

## **TAX & ACCOUNTING: CHANGES IN LAW & PRACTICE**

On 1 August 2001, the Inland Revenue published a Press Release giving details of legislative changes that the Government will introduce in the Finance Bill 2002. The changes will have effect, assuming the provisions are enacted by Parliament, for periods of account ending on or after 1 August 2001, and in some cases in relation to returns for earlier periods filed on or after that date.

The Press Release also announced that draft clauses would be published shortly. The clauses and Explanatory Notes on them are now attached to this note.

The Inland Revenue recognises that the definition of "insurance business" in clause 2 will need to be updated as a result of the coming into force of the Financial Services and Markets Act 2000.

Comments on the draft clauses should be sent, preferably by e-mail to richard.thomas@ir.gsi.gov.uk, or to

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It will have become apparent from the Press Release that the Inland Revenue has come to a change of view on the acceptability of the mark to market basis of accounting as a valid tax basis. Accordingly, passages in its Guidance Manuals referring to mark to market are no longer considered to represent the Inland Revenue's view of the law. They will be amended at the next available opportunity. The relevant paragraphs are:-

Inspector's Manual: paragraph 553b  
Banking Manuals: paragraphs 4.305 & 4.306  
General Insurance Manual: paragraph 4.39  
Life Assurance Manual : paragraph 11.14

## EXPLANATORY NOTES

### Summary

Clause 1 and Schedule 1 provide a comprehensive set of rules for ensuring that on either

- a change of accounting basis; or
- a change in the way tax adjustments are made to accounts profits

profits and losses are neither counted more than once, nor are left out of account to any extent.

They replace the rules in section 44 of, and Schedule 6 to, the Finance Act 1998. Those rules dealt only with a change of accounting basis.

There are two types of adjustment under the revised rules where the tax effect of the change of basis appears over a period, rather than being brought in at once, as happens under Schedule 6.

Clause 2 gives some special rules for insurance companies. Clause 3 amends legislation to make it work correctly where a “mark to market” basis is used.

### Clause 1

Subsection (1) sets out the circumstances in which the Schedule applies. It will apply where there is a change of basis of computing profits as between one period of account and another. It provides that the Schedule will only apply where the old basis was in accordance with either the law or the practice applicable at the time, and the new basis is in accordance with both law and any practice applicable.

“Practice applicable” means the practice applying in all cases of a particular description which affects the computation of profits for the purposes of Case I or II of Schedule D.

This subsection differs from section 44(1) and (2) FA 1998 in that-

- It applies to changes of tax basis as well as accounting basis – see note on subsection (2) below.
- The old basis can be in accordance with either law or practice: it does not have to be both. This is to cover cases where a decision of the courts shows that a previous practice was incorrect in law.

Subsection (2) defines change of basis. It means either a relevant change of accounting approach or a change in the tax adjustments applied.

“Relevant change of accounting approach” is further explained in subsections (3) and (4). It means one that is in accordance with normal accounting practice and gives rise to a prior period adjustment. Normal accounting practice is defined by reference to that practice as applied to UK company accounts.

The reference to prior period adjustments makes explicit what was implicit in section 44 and Schedule 6 FA 1998. Prior period adjustments are discussed in FRS 3 issued by the Accounting Standards Board. The section does not apply to those prior period adjustments which arise as a result of a fundamental error in previous periods of account (see FRS3 paragraph 63). This is because such accounts containing fundamental errors would have been neither in accordance with the law nor with practice.

“Tax adjustments” is defined in subsection (5) to mean the adjustments required or authorised by law in computing profits that are mentioned in section 42 FA 1998.

Subsections (6) and (7) amplify a “change in the tax adjustments applied”, the other type of change of basis. It includes any change made as a result of a change of view of the law, but does not include any change made by specific legislation. Such legislation will usually have its own provisions for transition, or for changes in basis (such as for example section 90 FA 1996 – loan relationships).

“Period of account” means (subsection (8)) the period for which accounts are drawn up. This has the same meaning as the phrase “period of account” in section 834(1) ICTA 1988 (Corporation Tax Acts: interpretation), despite the difference in wording there (where it says “makes up its accounts”). It also applies for income tax.

Subsection (9) provides that the section and Schedule replace section 44 and Schedule 6 FA 1998.

## **Schedule 1**

### **Part 1 Introduction**

Paragraph 1 is introductory. It provides that if there is a change of basis within the meaning of section 1(2), adjustments shall be made in accordance with the rest of the Schedule.

### **Part 2 The general rules**

Paragraph 2 is the heart of the Schedule. It sets out how the adjustments are calculated. It follows closely the provisions of paragraph 3 Schedule 6 FA 1998, but with certain adjustments.

In the first step, the only change is that “period” is now “period of account”. The first step establishes the amounts which would, but for the Schedule, result in an understatement of profits (or overstatement of losses). They may be receipts which were not brought in on the old basis, and will not be brought in on the new, or expenses which would be deducted more than once.

In the second step, “taken into account” has been changed to “brought into account” for consistency. As in step 1, “period” is now “period of account”.

Item 2 of Step 2 has been expanded. There is an additional requirement that the expenses concerned would have been brought into account under the old basis if the change had not occurred. This is so that the adjustment applies only in cases where there is a timing change.

The second step establishes the amounts which would, but for the Schedule, result in an overstatement of profits (or understatement of losses). They may be receipts which were brought in on the old basis, and will be brought in again on the new, or expenses which were not deducted before and would not be deducted after the change.

There is no third step in this paragraph. The third step in Schedule 6 FA 1998 was to deal with a particular problem on the change from a cash basis to an earnings basis for certain professions.

The substance of paragraph 3(2) of Schedule 6 is reproduced now in paragraph 3 of this Schedule.

Paragraph 3 reproduces the substance of what was in paragraph 3(2) Schedule 6 FA 1998, but “brought into account” now means brought into account in accordance with applicable law or practice, rather than law and practice. Paragraph 3(3) defines “applicable practice” to mean the same as in clause 1(1).

Paragraphs 4 and 5 are the equivalent of paragraph 2 Schedule 6 FA 1998 and explain how adjustment amounts are to be treated for tax purposes. They follow paragraph 2 of that Schedule except that for corporation tax purposes positive adjustments are treated as receipts of the trade or profession to bring them into line with the treatment of negative amounts. Positive amounts are now treated as arising on the last day of the period of account, not the first.

Expenses arising from negative adjustments (paragraph 5) are now explicitly treated as arising on the last day of the period.

### **Part 3 Special Rules For Certain Cases**

Paragraph 6 is the first of the special rules which has no counterpart in Schedule 6 FA 1998.

It applies where expenses were brought into account under the old basis, and would fall to be brought into account again under the new, but for paragraph 2 of the Schedule. An example is expenses which although representing revenue expenditure were taken directly to the balance sheet, and then amortised over the period of useful life of the asset on which they were incurred. Under previous practice (and the then view of the law) such expenses were allowed in full in the period in which they were disbursed. Following a change in the view of the law, they fall to be allowed as the amortised amounts are taken to the profit and loss account.

Without special rules, the effect of paragraph 2 of the Schedule would be to bring into account as a positive adjustment (and therefore a trading receipt) in the first period of change of basis all the expenditure which had not at that time been taken to profit and loss account. This paragraph prevents that happening and simply provides that any amount previously allowed before the change is disallowed for periods after the change. This provision puts in statutory form the Revenue's view of what the law already requires, as expressed in the Revenue Interpretation "Interaction of tax and accountancy: 'deferred revenue expenditure'" in Tax Bulletin 53 (June 2001).

Paragraph 7 is the second new special rule. It applies where a company moves from a realisation basis to a mark to market basis for assets which, although not stock-in-trade, are sold in the ordinary course of a business (usually a financial trade such as banking or insurance). The "realisation basis" is a basis under which a profit or loss on such an asset does not arise until the asset is realised on sale or exchange. In a "mark to market" basis, a profit or loss is recognised as the difference between the fair value of the asset at the end of the period and the fair value at the beginning, even if the asset has not been disposed of.

The rule is that any difference between the fair value at the start of the first new basis period, and the cost of the asset, is not recognised in whole in the first period of change, as would be required by the general rule in paragraph 2, but is brought into account only when the asset is disposed of.

Paragraph 8 provides an alternative rule for cases within paragraph 7 where the company so elects. If it does elect, the difference arising on all its assets affected by the change is calculated, and is brought into account in six equal amounts in the first period of change and the five subsequent periods. If the trade or profession is permanently discontinued before all amounts have been brought into account, all remaining amounts are brought into account immediately before the discontinuance.

The election must be made in accordance with the normal self-assessment time limits.

Paragraph 9 reproduces the special rule for barristers and advocates changing from a cash basis to an earnings basis that appears as paragraph 4 Schedule 6 FA 1998 where they have taken account of the exemption for

early years of practice given by section 43 FA 1998. Paragraph 10 reproduces paragraph 5 Schedule 6 (election to accelerate the payment of the adjustment charge where paragraph 9 has applied).

Paragraph 11 reproduces, with necessary amendments, paragraph 6 Schedule 6 FA 1998 dealing with partnerships. The amendments follow from the inclusion of tax basis changes made by clause 1.

Paragraph 12 reproduces paragraph 7 Schedule 6 FA 1998 dealing with the death of individual traders or professionals.

Paragraph 13 reproduces paragraph 8 Schedule 6 FA 1998 – interpretation. It now defines "tax year".

## **Part 5 Commencement**

Paragraph 14 gives the general commencement rule for the Schedule. It applies to a change of basis taking effect in a period of account ending on or after 1 August 2001 (the date of announcement of the changes). Paragraph 16 defines what is meant by the period in which a change takes effect – it is the first period in which the new basis is adopted.

Paragraph 15 gives some exceptions. If a case is one to which paragraph 6 (expenses previously allowed disallowed in the period in which taken to profit and loss account) or paragraph 7 (change from realisation to mark to market basis) applies, the new rules apply in addition where a return (including an amended return) is filed on or after 1 August 2001, whatever the period to which it relates.

Any adjustment required by paragraph 6 or 7 for a period ending before 1 August 2001, is only brought into account in the first period to end on or after that date.

## **Clause 2**

This clause gives special rules for insurance companies.

Clause 2(1) provides that it does not apply to the life assurance business of such companies, but does apply to long term business which is not life assurance business, such as permanent health insurance business and pre-1938 capital redemption business. The subsection also defines the scope of its application - to insurance companies which are

- resident in the United Kingdom;
- not resident here but trading here through a branch or agency; or
- a controlled foreign company

Clause 2(2) preserves the realisation basis as a valid and correct basis for tax purposes even though since at least 1998 it has not been a valid basis. This is because for periods of account ending on 31 December 1998 and after, an insurance company has been required by Schedule 9A Companies Act 1989, and by the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers, to use a mark to market basis, and no other, for its portfolio assets, and to recognise any profits or losses found by a comparison of fair values in its technical account or its non-technical account, and not in a reserve.

Clause 2(3) defines “realisation basis” and “mark to market basis”.

It has however been the practice of the vast majority of insurance companies to continue to use the realisation basis. In recognition of this, clause 2(4) provides that companies will be permitted to use that basis up to, but not including, their first period of account to begin on or after 1 August 2001. Thus for companies whose period of account is the calendar year, the first period for which mark to market will be required is the period beginning 1 January 2002.

Under clause 2(5) companies that are required to move to mark to market for such periods will however be able to elect to continue the realisation basis, but only for assets they held on 1 August 2001. The election must be made within 12 months of the end of the period that includes 1 August 2001 – clause 2(6)

Clause 2(7) provides an identification rule where in a period of account beginning on or after 1 August 2001 a company disposes of assets

- which are of a kind not readily identifiable (e.g. shares - see section 104(3) TCGA 1992)
- and the disposal does not exhaust the company's holding of those assets (i.e. it is a part disposal of the holding)
- some of the assets in the holding were acquired on or before 1st August 2001.

The rule is that the disposed of assets are identified first with pre-1 August assets.

Clause 2(8) gives definitions for various terms.

### **Clause 3**

This makes some amendments to legislation applying to financial concerns so that they work properly where a mark to market basis is used. Subsections (1) and (2) affect section 473 ICTA (reconstructions). Subsection (1) removes some unnecessary words in section 473(1) and makes consequential amendments in other parts. Subsection (2) disapplies section 473 where

mark to market applies to the securities in the period in which the relevant transaction takes place.

Subsection (3) adds a new subsection (13) to section 81 FA 1999. That section gave rules for assets which had been the subject of a non-statutory grouping arrangement between insurance companies, and in particular where assets had been transferred from one company within the arrangement to another in circumstances where, in accordance with the arrangement, no gain or loss arose on the transfer. The new subsection ensures that where an adjustment falls to be made under Schedule 1 – for example where paragraph 8 applies – any adjustment is calculated by reference to the cost of the asset to the original holder.

Subsection (4) gives the commencement rules. For the section 473 changes – it is the general rule, that is for accounting periods ending on or after 1 August 2001 - paragraph (a). The section 81 FA 1999 change applies when an adjustment falls to be made by virtue of Schedule 1 - paragraph (b).

Subsection (5) defines “period of account” for this section.

# Finance Bill

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*Computation of profits***1 Computation of profits: adjustment on change of basis**

- (1) The provisions of Schedule 1 to this Act have effect as to the adjustment or adjustments to be made for tax purposes where—
- (a) there is, from one period of account to the next of a trade, profession or vocation, a change of basis in computing profits for the purposes of Case I or II of Schedule D,
  - (b) the old basis accorded with the law or practice applicable in relation to the period of account before the change, and
  - (c) the new basis accords with the law and practice applicable in relation to the period of account after the change.

For the purposes of paragraphs (b) and (c) the practice applicable in any case means the accepted practice in cases of that description as to how profits should be computed for the purposes of Case I or II of Schedule D.

- (2) A “change of basis” means—
- (a) a relevant change of accounting approach (see subsections (3) and (4) below), or
  - (b) a change in the tax adjustments applied (see subsections (5) and (6) below).
- (3) A “relevant change of accounting approach” means a change of accounting principle or practice that, in accordance with normal accounting practice, gives rise (or, if normal accounting practice applied, would give rise) to a prior period adjustment.
- (4) In subsection (3) “normal accounting practice” means normal accounting practice with respect to the accounts of companies incorporated in the United Kingdom.
- (5) A “tax adjustment” means any such adjustment as is mentioned in section 42(1) of the Finance Act 1998 (c. 36) (adjustments required or authorised by law in computing profits for tax purposes).
- (6) A “change in the tax adjustments applied” —
- (a) does not include a change made in order to comply with amending legislation not applicable to the previous period of account, but
  - (b) includes a change resulting from a change of view as to what is required or authorised by law, or as to whether any adjustment is so required or authorised.

- (7) In this section a “period of account” means any period for which accounts of the trade, profession or vocation are drawn up.
- (8) The provisions of this section and Schedule 1 to this Act have effect in place of the provisions of section 44 of, and Schedule 6 to, the Finance Act 1998 (c. 36).

## **2 Insurance companies: postponement of change to mark to market**

- (1) This section applies in relation to the computation in accordance with the provisions of Case I of Schedule D of the profits of the insurance business, other than life assurance business, of—
  - (a) an insurance company within the meaning of Chapter 1 of Part 12 of the Taxes Act 1988, or
  - (b) a controlled foreign company within the meaning of Chapter 4 of Part 17 of that Act.
- (2) Where this section applies nothing in—
  - (a) section 70 of the Taxes Act 1988 (assessment to corporation tax on full amount of profits, etc.), or
  - (b) section 42 of the Finance Act 1998 (c. 36) (computation of profits to be on basis giving true and fair view),prevents the company from computing the profits of that business on a realisation basis rather than a mark to market basis.
- (3) In subsection (2)—
  - (a) a “realisation basis” means not recognising a profit or loss on an asset until it is realised, and
  - (b) a “mark to market basis” means bringing assets into account in each period of account at a fair value.
- (4) This section applies in relation to periods of account—
  - (a) beginning before 1st August 2001, and
  - (b) ending on or after 31st December 1998 and before 31st July 2002.
- (5) A company may elect that this section shall continue to apply in relation to subsequent periods of account as regards assets held by it on 1st August 2001.
- (6) Any election to that effect must be made within twelve months after the end of the accounting period of the company current on 1st August 2001.
- (7) For the purposes of determining whether an election under subsection (5) applies to assets held by a company, where—
  - (a) assets are realised by the company in an accounting period beginning on or after 1st January 2002,
  - (b) the assets are of such a kind that the particular assets realised are not readily identifiable,
  - (c) the realisation does not exhaust the company’s holding, and
  - (d) some but not all of the company’s holding was acquired after 1st August 2001,the assets realised shall be identified with assets acquired on or before 1st August 2001 in priority to assets acquired after that day.
- (8) In this section—

“insurance business” has the same meaning as in the Insurance Companies Act 1982 (c. 50);

“life assurance business” has the same meaning as in Chapter 1 of Part 12 of the Taxes Act 1988; and

“period of account” means any period for which accounts of the business are drawn up.

### 3 Mark to market: miscellaneous amendments

- (1) In section 473 of the Taxes Act 1988 (roll-over of securities held as circulating capital)—
  - (a) in the opening words of subsection (2), omit “, if the securities were not such as are mentioned in subsection (1)(b) above”;
  - (b) in subsection (2)(a), and in subsection (7), for “would result” substitute “results”; and
  - (c) in subsection (2)(b) for “would be” substitute “is”.

- (2) After subsection (2) of that section insert—

“(2A) This section does not apply to securities in respect of which unrealised profits or losses, calculated by reference to the fair value of the securities at the end of a period of account, are taken into account in the period of account in which the transaction mentioned in subsection (2) above occurs.

In this subsection a “period of account” means any period for which accounts of the business are drawn up.”.

- (3) In section 81 of the Finance Act 1999 (c. 16) (acquisitions disregarded under insurance companies concession), at the end add —

“(13) If the relevant company changes from—

- (a) not recognising a profit or loss on an asset until it is realised, to
- (b) bringing assets into account in each period of account at a fair value,

then, in calculating the amount of any adjustment required under Schedule 1 to the Finance Act 2002 (calculation of adjustment on change of basis), the amount to be taken into account as the cost of the asset in relation to a period of account before the change is the cost of the previous acquisition.

In this subsection a “period of account” means any period for which accounts of the business are drawn up.”.

- (4) The provisions of this section come into force as follows—
  - (a) the amendments in subsections (1) and (2) apply in relation to periods of account ending on or after 1st August 2001;
  - (b) the amendment in subsection (3) applies wherever an adjustment falls to be made under Schedule 1 to the Finance Act 2002 (see Part 5 of that Schedule).
- (5) In this section a “period of account” means any period for which accounts of the business in question are drawn up.

## SCHEDULES

### SCHEDULE 1

#### COMPUTATION OF PROFITS: ADJUSTMENT ON CHANGE OF BASIS

##### PART 1

##### INTRODUCTION

###### *General scheme*

- 1 (1) Where there is a change of basis within section 1, one or more adjustments shall be made in accordance with this Schedule.
- (2) Any such adjustment shall be calculated and given effect in accordance with the provisions of Part 2 of this Schedule (general rules), subject to the provisions of Part 3 of this Schedule (special rules for certain cases).
- (3) Part 4 of this Schedule contains supplementary provisions and Part 5 provides for commencement.

##### PART 2

##### GENERAL RULES

###### *Calculation of adjustment*

- 2 The amount of the adjustment is calculated as follows:

###### *First step*

Add together any amounts representing the extent to which, comparing the two bases, profits were understated (or losses overstated) on the old basis:

1. Receipts which on the new basis would have been brought into account in computing the profits of a period of account before the change of basis, to the extent that they were not so brought into account.
2. Expenses which on the new basis fall to be brought into account in computing the profits of a period of account after the change, to the extent that they were brought into account in computing the profits of a period of account before the change of basis.
3. Deductions in respect of opening trading stock or opening work in progress in the first period of account on the new basis to the extent to which they are not matched by credits in respect of closing trading stock or closing work in progress in the last period of account before the change.

*Second step*

Then deduct any amounts representing the extent to which, comparing the two bases, profits were overstated (or losses understated) on the old basis:

1. Receipts which were brought into account in a period of account before the change, to the extent that they would not have been so brought into account if the profits had been computed on the new basis.
2. Expenses which were not brought into account in computing the profits of a period of account before the change, to the extent that they—
  - (a) would have been brought into account for a period of account before the change if the profits had been computed on the new basis, and
  - (b) would have been brought into account for a period of account after the change if the profits had continued to be computed on the old basis.
3. Credits in respect of closing trading stock or closing work in progress in the last period of account before the change of basis to the extent to which they are not matched by deductions in respect of opening trading stock or opening work in progress in the first period of account on the new basis.

An amount so deducted may not be deducted again in computing the profits of a period of account.

*Meaning of items being brought into account*

- 3 (1) The references in paragraph 2 to items being brought into account in a period of account before the change of basis are to their being brought into account—
  - (a) in computing the profits of the same trade, profession or vocation, and
  - (b) in accordance with the law or practice then applicable.
- (2) For the purposes of sub-paragraph (1)(a) a trade, profession or vocation is not regarded as the same if section 113(1) or 337(1) of the Taxes Act 1988 applies (deemed discontinuance on change of persons carrying on trade, profession or vocation).
- (3) For the purposes of sub-paragraph (1)(b) the practice applicable in any case means the accepted practice in cases of that description as to how profits should be computed for the purposes of Case I or II of Schedule D.

*Giving effect to positive adjustment*

- 4 (1) If the amount of the adjustment is positive, it is chargeable to tax.
- (2) An amount so chargeable to income tax—
  - (a) is treated as income arising on the last day of the first period of account for which the new basis is adopted;
  - (b) is chargeable under Case VI of Schedule D;
  - (c) in the case of an individual whose income from the trade, profession or vocation in question is —

- (i) relevant earnings within section 623(2)(c) or 644(2)(c) of the Taxes Act 1988, or
  - (ii) earned income within section 833(4)(c) of that Act, is similarly relevant earnings or earned income for the tax year in which it is charged to tax; and
  - (d) is treated for the purposes of Chapters 1 and 2 of Part 10 of the Taxes Act 1988 (loss relief) as profits of the trade, profession or vocation for the chargeable period for which it is charged to tax.
- (3) An amount so chargeable to corporation tax is treated as a receipt of the trade, profession or vocation arising on the last day of the first period of account for which the new basis is adopted.

*Giving effect to negative adjustment*

- 5 (1) If the amount of the adjustment is negative, it is allowed as a deduction in computing profits.
- (2) An amount so allowed as a deduction in computing profits is treated as an expense of the trade, profession or vocation arising on the last day of the first period of account for which the new basis is adopted.

PART 3

SPECIAL RULES FOR CERTAIN CASES

*No adjustment for certain expenses previously brought into account*

- 6 (1) This paragraph applies where as a result of a change of basis expenses brought into account before the change on the old basis would on the new basis be brought into account over more than one period of account after the change.
- (2) In such a case—
- (a) no adjustment shall be made under this Schedule, and
  - (b) the expenses may not be deducted in computing the profits of the trade, profession or vocation for any period of account after the change.

*Change from realisation basis to mark to market*

- 7 (1) This paragraph applies where there is a change of basis from—
- (a) not recognising a profit or loss on an asset until the asset is realised, to
  - (b) bringing assets into account in each period of account at a fair value.
- (2) To the extent that in such a case—
- (a) a receipt within item 1 of the First step in paragraph 2 represents the fair value of an asset that is trading stock (within the meaning of section 100 of the Taxes Act 1988), or
  - (b) an expense within item 2 of that step relates to such an asset,
- any resulting adjustment shall not be given effect until the period of account in which the value of the asset in question is realised.

This is subject to any election under paragraph 8.

*Election for spreading where paragraph 7 applies*

- 8 (1) Where paragraph 7 applies the person who is chargeable to tax in respect of any adjustment charge may elect that the adjustment charge shall be spread over six periods of account in accordance with the following provisions.
- (2) The election must be made –
- (a) by notice in writing,
  - (b) to an officer of the Board,
  - (c) within the time allowed.
- (3) The time allowed is –
- (a) for income tax purposes, up to and including the 31st January following the tax year in which the change of basis occurs;
  - (b) for corporation tax purposes, within 12 months of the end of the first accounting period to which the new basis applies.
- (4) If an election is made, then, in each of the six periods of account beginning with the first period to which the new basis applies an amount equal to one-sixth of the amount of the adjustment charge is treated as arising and chargeable to tax.
- (5) If before the whole of the adjustment charge has been charged to tax the trade, profession or vocation is permanently discontinued, the whole of the amount so far as not previously brought into charge to tax is treated as arising and chargeable to tax immediately before the discontinuance.

*Spreading of adjustment charge on ending of exemption for barristers and advocates*

- 9 (1) This paragraph applies where an individual makes a change of basis –
- (a) on ceasing to take advantage of the exemption given by section 43 of the Finance Act 1998 (c. 36) (barristers and advocates in early years of practice), or
  - (b) on that exemption coming to an end.
- (2) Where this paragraph applies any adjustment charge is spread over ten tax years, as follows.
- (3) In each of the nine tax years beginning with that in which the whole amount would otherwise be chargeable to tax, an amount equal to whichever is the less of –
- (a) one-tenth of the amount of the adjustment charge, and
  - (b) 10% of the profits of the profession for that tax year,
- is treated as arising and chargeable to tax.

For the purposes of paragraph (b) the profits of the profession means the profits as computed for the purposes of Case II of Schedule D, leaving out of account any allowances or charges under the Capital Allowances Act 2001 (c. 2).

- (4) In the tenth tax year the balance of the adjustment charge is treated as arising and chargeable to tax.
- (5) If before the whole of the adjustment charge has been charged to tax the profession is permanently discontinued, the preceding provisions of this

paragraph continue to apply, but with the omission of the alternative limit in sub-paragraph (3)(b) by reference to profits of the profession.

- (6) This paragraph has effect subject to any election under paragraph 10.

*Election to accelerate payment of adjustment charge under paragraph 9*

- 10 (1) A person who under paragraph 9 is chargeable to tax for a tax year on an amount representing part of an adjustment charge may elect that the amount treated as income arising in that tax year should be increased.
- (2) The election must be made—
- (a) by notice in writing,
  - (b) to an officer of the Board,
  - (c) on or before the 31st January following the tax year in question.
- (3) The election must specify the amount to be treated as income arising in the tax year, which may be any amount up to the whole of the adjustment charge so far as not previously charged to tax.
- (4) Where an election has been made, paragraph 9 applies in relation to any subsequent tax year as if the original amount of the adjustment charge were reduced by the additional amount treated as arising in the year for which the election was made.

PART 4

SUPPLEMENTARY PROVISIONS

*Application of provisions to partnerships*

- 11 (1) In the case of a trade, profession or vocation carried on in partnership, the amount of any adjustment under this Schedule shall be computed—
- (a) for income tax purposes, as if the partnership were an individual resident in the United Kingdom, and
  - (b) for corporation tax purposes, as if the partnership were a company resident in the United Kingdom.
- (2) Subject to the following provisions of this paragraph—
- (a) each partner's share of any amount chargeable to tax under this Schedule shall be determined according to the profit-sharing arrangements for the twelve months ending immediately before the date on which the new basis was adopted; and
  - (b) any election under this Schedule must be made jointly by all the persons who have been members of the partnership in that twelve month period.
- (3) If paragraph 9 applies (spreading of adjustment charge in certain cases), then, subject to sub-paragraph (4) below, each partner's share of the amount chargeable in any tax year shall be determined—
- (a) for the first tax year, according to the profit-sharing arrangements for the twelve months ending immediately before the date on which the new basis was adopted, and

- (b) for any subsequent tax year, according to the profit-sharing arrangements for the twelve months immediately preceding the anniversary in that year of that date.
- (4) If paragraph 9(5) applies (effect of discontinuance of profession), then—
  - (a) each partner’s share of any amount chargeable on or after the discontinuance is determined as follows—
    - (i) if the discontinuance occurs on the date on which the new basis was adopted, according to the profit-sharing arrangements for the twelve months ending immediately before that date;
    - (ii) if the discontinuance occurs after that date but before the first anniversary of that date, according to the profit-sharing arrangements for the period between that date and the date of discontinuance;
    - (iii) if the discontinuance occurs after the first anniversary of the date on which the new basis was adopted, according to the profit-sharing arrangements for the period between the immediately preceding anniversary of that date and the date of discontinuance; and
  - (b) any election under paragraph 10 after the discontinuance must be made by each former partner separately.
- (5) For the purposes of this paragraph—
  - (a) “profit-sharing arrangements” means the rights of the partners to share in the profits of the trade, profession or vocation for the period in question; and
  - (b) references to the date on which a new basis was adopted are to the first day of the first period of account for which the new basis was adopted.
- (6) The provisions of section 111 of the Taxes Act 1988 (general provisions as to taxation of partnerships), except subsection (1) (partnership not to be treated as separate entity), do not apply to the extent that the preceding provisions of this paragraph apply.

*Liability of personal representatives in case of death of person chargeable*

- 12 In the case of the death of a person who, if he had not died, would have been chargeable to tax under this Schedule on an amount representing part of an adjustment charge—
  - (a) the tax which would have been so chargeable shall be assessed and charged on his personal representatives and shall be a debt due from and payable out of his estate, and
  - (b) his personal representatives may make any election under this Schedule that he might have made.

*Interpretation*

- 13 In this Schedule—
  - “adjustment charge” means a charge under Part 2 of this Schedule;
  - “period of account” means any period for which accounts of the trade, profession or vocation are drawn up; and
  - “tax year” means a year of assessment.

PART 5

COMMENCEMENT

*General rule*

- 14 The provisions of this Schedule apply to a change of basis taking effect in a period of account ending on or after 1st August 2001.

*Application of provisions to certain earlier changes of basis*

- 15 (1) So far as they relate to a change of basis within –
- (a) paragraph 6 (no adjustment for certain expenses previously brought into account), or
  - (b) paragraph 7 (change from realisation basis to mark to market),
- the provisions of this Schedule apply to a change of basis taking effect in a period of account ending before 1st August 2001 if a relevant return is delivered or voluntarily amended by the taxpayer on or after that date.
- (2) For the purposes of sub-paragraph (1) a “relevant return” means –
- (a) a return under section 8 or 8A of the Taxes Management Act 1970 (c. 9) (personal or trustee return),
  - (b) a partnership return, or
  - (c) a company tax return,
- for the period in which the change of basis took effect or a subsequent period of account ending before 1st August 2001.
- (3) The reference in sub-paragraph (1) to the voluntary amendment of such a return is to –
- (a) an amendment under section 9ZA or 12ABA of the Taxes Management Act 1970 (c. 9) (amendment of personal, trustee or partnership return by taxpayer), or
  - (b) an amendment of a company tax return by the company otherwise than in response to a closure notice.
- (4) An adjustment that would be required by virtue of this paragraph to be given effect in a period of account ending before 1st August 2001 shall be given effect in the first period of account ending on or after that date.

*Period in which change of basis takes effect*

- 16 The references in paragraphs 14 and 15 to the period of account in which a change of basis takes effect are to the first period of account in which the new basis is adopted.

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SCHEDULE 2

REPEALS

( ) COMPUTATION OF PROFITS

<i>Short title and chapter</i>	<i>Extent of repeal</i>
Income and Corporation Taxes Act 1988 (c. 1).	In section 473(2), the words “, if the securities were not such as are mentioned in subsection (1)(b) above”.
Finance Act 1998 (c. 36).	Section 44. Schedule 6.

- 1 The repeal in section 473(2) of the Taxes Act 1988 has effect in accordance with section 3(4)(a).
- 2 The repeals in the Finance Act 1998 have effect in accordance with section 1(8) and paragraphs 14 and 15 of Schedule 1 to this Act.