of Part 9 of ITEPA. (The text of the note explaining that change in the law is given below for ease of reference.)

The deduction provided by section 65(2) of ICTA does not extend to pensions arising in the Republic of Ireland. Section 68 of ICTA disapplies section 65 of ICTA for all income arising in the Republic of Ireland which is chargeable under Schedule D Case IV or V. Section 68 of ICTA provides calculation rules for the taxable amount of such income, although the differences from those in section 65 of ICTA are in practice limited to the non-availability of the remittance basis set out in section 65(4) to (9) of ICTA. Section 68(5) of ICTA provides a deduction from *pensions* which is equivalent to that provided by section 65(2) of ICTA. But this does not extend to annuities, even where they are in the nature of pensions. The need to extend the benefit of section 68(5) of ICTA to annuities arising in the Republic of Ireland was overlooked in drafting section 613(4) of ITEPA.

The amendments of section 613 of ITEPA in paragraph 607 of Schedule 1 to this Act replace the references to Schedule D Case V and to provisions in ICTA, all of which are repealed by Schedule 3 to this Act (for income tax purposes only, where appropriate). In doing so, the amendments extend the benefit of the 10% deduction provided by section 68(5) of ICTA to annuities arising in the Republic of Ireland which are within Chapter 10 of Part 9 of ITEPA.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

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Change 138: Other employment-related annuities: income chargeable: foreign annuities: section 613

This ensures that 10% can be deducted when calculating what amount of certain foreign annuities is to be taxed and also that retrospective payments of these annuities can be spread out over previous tax years when calculating tax liability.

Sections 65(2) and 585(2) of ICTA both concern pensions taxable under Schedule D, Case V. Schedule D, Case V taxes foreign income and so most pensions arising outside the United Kingdom are taxed under it.

Under section 65(2) of ICTA, the amount of the pension which is taxed under Schedule D, Case V is reduced by 10%.

Section 585(2) of ICTA concerns any pension (or increase in a pension) taxed under Schedule D, Case V which is granted retrospectively (i.e. granted for a period before the time of the grant). The pension (or increase) is treated as arising in the period for which it is granted, not at the time when it is actually granted. This may allow the pensioner’s liability to tax on the retrospective payment to be spread out over more than one tax year.

Section 65(2) and section 585(2) both refer only to pensions, not to annuities. However, certain kinds of annuities taxed under Schedule D are in the nature of pensions. In cases where annuities like these arise outside the United Kingdom (and so are also taxed under

Case V), the practice of the Inland Revenue is to allow sections 65(2) and 585(2) to be applied.

The following provisions of Part 9 of the Act (pension income) provide for tax to be charged on those Schedule D annuities which are in the nature of pensions–

- section 609: annuities for the benefit of dependants;
- section 610: annuities under sponsored superannuation schemes; and
- section 611: annuities in recognition of another person's services.

In cases where these annuities arise outside the United Kingdom, the amount which is taxed is determined in accordance with section 613 of the Act. This section applies certain provisions of ICTA, including sections 65 and 585 (see section 613(1)(a) and (c)). Section 613(4) makes clear that when sections 65 and 585 apply for these purposes, the references in sections 65(2) and 585(2) to pensions are to be read as references to these kinds of annuity.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 156: Post-cessation receipts: paragraph 61 of Schedule 2

This change removes the charge on some receipts of individuals born before 6 April 1917 following the cessation of a trade etc before 6 April 2000 or a change of accounting basis before 6 April 1999.

As a result, section 109 of ICTA (which applies in the case of a charge under section 104, but not section 103, of ICTA) need not be rewritten.

Section 104 of ICTA applies where profits have been calculated on a conventional basis (that is, otherwise than by reference to earnings). The section charges tax in two circumstances. First, if there are post-cessation receipts ("sums arising from the carrying on of the trade … before the discontinuance … not brought to account … before the discontinuance" – section 104(2) of ICTA). Second, if there are sums received after a change of accounting basis (section 104(4) of ICTA), being "sums arising from the carrying on of the trade … before the change … not brought to account … for any period" – section 104(5) of ICTA.

Post-cessation receipts

The charge on post-cessation receipts is restricted to sums that are not "otherwise chargeable to tax" (section 104(2) of ICTA). So, if they are chargeable under section 103 of ICTA they are not charged under section 104 of ICTA. The effect of this restriction is that the only post-cessation receipts charged by section 104 of ICTA (under subsection (2)) are those excluded from section 103 of ICTA by section 103(2)(b). This is where the profits are calculated on a "conventional" basis and the receipt would have been included in profits if those profits had been calculated by reference to earnings.

Change of basis

The second charge under section 104 of ICTA, under subsection (4) on a change of accounting basis, was replaced by section 44(3) of FA 1998 but only for changes of accounting basis on or after 6 April 1999. The replacement charge was under Schedule 6 to FA 1998, later replaced by Schedule 22 to FA 2002. The two sets of rules tackled a change of

basis in different ways: the charge under section 104(4) of ICTA was triggered by the receipt of a sum (which may be some time after the change of accounting basis); the replacement charges arise on the change of accounting basis.

So section 104(4) of ICTA may theoretically apply, despite its repeal, to a sum which arose before a change of accounting basis before 6 April 1999 but which is received in 2005-06 or later.

Section 109 of ICTA was introduced at the same time as the charges under section 104 to give a measure of relief for cash basis people who were (at the time – in 1968) within ten years of retirement.

Who is chargeable?

There are three possibilities of a charge under section 104 of ICTA:

(a) The recipient ceased trading (calculating profits on a conventional basis) on or before 5 April 2000 (the last date possible, unless the recipient is a barrister) and receives a sum in 2005-06 or later.

(b) The recipient ceased trading (calculating profits on a conventional basis) after 5 April 2000 and receives a sum in 2005-06 or later. Such a person must be a barrister in the early years of practice (section 43 of FA 1998) because that is the only person for whom the earnings basis is not obligatory under section 42 of FA 1998.

(c) The recipient had a change of accounting basis before 6 April 1999 and receives a sum in 2005-06 or later.

The approach of the Act

This transitional provision changes the spreading relief in section 109 of ICTA into an exemption. But the exemption, like the relief in section 109 of ICTA, applies only to individuals born before 6 April 1917. For those individuals the effect is as follows:

The charge for individuals within paragraph (a) is removed.

An individual within paragraph (b) cannot both have been carrying on the profession on 18 March 1968 (as required by section 109(1)(a) of ICTA) and be in the early years of practice on cessation after 5 April 2000. So the relief in section 109 of ICTA does not apply.

Section 104 of ICTA no longer applies to pre-1999 changes of accounting basis for individuals born before 6 April 1917. So the charge for individuals within paragraph (c) is removed.

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 157: Gains from contracts for life insurance etc: time limit for policy holders previously not resident in the United Kingdom to vary policy or contract so it is not a personal portfolio bond: paragraph 125 of Schedule 2

This change gives statutory effect to Part 3 of ESC B53.

Regulation 3 of the Personal Portfolio Bonds (Tax) Regulations 1999 SI 1999/1029 contains exceptions from the definition of "personal portfolio bond" for certain pre-17 March 1998 policies or contracts. One exception applies to a policy or contract which is varied before the

end of the first insurance year which begins on or after 6 April 1999 to restrict the kinds of property or index which may be selected under its terms.

A further refinement applies if the policy holder was not resident in the United Kingdom on 17 March 1998, but later becomes UK resident. To prevent the policy or contract from being a personal portfolio bond, the policy holder may vary it before the later of the end of the first insurance year which begins on or after 6 April 1999, and the end of the first insurance year which begins after the time when the policy holder first becomes resident in the United Kingdom after 17 March 1998.

An individual who becomes UK resident during a tax year is treated as being resident for the whole of that tax year. So where the insurance year in relation to a policy or contract begins shortly after the beginning of a tax year, and the policy holder arrives in the United Kingdom close to the end of the tax year, the period for variation of the policy or contract may end shortly after the policy holder's arrival in the United Kingdom.

Part 3 of the concession moderates the effect of this rule in a case where a policy holder arrives in the United Kingdom after 17 March 1998 to take up permanent residence, or to stay for at least two years. In that case the insurance year within which the policy or contract may be varied is the first insurance year to begin on or after the date the policy holder first arrives in the United Kingdom to take up permanent residence or to stay for at least two years.

Paragraph 125 of Schedule 2 to this Act ("policy holders becoming permanently UK resident after 17th March 1998") gives statutory effect to this part of the concession.

It applies where a policy holder was not UK resident on 17 March 1998, but becomes UK resident after that time. The policy holder must, on the date of his or her arrival by virtue of which he or she becomes UK resident, have the intention to take up permanent residence, or to stay for at least two years.

Where those conditions are met the policy or contract may be varied to take it outside the definition of "personal portfolio bond" before the later of the end of the first insurance year beginning on or after 6 April 1999, and the end of the first insurance year beginning on or after the date of his arrival by virtue of which he became UK resident.

Part 3 of ESC B53 does not say in terms that no gain arises under the Personal Portfolio Bonds (Tax) Regulations 1999 in relation to any insurance year ending after the date on which the policy holder became UK resident, but before the insurance year in which the variation is made. This is how the ESC is operated in practice, and the paragraph mentioned above spells this out.

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: Redundant material – Table 1

This change concerns the omission of redundant material.

The omission of provisions that are redundant in whole or in part is an integral part of the rewrite process and, strictly speaking, does not involve any change in the substantive law.

But for ease of reference those omissions worthy of specific explanation are listed in the table below. The table sets out where those explanations can be found.

This change has no implications for the amount of tax due, who pays it or when.

Redundant provision	**Topic**	**See commentary on section etc**
Industry Act 1972 etc	Industrial development grants	105
Industrial Devpt. Act 1982	Regional development grants	105
ICTA s.18(3) Case III(a) (part)	Interest – "payable out of UK"	369
ICTA s.18(3) Case III(a) (part)	Annual payments – "payable out of UK"	683
ICTA s.18(3) Case III(a) (part)	Interest – "of money, yearly, etc"	369
ICTA s.18(3) Case III(a) (part)	Annual payments – omission of examples of annual payments	683
ICTA s.18(3) Case III(a) (part)	Annual payments – omission of "any annuity"	683
ICTA s.18(3) Case III(c)	Interest – government securities	369
ICTA s.18(6)	Interest and royalties exemption	758
ICTA s.24(6)(a)	Definition of "lease"	317
ICTA s.40(1),(2),(3),(4),(4A)	Apportionment of sale proceeds	320
ICTA s.53(2)	Farming – body of persons	9
ICTA s.56(2) (part)	Transactions in deposits – person liable	554
ICTA s.56(3)(a)	Transactions in deposits	Chapter 11 of Part 4
ICTA s.56A(3)(a)	Transactions in deposits – person liable	554
ICTA s.59(2)	Person liable – "concerns"	8
ICTA s.60(4)	Death of taxpayer	paragraph 36 of Schedule 1
ICTA s.64 (part)	Annual payments – "without any deduction"	684
ICTA s.64 (part)	Interest, etc – "without any deduction"	370
ICTA s.64 (part)	Purchased life annuities – "without any deduction"	424
ICTA s.65(1)	Foreign income – whether income received in United Kingdom	Part 8 (overview)
ICTA s.68(3) (part)	Foreign income – Irish trades and pensions	7

ICTA s.71	Computation of income tax where no profits in year of assessment	paragraph 43 of Schedule 1
ICTA s.74(1)(b)	Private expenses	paragraph 45 of Schedule 1
ICTA s.74(1)(c)	Private expenses – rent	34
ICTA s.74(1)(d)	Trade tools	68
ICTA s.74(1)(g)	Improvements	33
ICTA s.74(1)(h)	Notional interest	paragraph 45 of Schedule 1
ICTA s.74(1)(k)	Average losses	paragraph 45 of Schedule 1
ICTA s.74(1)(m)	Annuities	paragraph 45 of Schedule 1
ICTA s.74(1)(o)	Miras	paragraph 45 of Schedule 1
ICTA s.82	Interest to non-residents	paragraph 53 of Schedule 1
ICTA s.86(5)(d)	Seconded employees	paragraph 60 of Schedule 1
ICTA s.92	Regional development grants	paragraph 45 of Schedule 1
ICTA s.96(7)(c)	Averaging – stock relief	221
ICTA s.105(1) (part), (3)	Post-cessation receipts – capital allowances	255
ICTA s.113(6)	Successions	paragraph 94 of Schedule 1
ICTA s.119(2)	Mineral rents paid in kind	335
ICTA s.122(4)	Income tax deducted from mineral rents	paragraph 106 of Schedule 1
ICTA s.232(1) (part)	Tax credits – non-residents – "having made a claim in that behalf"	397
ICTA s.251B(2)	Share incentive plans – drop "(except to the extent that it represents a foreign cash dividend)"	393
ICTA s.325 (part)	NSB ordinary account interest	691

ICTA s.326(1) (part)	SAYE schemes – "other sum"	702
ICTA s.347A(2)(d) – cross reference to section 125(1)	Annual payments – payments to which 347A applies	729
ICTA s.347A(5) (part)	Annual payments – deductions – reference to section 355 of ITEPA	paragraph 146 of Schedule 1
ICTA s.349(7) (part)	Interest and royalties exemption	757
ICTA s.443	Insurance policies paid in kind	Schedule 1
ICTA s.491(9),(11)	Mutual concerns – examples dropped	104
ICTA s.524(10)	Patent rights – election by non-residents	591
ICTA s.526(2) (part)	Relief for expenses: patent income	600
ICTA s.531(8) (part)	Disposals of know-how	583
ICTA s.533(4) (part)	Patent rights – sums paid for Crown use etc.	599
ICTA s.540(1)(b) (part)	Gains on contracts for life insurance policies etc	485
ICTA s.553A(3) (part)	Gains on contracts for life insurance policies etc	531
ICTA s.554	Borrowing on life policies	paragraph 229 of Schedule 1
ICTA s.580B(4)	Health and employment insurance – terms of a policy	740
ICTA s.585(3) (part), (4), (5)	Delayed remittances – application of relief	835
ICTA s.586	Disallowance war risk premiums	paragraph 247 of Schedule 1
ICTA s.587	Disallowance war injury payments	paragraph 248 of Schedule 1
ICTA s.656(2)(a)	Purchased life annuities	718
ICTA s.660C(1A)(c), (d) and (e)	Settlements	619
ICTA s.698(1) (part)	Income from estates	664
ICTA s.699(6)(b)	Income from estates	669
ICTA s.699A(1)(b)	Income from estates	680
ICTA s.701(6) and (7)	Income from estates	666

ICTA s.817	Deductions not allowed	paragraph 327 of Schedule 1
ICTA s.832(1)	Definition of farming	876
ICTA Sch. 5 para. 3(4)(b)	Herd basis – replacement of animals	116
ICTA Sch. 5 paras. 7 and 9(5)	Herd basis – working animal rule	112
ICTA Sch 5AA par. 4(1)	Guaranteed returns on futures and options – disposal, etc to include more than one	562
ICTA Sch. 15B para. 7(3)(a)	Venture capital trusts "(including a capital dividend)"	709
ICTA Sch.30 para. 5	Schedule A transitional	paragraph 352 of Schedule 1
ICTA Sch.30 para. 18	Stock relief transitional	paragraph 352 of Schedule 1
FA 1996 Sch.13 para. 3(2) (part)	Deep gain securities "disregarding"	435
FA 1996 Sch. 13 para. 4(4)	Deep gain securities "Whether by the exercise"	438
FA 1996 Sch. 13 para 9A(2)(b)	"connected with the company"	456
FA 1996 Sch. 13 para 14D(6) (part)	"otherwise giving effect"	447
FA 2000 Sch. 23 para. 4	Telecommunication rights – group accounts	147
FA 2002 Sch.22 para. 13(3) and (4)	Adjustment income: partnerships	238
FA 2004 s. 97(4)	Interest and royalties exemption. Effect of Treasury order	767
SI 1997/1029 para. 5(2B)(c)	Personal portfolio bonds – calculation of gain	524

Change 159: Case law - Table 2

This change concerns giving statutory effect to principles derived from case law.

If a principle derived from case law is clear and well established it has been given statutory effect. The table below lists the sections and subject matter concerned.

This change has no implications for the amount of tax due, who pays it or when.

Topic	**Case Law**	**Section**

Apportionment of expenses	Lochgelly Iron Co v Crawford (1913)[4]	34
Capital receipts	Attorney General v LCC (1900)[5]	96
Territorial scope – Part 4	Colquhoun v Brooks (1892)[6]	368
Territorial scope – Part 5		577
Purchased life annuities – tax deducted	Allchin v Corporation of South Shields (1943)[7]	426
Patent income – tax deducted		602
Annual payments – tax deducted	Stokes v Bennett (1953)[8]	686
Telecommunications – tax deducted	Grosvenor Place Estates Ltd v Roberts (1960)[9]	618
Intellectual property: certain income	Curtis Brown Ltd v Jarvis (1929)[10]	582
Films and sound recordings: non-trade businesses		612
Telecommunication rights: certain income		617

[4] 6 TC 267
[5] 4 TC 265
[6] 2 TC 490
[7] 25 TC 445
[8] 34 TC 337
[9] 39 TC 433
[10] 14 TC 744

ANNEX 2: DESTINATION OF REWRITTEN EXTRA-STATUTORY CONCESSIONS

ESC Number	Description	See Annex 1
A29	Farming and market gardening: relief for fluctuating profits	Change 59
A30	Interest on damages for personal injuries (foreign court awards)	Change 125
A34	Ulster savings certificates: certificates encashed after death of registered holder	Change 113
A46	Variable purchased life annuities: carry forward of excess of capital element	Changes 118 and 119
A55	Arrears of foreign pensions	Change 139
A96 (part)	Old life insurance policies: insurer stopping collection of premiums	Change 89
B29	Treatment of income from caravan sites where there is both trading and associated letting income	Change 3
B38	Tax concessions on overseas debts	Change 50
B42 (part)	"Free gifts" and insurance contracts	Change 91
B53 (part)	Non residents and gains on life insurance policies	Changes 88 and 157
B54	Tax relief for expenditure on films, tapes and discs confirmed	Change 38

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