

## **Part 1: Company Distributions**

### **Overview**

1. This Part contains rules to determine what is and what is not a distribution for tax purposes. It rewrites primarily Part 6 of ICTA, and includes the rewrite of section 418 of ICTA. In a number of places references to the source legislation have been retained to aid construction until such time as the relevant provisions are rewritten and their new locations are finalised.

2. This is a complete reissue of the clauses released at the end of March 2008. Most of the material is unchanged, but where there are changes they are noted below. Clause 19 in the March draft has been split into clauses 19 and 20

3. The clauses released in March 2008 did not contain the rewrite of provisions of an administrative nature – sections 216, 217, 226, 234, 234A, 250, 252 and 253 of ICTA. In addition, the clauses as published were confined to corporation tax whereas the source legislation, much of which applies for the purposes of the Corporation Tax Acts, is not so confined. This is because the definition of the Corporation Tax Acts in section 831(1)(a) of ICTA specifically includes enactments relating to “company distributions (including provisions relating also to income tax)”.

4. This reflects the unusual nature of these provisions and the close relationship between their effect on corporation tax and income tax. In the light of this we have looked again at whether the reissued clauses should be confined to corporation tax. We have concluded that they should not and that it would be most helpful for users to have all of the distributions material in one place. We are satisfied that all of this material falls within the scope of Bill 6.

5. As a consequence, references in the March draft to “corporation tax purposes” have been changed to “purposes of the Corporation Tax Acts”, except where noted (see clauses 59, 60, and 62 for clauses relating to corporation tax only). Clause 90 – chargeable payments – has been expanded to encompass income tax.

6. Where separate provision is needed for income tax, draft clauses have been inserted into ITTOIA. These are noted and explained in the relevant places.

7. Provisions of an administrative nature relating to specific aspects of distributions have been located alongside the provisions to which they relate. More general provisions about returns and information are in Chapter 6.

**Q1. We would welcome comments on the decision to rewrite (where possible) all of the material on distributions, including administration and related income tax rules, in one place.**

## **Chapter 1: Introduction**

### **Clause 1: Overview of Part**

8. This clause sets out the scope of the Part. It is new.

9. The clause provides signposts to rules that define what is and is not a distribution, to rules that extend the meaning of distribution, and to the power in section 152 of FA 1995 to make modifications in relation to open-ended investment companies. Section 152 of FA 1995 will be rewritten in Bill 6.

10. The structure is as follows:

- Chapter 2 sets out what is treated as a distribution
- Chapter 3 sets out what is not a distribution
- Chapter 4 deals with certain special cases
- Chapter 5 deals with demergers
- Chapter 6 contains provisions about returns and information
- Chapter 7 provides interpretation.

<b>Q2. We welcome comments on the structure of the legislation.</b>
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**Chapter 2: Matters which are distributions**

**Clause 2: Overview of Chapter**

11. This clause sets out the scope of Chapter 2 and provides signposts to other provisions in the Chapter, including those setting out exceptions. It is new.

**Clause 3: Priority of negative rules**

12. This clause directs that the Chapter is subject to any express exceptions, and lists some of those that most commonly affect what is to be treated as a distribution. It is based on section 209(1) of ICTA.

13. The clause specifically refers to paragraph 6 of Schedule 12 to FA 1988, which sets out a number of tax matters connected with the transfer of the whole of the business of a building society to a successor company. This provision covers a range of matters that would affect a specific transaction, and it has therefore been decided to keep it in its current form rather than split it across different parts of the tax legislation.

**Clause 4: Meaning of “distribution”**

14. This clause sets out the main circumstances that give rise to a distribution. It is based on section 209(2) and section 418 of ICTA.

15. The clause sets out a list, containing paragraphs A to H inclusive, referred to subsequently as the “clause 4(1) list”.

16. The references to the source legislation are as follows:

Paragraph	Origin (in ICTA).
A	section 209(2)(a).
B	section 209(2)(b).
C	section 209(2)(c).
D	section 209(2)(c).
E	section 209(2)(d).
F	section 209(2)(e).
G	section 209(4).
H	section 209(2)(f).

17. The clause also provides signposts to extensions to the meaning of distribution in clause 69 and clause 76.

**Clause 5: Provisions related to paragraphs A to H of the section 4(1) list**

18. This clause provides information and signposts to bring together in one place a list of the main provisions that explain, supplement or limit each of the categories of distribution. It is new.

19. It is not exhaustive, but is designed to provide a helpful set of signposts to aid construction.

**Q3. We would welcome comments on whether or not this table is useful as an aid to navigation through these provisions.**

**Clause 6: Exceptions for certain transfers of assets or liabilities between a company and its members**

20. This clause excludes two circumstances from the scope of paragraph B of the clause 4(1) list. It is based on section 209(5) and (6) of ICTA.

21. Section 209(5) and (6) of ICTA are written in slightly different terms. Subsection (5) first qualifies subsection (4). This qualification is rewritten in clause 24(1). Subsection (5) then goes on to disapply section 209(2)(b) of ICTA. Clause 6(1) picks up this link, which brings with it the interpretation material of section 209(7) ICTA, rewritten in clause 24(2) and (3).

22. Section 209(6) is rewritten in clause 6(2) and clause 24(4). This ensures that the qualifications are located close to the rewritten provisions that they modify.

23. The cross reference to section 416 of ICTA is retained for the present. Section 416 of ICTA will be rewritten in Bill 6.

**Clause 7: Redeemable share capital**

24. This clause explains how the amount of a distribution is identified when a distribution falls within paragraph C of the clause 4(1) list because redeemable share capital is issued partly for new consideration. It is based on section 209(2) and (8) of ICTA.

25. If a premium is payable to the holder of this type of share capital, either on redemption or otherwise, the amount of the premium is added to the value of the share capital for the purposes of calculating the distribution.

26. For example, the nominal value of the share capital is £1000 and the premium payable on redemption is £100. The total value calculated by clause 7 is therefore £1100. If the recipient gives, say, £900 for those shares the amount of the distribution is £200.

**Clause 8: Cases where the issue is partly for new consideration**

27. This clause performs a role similar to that of clause 7, but in this case in relation to paragraph D of the clause 4(1) list - securities issued partly for new consideration. It is based on section 209(2) and (8) of ICTA.

**Clause 9: Meaning of “non-commercial securities”**

28. This clause sets out the definition of a non-commercial security for the purposes of paragraph E in the clause 4(1) list. It is based on section 209(2)(d) of ICTA.

29. Clauses 10 to 17 also affect the scope and amount of a distribution within paragraph E of the clause 4(1) list.

**Clause 10: The principal secured: non-commercial securities**

30. This clause provides some qualifications to the meaning of “the principal secured” for the purposes of clause 9 and of paragraph E of the clause 4(1) list. It is based on section 209(3) and (3A) of ICTA.

31. The basic meaning of “principal secured” is not defined in tax statute and takes its general meaning, subject to any relevant specific tax rules.

32. In measuring the extent to which there is more than a reasonable commercial return for the use of the principal, the “principal secured” cannot be greater than the amount given for the issue of the security.

33. Clause 121(6) provides a further qualification if securities are issued at a price less than the amount repayable on them, and are not listed on a recognised stock exchange.

34. If a security is issued at a premium, the amount of the premium is taken into account in determining both the amount of the principal secured and the extent to which the return on the securities is more than a reasonable commercial return.

35. Clause 11 qualifies this clause, and there is a table at the end of the note on clause 16 summarising the interaction of clauses 10 to 16.

**Clause 11: Consideration exceeding amount of principal secured: modification of section 10**

36. This clause explains what happens when the amount of the consideration paid for securities exceeds the principal secured. It is based on section 209(3AA) of ICTA.

37. In such a case the principal secured is deemed to be increased to the amount of the consideration, for the purposes of determining whether or to what extent paragraph E of the clause 4(1) list applies. The rules in clause 10(3) and (4) concerning issue at a premium do not apply.

38. An example is where the security is linked to movement in the value of a basket of shares. The amount received back by the investor could be lower than the amount paid for the security, so the value of the principal secured could be very small in such an example. This could on one view appear to be above a commercial return for that principal, but not so when viewed in relation to the amount actually paid by the investor for the security.

**Clause 12: Security linked to shares: exclusion of section 11**

39. This clause is the first of two that qualify clause 11. It is based on section 209A(1), (2) and (4) of ICTA.

40. The clause applies where a security is linked to shares of the issuing company or any of its associated companies. The effect is that if the consideration given for the security exceeds the principal secured, the increase provided for by clause 11 is not made, but the rules in clause 10(3) and (4) concerning issue at a premium do apply.

41. Clause 12 does not apply if the link to shares of a company or its associated companies arises solely because a bank or securities house has issued, as part of its normal business, securities based on a “qualifying index”. This could happen if the basket of shares forming the subject matter of the index includes shares in the issuing bank itself or in one of its associated companies.

42. The second qualification is in clause 15.

**Clause 13: Meaning of “qualifying index” in section 12**

43. This clause defines “qualifying index”. It is based on section 209A(3) of ICTA.

44. The index must include shares of at least one company that is not either the issuing company or one of its associated companies, and those shares must be a “significant proportion” of the market value of the shares that make up the index.

**Clause 14: Meaning of “associated company” in section 12**

45. This clause defines the term “associated company” as it applies in clause 12. It is based on section 209A(5) to (7) of ICTA.

46. The clause sets out how a person can control a company for this purpose. Any shares held on trading account (but not part of an insurance company’s long-term insurance fund) are disregarded for this purpose.

**Clause 15: Hedging arrangements**

47. This clause provides the second exception to clause 11. It disapplies clause 11 if there are “hedging arrangements” in place. It is based on section 209B(1) and (3) of ICTA.

48. Clause 15 takes effect either from the time when the hedging arrangements come into effect, or from a later time in relation to earlier hedging arrangements (but only if those arrangements were in place on or after 17 April 2002). An example of the latter is where a distribution in respect of a security did not initially fall within paragraph E of the clause 4(1) list, but did so subsequently and there were hedging arrangements in place before the distribution fell within paragraph E.

49. At any time when clause 15 takes effect, paragraph E of the clause 4(1) list operates from that time as if the adjustment under clause 11, increasing the principal secured to the consideration given on issue, had not been made.

50. For example, a security with principal secured of £100 is issued for £120. Clause 11 would normally deem the principal secured to be increased to £120, and the return would be evaluated against that amount for the purposes of paragraph E of the clause 4(1) list. If hedging arrangements are subsequently put in place, the principal secured from that point onwards is £100.

51. The definition of “hedging arrangements” is in clause 17.

**Clause 16: Exception to section 15**

52. This clause sets out a series of circumstances in which clause 15 does not apply, and hence clause 11 does apply. It is based on section 209B(2), (4), (5), (6), (7) and (9) of ICTA.

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53. All the four conditions A to D must be met and have been met at all times in which any hedging arrangements have been in place in relation to that security (but only on or after 17 April 2002).

54. Once any one of the conditions A to D in this clause is not met, clause 15 will apply from that point onwards, and will continue to apply even if all the conditions are subsequently satisfied.

55. The clause refers to the group relief rules, currently in Chapter 4 of Part 10 of ICTA. These provisions will be rewritten in Bill 6 – draft clauses were published in September 2007.

56. The following table summarises the interaction of clauses 10 to 16.

	Clause 11 applies?	Clauses 10 (3) and (4) apply?
Security issued at a premium representing new consideration <b>and</b> the consideration is not greater than the principal secured – clause 10(2)	NO	YES
New consideration received exceeds the principal secured, but not in the form of a premium on issue – clause 11(1)	YES	NO
Clause 12(1) applies – securities linked to shares	NO	YES
Clause 12(3) applies, overrides clause 12(1)	YES	NO
Clause 15 applies – hedging arrangements	NO	YES
Clause 16 applies, overrides clause 15	YES	NO

**Clause 17: Meaning of “hedging arrangements”**

57. This clause defines “hedging arrangements” for the purposes of clauses 15 and 16. It is based on section 209B(8) of ICTA.

58. The “hedging arrangements” are looked at from the point of view of the issuing company. The essence of the definition is that there is an amount that offsets amounts that the company has to meet in relation to the security.

**Clause 18: Meaning of “special securities”**

59. This clause defines “special securities” for the purpose of paragraph F of the clause 4(1) list. It is based on, and covers, the various circumstances that are set out in section 209(2)(e) of ICTA.

60. There are five sets of circumstances listed, corresponding as follows to the provisions in section 209(2)(e) of ICTA:

Condition A	section 209(2)(e)(i).
Condition B	section 209(2)(e)(ii).
Condition C	section 209(2)(e)(iii).
Condition D	section 209(2)(e)(vi).
Condition E	section 209(2)(e)(vii).

**Clause 19: Meaning of “equity note” in section 18**

61. This clause provides the definition of “equity note”. It is based on section 209(9) of ICTA.

62. This clause has been separated out from what is now clause 20 from the March 2008 draft.

**Clause 20: Section 18: other interpretation**

63. This clause provides additional definitions for the purpose of clause 18. It is based on section 209(2), (3B), (10) and (11) of ICTA.

64. *Subsection (1)* qualifies condition C in clause 18 if the return on a security is dependent on the results of the company’s business. This is based on section 209(3B) of ICTA.

65. *Subsection (2)* expands the meaning of “securities connected with shares in the company” for the purpose of condition D. It is based on section 209(2)(e)(vi) of ICTA.

66. Interpretation concerning equity notes was in this clause in the March 2008 draft but has been moved to clause 19.

**Clause 21: The principal secured: special securities**

67. This clause qualifies the meaning of “principal secured” for the purposes of clause 18 if securities are issued at a premium. It is based on section 209(3) and (3A) of ICTA.

68. The clause performs the same function in relation to securities as clause 10(3) does in relation to shares. Note however that there is no equivalent of clause 10(4).

**Clause 22: Alternative finance arrangements**

69. This clause ensures that returns from certain Alternative Finance Arrangements are not treated as distributions for corporation tax. It is based on sections 54 and 57 of FA 2005 (the relevant parts of which are expected to be rewritten as section 209(6A) of ICTA in Bill 5 – see Schedule 1 to the draft bill published in February 2008).

70. The main part of the corporation tax legislation concerning alternative finance arrangements will be rewritten in Bill 5 – see Chapter 6 of Part 7 of the draft Bill published in February 2008.

**Clause 23: Transfers of assets or liabilities treated as distributions**

71. This clause treats a company as making a distribution, and describes how to calculate the amount of the distribution, if assets or liabilities are transferred by a company to its members or vice versa (paragraph G of the clause 4(1) list). It is based on section 209(4) of ICTA.

72. The value of the benefit to the member is determined, and is then compared with the amount of any new consideration. If the amount given by the member is less than the value provided to the member, a distribution arises equal to the difference between those two amounts.

73. This clause is subject to the exceptions in clause 24.

**Clause 24: Section 23 exceptions**

74. This clause sets out two circumstances where clause 23 does not apply. It is based on section 209(5) to (7) of ICTA.

75. *Subsection (1)* sets out the two exceptions. *Subsections (2) to (5)* contain further interpretation.

76. Note that if subsection (1) disapplies clause 23 and thereby takes something out of being a distribution, it is not to be treated as a distribution under paragraph B of the clause 4(1) list. Clause 6(1) makes the necessary link.

77. The clause takes the definition of “control” from section 416 of ICTA, which will be rewritten in Bill 6.

**Clause 25: Bonus issues following repayment of share capital treated as distributions**

78. This clause sets out how a distribution can arise when a company makes a bonus issue of shares following a repayment of share capital. It is based on section 210 of ICTA.

79. The rules for a repayment of share capital following a bonus issue of shares are in clause 28.

80. *Subsection (5)* refers to section 704 of ICTA, which will be rewritten in Bill 6.

**Clause 26: Premiums paid on redemption of share capital**

81. This clause and clause 27 work together to determine what is treated as a repayment of share capital. It is based on section 211(7) of ICTA.

82. The starting point is that a premium paid on redemption of share capital is not treated as a repayment of share capital. This is further qualified by clause 27.

83. The source legislation in section 211(7) of ICTA was not expressly limited in its application, but analysis of the legislation has shown that its practical application is limited to matters within the distributions legislation. This has now been made explicit by limiting its effect to this Chapter. See *Change 648* in Annex 1.

<p><b>Q4. We welcome comments on the proposals to clarify the scope of the provision concerning premiums paid on the redemption of share capital</b></p>
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**Clause 27: Share capital issued at a premium representing new consideration**

84. This clause provides further interpretation of what constitutes a repayment of share capital. It is based on section 211(5) and (6) of ICTA.

85. If a premium is paid by the purchaser on the issue of share capital, the amount of the premium is considered to be part of the value of that share capital for the purpose of determining what is subsequently to be treated as a repayment of share capital or as a distribution.

86. For example, taking clauses 26 and 27 together, if share capital with a nominal value of £100 is issued at par and is later repaid with a redemption premium of £20 then only £100 is considered to be a repayment of share capital.

87. However, if that same share capital was issued at an issue premium of £10, then £110 of the £120 would be regarded as a repayment of that share capital. However, all or part of the £10 issue premium is not regarded as a repayment of share capital to the extent that it has already been applied in paying up any share capital – see *subsection (3)*.

**Clause 28: Distributions following a bonus issue**

88. This clause sets out the circumstances in which certain distributions are not treated as repayments of share capital because they follow an earlier issue of bonus shares. It is based on section 211(1), (2) and (4) of ICTA.

89. The clause applies only if the issue of bonus shares does not fall to be treated as a qualifying distribution under another provision. A qualifying distribution is any distribution other than one that is a distribution solely because of paragraph C or D of the clause 4 list (see clause 127 for the definition).

90. Distributions made more than ten years after any bonus issue can be treated as repayments of share capital provided that paragraph D of section 704 of ICTA does not apply to the company, and provided that the shares are not redeemable share capital. Section 704 of ICTA will be rewritten in Bill 6.

91. Clause 29 contains a further qualification.

92. Paragraph 5 of Schedule 2 contains savings for certain bonus issues that took place before 7 April 1973.

**Clause 29: Cap on amount of distributions affected by section 28**

93. This clause qualifies clause 28. It is based on section 211(1) and (3) of ICTA.

94. The clause limits the amount of the distribution to the total value of any previous bonus issues that:

- have not already been treated as distributions, and
- have not been met by new consideration (defined as the “cap”).

**Clause 30: Certain payments connected with exempt distributions**

95. This clause affects clause 25 by treating chargeable payments made within five years of an exempt distribution as not being repayments of share capital for the purposes of those clauses. It is based on section 214 of ICTA.

96. Exempt distributions and chargeable payments are dealt with in clauses 77 to 106. Chargeable payments are charged to corporation tax by clause 90. The appropriate location for the equivalent income tax charge is still under consideration.

**Chapter 3: Matters which are not distributions**

**Clause 31: Overview of Chapter**

97. This clause sets out the scope of the Chapter. It is new.

98. The clause refers to paragraph 6 of Schedule 12 to FA 1988. A decision is still to be taken as to the location for the rewrite of this provision.

**Clause 32: Distributions in respect of share capital in a winding up**

99. This clause excludes distributions made in a winding up from the scope of distributions for tax purposes. It is based on section 209(1) of ICTA.

**Clause 33: Distribution as part of a cross-border merger**

100. This clause ensures that certain distributions made in the course of a cross-border merger are not treated as distributions for corporation tax purposes. It is based on section 209(1A) of ICTA.

101. The source legislation was introduced by Part 2 of The Corporation Tax (Implementation of the Mergers Directive) Regulations 2007, SI 2007/3186, which came into effect on 29 November 2007. Provided certain conditions are met, if a company makes a distribution as part of a cross-border merger and then ceases to exist without being formally wound up, that distribution is not treated as a distribution for corporation tax purposes.

**Clause 34: Interest etc paid in respect of certain securities**

102. This clause qualifies paragraph F of the clause 4(1) list. It is based on section 212(1) and (3) of ICTA.

103. The clause excludes from the meaning of a distribution amounts paid to companies within the charge to corporation tax, but not if the distribution falls within the rules for non-commercial securities in paragraph E of the clause 4(1) list.

104. Paragraph 6 of Schedule 2 contains savings for certain obligations entered into before 9 March 1982, or entered into before 1 July 1982 as a result of negotiations that were in progress before 9 March 1982.

105. Section 208 of ICTA will be rewritten in Bill 5 – see clause 1209[j5208] of the draft Bill published in February 2008.

**Clause 35: Purchase by unquoted trading company of own shares**

106. This clause sets out the conditions that must apply so that the purchase by an unquoted trading company of its own shares is not treated as a distribution for tax purposes. It is based on section 219 of ICTA.

107. The consideration for the purchase of own shares will potentially fall into the computation of a chargeable gain in the hands of the seller, subject to any necessary matters to be taken into account under the chargeable gains legislation. This was confirmed by the judgement in the Court of Appeal in *Strand Options and Futures Ltd v Vojak* [2004] STC 64.

108. This clause is supplemented by clauses 36 to 52.

**Clause 36: Requirements as to residence**

109. This clause sets out requirements relating to the residence and ordinary residence (for tax purposes) of the seller, and includes cases where the shares are held through a nominee or by a personal representative. It is based on section 220(1), (3) and (4) of ICTA.

**Clause 37: Requirement as to period of ownership**

110. This clause sets a minimum period throughout which the shares disposed of must have been held, and contains rules to determine, in certain circumstances, when those shares were acquired. It is based on section 220(5), (8) and (9) of ICTA.

**Clause 38: Determining the period of ownership**

111. This clause extends the period during which the seller is deemed to own the shares. It is based on section 220 (6) and (7) of ICTA.

112. Subject to certain conditions, periods of ownership by a spouse or civil partner of the seller, or by a person whose shares are transferred to the seller under a will or intestacy, are treated as periods of ownership by the seller.

113. The definition in section 1011 of ITA relating to married persons or civil partners living together applies for the purposes of the Income Tax Acts, which in turn include corporation tax provisions which relate to income tax. The purchase of own share rules fall within that scope. The definition of persons “living together” has been provided in this legislation to avoid the need to refer to section 1011 of ITA - see clause 120.

**Clause 39: Reduction of seller’s interest as shareholder**

114. This clause is the first of two that place conditions on the seller’s interest in the company after the purchase by the company of its own shares. It is based on section 221(1), (2), (3) and (4) of ICTA.

115. The seller’s shareholding in the company must be reduced to no more than 75% of what it was before the company’s purchase of its own shares took place. For this purpose, the shareholdings of the seller and any shareholdings of the seller’s associates are looked at as one. The definition of associated persons is in clauses 64 to 66.

116. The clause is qualified generally by clause 40 and clause 45, and by clauses 41 to 44 if the company making the purchase is a member of a group.

**Clause 40: Section 39: effect of entitlement to profits**

117. This clause sets out the second condition concerning the seller’s interest in the company after the purchase of its own shares. It is based on section 221(5), (6), (7) and (8) of ICTA.

118. The seller's entitlement to the profits of the company after the purchase must be no more than 75% of what it was before the purchase. There is a further requirement in clause 41 where the company is a member of a group.

**Clause 41: Requirements applicable where purchasing company is a member of a group**

119. This clause supplements the requirements of clause 39 and clause 40 where the company is a member of a group. It is based on section 222(1), and (3) of ICTA.

120. The seller's shareholding in all companies in the group must be substantially reduced after the purchase of own shares, taking into account any shares in the group held by any of the seller's associates – even if the seller holds no shares in the company making the purchase after the purchase has taken place.

121. There are further qualifications in clause 42 and clause 45.

**Clause 42: Determining whether interests as shareholders in a group are substantially reduced**

122. This clause sets out how to determine whether the seller's shareholding in the purchaser's group is substantially reduced. It is based on section 222(2), (4), (5) and (6) of ICTA.

123. The seller's shareholding in the group, taken together with any shareholdings of the seller's associates, must be no greater than 75% of what it was before the purchase of own shares took place.

**Clause 43: Section 42: effect of entitlement to profits**

124. This clause stipulates that the seller's entitlement to the profits of the group must be no greater than 75% of what it was before the purchase of shares took place. It is based on section 222(7) and (8) of ICTA.

**Clause 44: Other requirements**

125. This clause places certain further requirements on the seller and on the transaction. It is based on section 223 of ICTA.

126. The definition of "connected" for this purpose is in clause 67.

**Clause 45: Relaxation of requirements in certain cases**

127. This clause treats the seller as meeting the necessary conditions if the seller agreed to the purchase in order to permit an associate's shareholding to be substantially reduced. It is based on section 224 of ICTA.

**Clause 46: Advance clearance of payments by Commissioners**

128. This clause permits the company to apply to the Commissioners for Revenue and Customs for a decision on whether or not clause 35 will apply. It is based on section 225(1) of ICTA.

129. The words “the Commissioners for Her Majesty’s Revenue and Customs” have been substituted for the words “the Board” in the source legislation. This gives effect to section 50(1) and (2) of CRCA which requires references to the terms in the source legislation to be taken as references to the substituted terms.

**Clause 47: Advance clearance: supplementary**

130. This clause sets out time limits and further procedural rules in relation to the consideration of an application under clause 46. It is based on section 225(2) to (5) of ICTA.

**Clause 48: Purchase of own shares: returns**

131. This clause requires a company to make a return of a payment that it considers is within clause 35. It is based on section 226(1) of ICTA.

132. Clauses 48, 49 and 50 are additions to the March 2008 draft clauses.

**Clause 49: Information about schemes etc**

133. This clause requires a company or any person connected with it to provide information about schemes or arrangements in relation to payments treated as falling within clause 35. It is based on section 226(2) and (3) of ICTA.

**Clause 50: Information about the person for whom a payment is received**

134. This clause requires certain information to be provided where a payment falling within clause 35 is received on behalf of another person. It is based on section 226(4) of ICTA.

**Clause 51: Meaning of “group” and “51% subsidiary” in sections 35 to 51**

135. This clause widens the general meaning of “group” and “51% subsidiary” for the purpose of the purchase of own share rules. It is based on section 222(9) to (12) of ICTA.

**Clause 52: Sections 35 to 51: other interpretation**

136. This clause contains definitions. It is based on section 229 of ICTA.

137. “Personal representative” will be defined for all Bill 6 purposes, using the same definition as that in section 989 of ITA. This definition was a change from the source legislation. As with ITA we anticipate that the detail of the equivalent proposed change for corporation tax will be published with the draft Bill.

**Clause 53: Stock dividends**

138. This clause sets out the treatment of a dividend taken in shares instead of cash, and an issue of bonus shares derived from rights attaching to those shares. It is based on sections 230 and 249 of ICTA.

139. If the value of the shares is charged to tax as income of the recipient under ITTOIA, the issue of those shares is not treated as a distribution.

140. The clause is supplemented by clauses 54 and 55, and there are special rules in Schedule 2 for share capital issued before 6 April 1975.

141. Schedule 1 contains consequential amendments to the stock dividend provisions of ITTOIA.

**Clause 54: Application of section 53 where bonus share capital is converted etc**

142. This clause sets out the tax treatment of the shares issued in an exchange or conversion of shares that were themselves bonus shares taxed as a stock dividend. It is based on section 249(9) of ICTA.

143. If the stock dividend was taxed as income then the issue of the replacement shares:

- is not taxed as a stock dividend - *subsection (4)*,
- is not treated as a distribution, and
- is not regarded as issued for new consideration – *subsection (5)*.

144. Some bonus issues do not fall within the rules of the predecessors to clause 53, either because they were issued before the original rule was introduced (section 34 of the Finance (No 2) Act 1975) or because the rights to the bonus issue were contained in shares issued before 6 April 1975 (the transitional rule in section 249(8) of ICTA, rewritten as paragraph 78A of Schedule 2 to ITTOIA).

145. If this is the case, clause 53 does not apply to the replacement shares. Therefore, the issue of those shares is treated as a distribution and they are not treated as issued for new consideration – *subsection (3)*.

**Clause 55: “Bonus share capital” and “in lieu of a cash dividend”**

146. This clause provides interpretation for the stock dividend rules. It is based on sections 249(1) and 251(1) of ICTA.

**Clause 56: Share capital to which section 53 applies: returns**

147. This clause makes provision for certain returns to be made in relation to stock dividends. It is based on section 250(1), (3), (4), (5) and (6) of ICTA.

148. This clause and clauses 57 and 58 are additions to the March 2008 draft clauses.

**Clause 57: Return periods**

149. This clause sets out the return periods for the purposes of clause 56. It is based on section 250(2) of ICTA.

**Clause 58: Power to require further information**

150. This clause enables an officer of Revenue & Customs to require certain information in relation to the stock dividend provisions. It is based on section 250(7) of ICTA.

**Clause 59: Building society payments**

151. This clause ensures that interest or dividends paid in respect of accounts held with a building society are not treated as distributions for corporation tax. It is based on section 477A(3)(b) and (9) of ICTA.

152. This clause is one of the few that relate to corporation tax only. Such payments are charged to income tax as interest by section 372 of ITTOIA, and to corporation tax by section 477A of ICTA (see clause 485 of the draft Corporation Tax Bill).

**Clause 60: Industrial and provident societies: interest and share dividends**

153. This clause states that payments made to members by an industrial or provident society in the form of a share of profits – for example the traditional “divi” from the Co-op – will not be treated as a distribution for corporation tax. It is based on section 486(1) and (12) of ICTA.

154. This clause relates to corporation tax only. Such payments are charged to income tax under section 379 of ITTOIA. Section 486(4) of ICTA charges the payment to corporation tax under Case III of Schedule D. This provision will be rewritten in Bill 5 – see clause 486 of the draft Bill published in February 2008.

**Clause 61: Dividend or bonus relating to transactions**

155. This clause ensures that any payment made by an industrial and provident society that is deductible for corporation tax by virtue of section 486(10) of ICTA is not treated as a distribution. It is based on section 486(10) and (11) of ICTA.

156. Section 486(10) of ICTA will be rewritten in Bill 5 – see clause 131 of the draft bill published in February 2008. That subsection is also an origin for this clause because of the link in the source legislation between section 486(10) and (11) of ICTA.

157. Bill 5 rewrites section 486(11) of ICTA as section 230A of ICTA – see paragraph 81 of Schedule 1 to the draft Bill published in February 2008.

**Clause 62: UK agricultural or fishing co-operatives: interest and share dividends**

158. This clause provides the same treatment for payments made to members in the case of UK agricultural or fishing co-operatives as clause 60 provides for an industrial and provident society. It is based on section 486(1), (9) and (12) of ICTA.

159. This clause relates to corporation tax only.

**Clause 63: Meaning of “UK agricultural or fishing co-operative”**

160. This clause provides definitions for the purpose of clause 62. It is based on section 486(12) of ICTA.

161. The reference to the Department for Agriculture in Northern Ireland in section 486(12) of ICTA is rewritten in subsection (4) as “the Department of Agriculture and Rural Development”, its current title.

**Clause 64: Associated persons**

162. This clause contains the basic definition of “associated person” for the provisions contained in Chapter 3. It is based on section 227(1), (2), (3), (4) and (7) of ICTA. As with clause 38 the definition of persons “living together” has been brought directly into the legislation – see clause 120.

163. Further rules in clauses 65 and 66 extend the meaning in the case of trustees and personal representatives.

**Clause 65: Associated persons: trustees**

164. This clause supplements the definition of “associated person” in clause 64. It is based on section 227(5), (8) and (9) of ICTA.

**Clause 66: Associated persons: personal representatives**

165. This clause also supplements the definition of “associated person” in clause 64. It is based on section 227(6) and (9) of ICTA.

**Clause 67: Connected persons**

166. This clause sets out rules for identifying a “connected person” for the purposes of Chapter 3. It is based on section 228(1) to (5) of ICTA.

167. These rules are supplemented by clause 68.

**Clause 68: Section 67: supplementary**

168. This clause supplements the definitions in clause 67. It is based on section 228(6), (7) and (8) of ICTA.

**Chapter 4: Special rules for distributions made by certain companies**

**Clause 69: Certain expenses of close companies treated as distributions**

169. This clause extends the meaning of a distribution to include certain expenses incurred by a close company in providing benefits for participators. It is based on section 418 of ICTA.

170. Expenses that fall within the rules are treated as distributions, the amount being measured in the same way as if a benefit had been provided to an employee under the income tax code.

171. Clarification has been provided in *subsection (3)(b)* in relation to the question of amounts “made good” by the participator. The source legislation measures the amount of the “expense” in section 418(4) of ICTA by reference to the income tax legislation relating to employee benefits in kind – see *subsection (4)*. The amount found under those rules is the net amount after any amounts made good or contributed by the employee.

172. The purpose of section 418(2) of ICTA is to set out the conditions for an amount to be treated as a distribution. However, section 418(2) also provides that the amount of the “expense” is reduced by any amount “made good”. On plain words, an amount can only be “made good” if it has been borne by the company – and if the participator has already made good any amount in arriving at the section 418(4) calculation then it is not possible to make it good again because the company has not borne the expense (or that part of it). The rewritten legislation makes this explicit.

173. Where an amount contributed by the participator is not taken into account in the computation made using the employee benefit in kind rules, the reduction provided for in section 418(2) of ICTA can then take effect.

174. Clauses 70 and 71 set out two exceptions. Clause 72 contains supplementary material.

**Clause 70: Exception for benefits treated as employment income etc**

175. This clause sets out the first circumstance where clause 69 does not apply. It is based on section 418(3) of ICTA.

176. The exceptions are set out in a table. The exceptions arise where the participator is also an employee within the benefit in kind rules of ITEPA (the benefits in kind rules apply instead), or in the case of certain death or retirement benefits for dependents of participators.

**Clause 71: Exception for certain transfers between UK resident companies.**

177. This clause sets out the second exception to clause 69. It is based on section 418(5) and (6) of ICTA.

**Clause 72: Extension of references to close companies and participators**

178. This clause deals with the situation where two or more close companies act together to provide benefits to each other’s participators. It is based on section 418(7) and (8) of ICTA.

179. In such a case the benefits are deemed to be provided by a close company to its own participator and hence treated as a distribution.

180. Clause 65(2) makes it explicit that section 418(7) of ICTA applies only for the purposes of section 418 of ICTA.

**Clause 73: Companies carrying on a mutual business**

181. This clause limits the extent of a distribution in the case of a company carrying on a mutual business. It is based on section 490(1) and (2) of ICTA.

182. The rules about distributions only apply to such a company to the extent that distributions are made out of taxable profits or franked investment income (FII). However, this limitation applies only if the distribution is made to persons who participate in the mutual business.

183. The inclusion of FII allows the company to in effect pass through dividend income to its members as its own distribution so that the members are taxable on the amount received as if they had received the dividends directly instead of earning them “through” the mutual company.

184. If the business is a mutual life business then the distribution rules do not apply at all (ie: there is no qualification in terms of being made out of taxable profits or FII) in the case of distributions made to persons participating in that business.

**Clause 74: Distributions out of surpluses not charged to tax etc**

185. This clause ensures that the tax treatment of a receipt in the hands of a member is not affected by reason of its being received from a mutual company of which that person is a member. It is based on section 490(3) of ICTA.

**Clause 75: Companies not carrying on a business**

186. This clause limits the measure of a distribution in the case of a company that does not carry on, or has never carried on, a trade or a business of holding investments. It is based on section 490(4) of ICTA.

187. In such a case the rules about distributions are limited to those amounts distributed out of taxable profits or franked investment income.

**Clause 76: Members of a 90% group**

188. This clause extends the meaning of distribution in the case of a company and its 90% subsidiaries. It is based on section 254(1), (3) and (4) of ICTA.

189. If this provision applies, the distribution rules are expanded to encompass anything distributed out of assets of the company in respect of shares or securities of any company in the group, unless the distribution is to another company in the group which is UK resident.

190. The source legislation in section 254(3) of ICTA was not limited in its application to Part 6 of ICTA - this has been reflected explicitly in the drafting of *subsection (1)*.

## **Chapter 5: Demergers**

### **Overview**

191. This Chapter rewrites the provisions concerning exempt distributions and chargeable payments in sections 213, 214, 215 and 218 of ICTA.

### **Clause 77: Key terms etc**

192. This clause provides signposts to the key terms used in this Chapter, and to the reference to chargeable payment in clause 30. It is new.

### **Clause 78: Purpose of provisions about demergers**

193. This clause explains the purpose of the rules concerning demergers and explains what provisions are included within the term “the provisions about demergers”. It is based on section 213(1) of ICTA.

### **Clause 79: Exempt distributions**

194. This clause states that an exempt distribution is not a distribution for corporation tax purposes, and provides signposts to the three types of exempt distribution (set out in the following three clauses). It is based on sections 213(2) and (3), 213A(1) and 218(1) of ICTA.

### **Clause 80: Transfer of shares in subsidiaries to members**

195. This clause defines the circumstances giving rise to the first type of exempt distribution. It is based on section 213(2) of ICTA.

196. Conditions A to D are in clause 85, conditions E and F are in clause 86, and conditions L and M are in clause 89.

### **Clause 81: Transfer by distributing company and issue of shares by transferee company**

197. This clause defines the circumstances giving rise to the second type of exempt distribution. It is based on section 213(2) and (3) of ICTA.

198. Conditions A to D are in clause 85, conditions G to K are in clause 87, and conditions L and M are in clause 89.

### **Clause 82: Division of business in a cross-border transfer**

199. This clause defines the circumstances giving rise to the third type of exempt distribution. It is based on section 213A(1) of ICTA.

200. Section 213A of ICTA was introduced by Part 2 of The Corporation Tax (Implementation of the Mergers Directive) Regulations 2007, SI 2007/3186, which came into effect on 29 November 2007.

### **Clause 83: “The distributing company”**

201. This clause defines the term “the distributing company” for the purposes of clauses 84. It is based on section 213(3) and section 213A(3) of ICTA.

**Clause 84: Meaning of “relevant company”**

202. This clause defines the term “relevant company” for the purposes of clauses 80, 81 and 82. It is based on section 213(3) and section 213A(3) of ICTA.

**Clause 85: General conditions**

203. This clause sets out the conditions (A to D) for an exempt distribution to be treated as such, and covers all exempt distributions of the first or second type – see clauses 80 and 81. It is based on section 213(4), (5), (10) and (11) of ICTA.

204. The clause is supplemented by clauses 86 and 87 which set out conditions that must be met in relation to specific types of exempt distribution.

**Clause 86: Conditions for distributions falling within section 80(a)**

205. This clause supplements clause 85 by requiring additional conditions (E and F) to be met if the exempt distribution is of a type involving the distribution by a company to its members of shares in one or more of its 75% subsidiaries. It is based on section 213(6), (7) and (12) of ICTA.

206. *Subsection (1)* sets out conditions relating to the company whose shares are transferred and *subsection (2)* sets out conditions relating to the company making the transfer.

207. Condition F in *subsection (2)*, the requirement for the company making the transfer to be a trading company after the distribution, does not apply if that company is itself a 75% subsidiary. Instead, clause 89 applies.

**Clause 87: Conditions for distributions falling within section 81**

208. This clause supplements clause 85 by requiring additional conditions (G to K) to be met if the exempt distribution consists of the transfer of a trade or trades, or shares in one or more 75% subsidiaries, followed by the issue of shares in the receiving company to the members of the company making the transfer. It is based on section 213(8) of ICTA.

209. The company making the transfer must dispose of substantially the whole of its interest in the trade or shareholding that it transfers.

210. Clause 88 further qualifies this clause.

**Clause 88: Cases where condition K does not apply**

211. This clause qualifies clause 87 by setting out circumstances where one of its conditions, condition K, does not apply. It is based on section 213(9) and (12) of ICTA.

**Clause 89: Conditions to be met if the distributing company is a 75% subsidiary**

212. This clause will apply instead of either condition F in clause 86 or condition K in clause 87 because the distributing company is itself a 75% subsidiary. It is based on section 213(12) of ICTA.

213. Without this clause a 75% subsidiary would not be able to meet the overarching requirement in clause 78(1), namely that the outcome of an exempt distribution is that a trade must be divided between two companies not in the same group or two independent groups. The categories of exempt distribution all involve transfers of shares to the members of the distributing company, and in the case of a 75% subsidiary the members would be the immediate holding company. Hence the conditions could not be met as everything would remain within the one group.

214. The “trading company or group” condition in condition F or K of the relevant clause is replaced by a requirement on the group to which the company belongs, in *subsection (3)*.

215. This clause then requires further distributions, each of which must meet all the relevant tests – apart from condition F or K where the distributing company is a 75% subsidiary. The final exempt distribution in this process must therefore be made by a company which is not itself a 75% subsidiary and which is capable of meeting the necessary conditions in clause 78(1).

**Clause 90: Chargeable payments connected with exempt distributions**

216. This clause sets out how a chargeable payment is charged to corporation tax or income tax, together with the condition that the charge only applies where the payment is made within five years after an exempt distribution. It is based on sections 214(1), (1A), (1B), (4) and (6) of ICTA.

217. Note that this clause has been expanded from the March 2008 draft to encompass the income tax charge and consequences.

218. *Subsection (3)* anticipates the wording adopted in Bill 5 for the charge to corporation tax – see paragraph 80(3) of Schedule 1 to the draft Bill published in February 2008, which consequentially amends section 214(1B) of ICTA.

**Clause 91: Chargeable payments not deductible in calculating profits**

219. This clause sets out the corporation tax treatment for the payer of a chargeable payment made within five years after an exempt distribution. It is based on section 214(1) and (2) of ICTA.

220. The chargeable payment is treated as a distribution for corporation tax purposes in the case of the payer. That is, the payer does not get a deduction for the payment. If the recipient is a company it is chargeable to corporation tax on the receipt – see clause 90 – despite the treatment in the hands of the payer as a distribution.

221. Section 337A(1)(a) of ICTA will be rewritten in Bill 5 – see clause 1228 of the draft Bill published in February 2008.

**Clause 92: Meaning of “chargeable payment”**

222. This clause sets out four conditions A to D, all of which must be met in order for a payment to be treated as a chargeable payment. It is based on section 214(2) of ICTA.

223. This clause is supplemented by clause 93 if any company concerned in the exempt distribution is an unquoted company.

**Clause 93: Meaning of “chargeable payment”: unquoted companies**

224. This clause expands the circumstances in which Condition A in clause 92 is met if a company concerned in an exempt distribution is an unquoted company. It is based on section 214(3) of ICTA.

225. The clause sets out conditions B1, C1 and D1. These are the parallel conditions to conditions B, C and D of clause 92. They have been given different but related labels to highlight their relationship.

**Clause 94: Meaning of “company concerned in an exempt distribution”**

226. This clause defines the term “company concerned in an exempt distribution” for the purposes of the Chapter. It is based on sections 214(4) and (5) of ICTA.

227. This term is necessary to underpin the four conditions in clause 92 and the extension in clause 93.

**Clause 95: Advance clearance of distributions**

228. This clause allows a company to seek a ruling from the Commissioners for Revenue and Customs as to whether a distribution will be treated as an exempt distribution. It is based on section 215(1) of ICTA, and is supplemented by clause 97.

229. The words “the Commissioners for Her Majesty’s Revenue and Customs” have been substituted for the words “the Board” in the source legislation. This gives effect to section 50(1) and (2) of CRCA which require references to the terms in the source legislation to be taken as references to the substituted terms.

**Clause 96: Advance clearance of payments**

230. This clause provides companies with an opportunity to seek advance clearance that a payment will not be treated by the legislation as a chargeable payment. It is based on section 215(2) and (3) of ICTA.

**Clause 97: Requirements relating to applications for clearance**

231. This clause sets out how the application must be made by the company and certain time limits that must be observed by the Commissioners and the company. It is based on section 215(5) of ICTA.

**Clause 98: Decision of the Commissioners or Special Commissioners**

232. This clause sets out the time limit in which the Commissioners must make a decision and the process for referring the application to the Special Commissioners. It is based on section 215(6) to (8) of ICTA.

**Clause 99: Exempt distributions: returns**

233. This clause requires a company to make a return of an exempt distribution. It is based on section 216(1) of ICTA.

234. Clauses 99 to 104 inclusive are additions to the March 2008 draft clauses.

**Clause 100 Payments falling within section 80(a) or 81(1)**

235. This clause enables an officer of Revenue & Customs to require information about certain schemes or arrangements connected with an exempt distribution. It is based on section 217(1) of ICTA.

**Clause 101 Chargeable payments etc: returns**

236. This clause requires returns to be made in relation to chargeable payments connected with an exempt distribution. It is based on section 216(2), (3) and (4) of ICTA.

**Clause 102 Chargeable payments etc: information**

237. This clause enables an officer of Revenue & Customs to require certain returns to be made in relation to chargeable payments connected with an exempt distribution. It is based on section 217(2) of ICTA.

238. The source legislation referred to section 214(1)(b) of ICTA. That provision was repealed by ITA 2007, but section 217 of ICTA was not amended. The necessary consequential amendments were made by article 2 of the Income Tax Act 2007 (Amendment) (No 3) Order, (SI 2007/3506), which came into force on 3 January 2008.

**Clause 103 Information about the existence of schemes etc**

239. This clause enables an officer of Revenue & Customs to require certain returns to be made in relation to a payment connected with an exempt distribution where the payment may be part of a scheme or arrangement. It is based on section 217(3) of ICTA.

240. The source legislation referred to section 214(1)(b) of ICTA. That provision was repealed by ITA 2007, but section 217 of ICTA was not amended. The necessary consequential amendments were made by article 2 of the Income Tax Act 2007 (Amendment) (No 3) Order, (SI 2007/3506), which came into force on 3 January 2008.

**Clause 104 Information about person for whom a payment is received**

241. This clause enables an officer of Revenue and Customs to require certain information of a person who receives a chargeable payment on behalf of another person, or the person on whose behalf it is received. It is based on section 217(4) of ICTA.

**Clause 105: Meaning of “unquoted company”**

242. This clause sets out a definition of “unquoted company” for the purposes of the Chapter. It is based on section 218(1) of ICTA.

**Clause 106: Other definitions etc**

243. This clause contains further interpretation. It is based on section 218(1), (2) and (3) of ICTA.

244. Section 416 of ICTA will be rewritten in Bill 6.

**Chapter 6: Information and Returns: Further provisions**

**Overview**

245. This Chapter contains clauses of an administrative nature that apply generally across the distributions legislation. Its contents are additions to the draft clauses published in March 2008.

**Clause 107: Qualifying distributions: right to request a statement**

246. This clause enables the recipient of a qualifying distribution to require certain information from the payer. It is based on section 234(1) and (2) of ICTA.

**Clause 108: Non-qualifying distributions etc: returns and information**

247. This clause requires the payer of a distribution that is not a qualifying distribution to make certain returns and provide certain information to HMRC. It is based on section 234(5) to (8) of ICTA.

248. The definition of what is and is not a qualifying distribution is in clause 127.

**Clause 109: Non-qualifying distributions etc: additional information**

249. This clause enables an officer of Revenue and Customs to require the provision of certain information in relation to distributions that are not qualifying distributions. It is based on section 234(9) of ICTA, and paragraphs 2, 3 and 4 of Schedule 12 to FA 1989.

250. The clause refers to section 417 of ICTA, which will be rewritten in Bill 6.

251. Paragraphs 2, 3 and 4 of Schedule 12 to FA 1989 have been rewritten here rather than being the subject of a cross-reference. The opportunity has been taken to modernise the language and introduce the term “reasonably requires” in *subsection (2)*, which rewrites paragraph 2 of Schedule 12 to FA 1989. See *Change 608* in Annex 1.

**Q5. We would welcome comments on the proposal to introduce the term “reasonably requires” in the rewrite of paragraph 2 of Schedule 12 to FA 1989.**

**Clause 110: Company distributing dividend or interest: duty to provide tax certificates**

252. This clause requires a company to provide a tax certificate when it makes a distribution. It is based on section 234A(1), (2) and (3) of ICTA.

253. The references to the Companies Act 1985 and the Companies (Northern Ireland) Order 1986 will be replaced by a reference to section 1 of the Companies Act 2006 when that provision comes into force.

**Clause 111: Duties of nominees**

254. This clause places certain duties on nominees who receive distributions on behalf of others. It is based on section 234A(4) and (5) of ICTA.

**Clause 112: Meaning of “tax certificate” etc**

255. This clause sets out what is required in a “tax certificate” and provides certain other definitions. It is based on section 234A(7), (8) and (8A) of ICTA.

256. Section 234A(6) has been omitted as it appears to have no effect because interest that is treated as a distribution can only be a qualifying distribution. See *Change 670* in Annex 1.

**Q6. We would welcome comments on the proposal to omit section 234A(6) of ICTA.**

**Clause 113: Penalties**

257. This clause provides for penalties to be charged for failure to provide a tax certificate. It is based on section 234A(9) of ICTA.

**Clause 114: Power to modify or replace sections 108 and 109**

258. This clause enables the Commissioners for Her Majesty’s Revenue and Customs to lay regulations amending clauses 108 and 109. It is based on section 253 of ICTA.

**Clause 115: Alternative means of compliance with sections 110 and 111**

259. This clause enables the Commissioners for Her Majesty’s Revenue and Customs to lay regulations providing for alternative methods by which a person may comply with their obligations under clause 110 or clause 111. It is based on section 234A(10) and (11) of ICTA.

**Chapter 7: Interpretation of Part**

**Clause 116: Arrangements between companies**

260. This clause extends the meaning of distribution to encompass arrangements between two or more companies to make distributions to each other's members. It is based on section 254(8) of ICTA.

261. *Subsection (2)* refers to sections 231AA and 231AB of ICTA, which will be rewritten in Bill 6 - see draft clauses 22, 23 and 24 published with paper CC/SC (08) 20.

**Clause 117: "In respect of shares"**

262. This clause provides interpretation of the term "in respect of shares in the company" for the distributions Part. It is based on section 254(1), (2), (4) and (12) of ICTA.

**Clause 118: "In respect of securities"**

263. This clause provides interpretation of the term "in respect of securities in the company" for the distributions Part. It is based on section 254(1), (2), (4) and (12) of ICTA.

**Clause 119: "New consideration"**

264. This clause provides interpretation of the term "new consideration" for the distributions Part. It is based on section 254(1), (5), (6) and (7) of ICTA.

**Clause 120: References to married persons, or civil partners, living together**

265. This clause contains the definition of "living together". It is based on section 1011 of ITA.

**Clause 121: Other interpretation**

266. This clause provides further interpretation. It is based on sections 218(1) and 254(9), (10), (11) and (12) of ICTA.

**Part 2: General**

**Chapter 1: Tax Credits, Franked Investment Income and Qualifying Distributions**

**Clause 122: Overview of Chapter**

267. This clause sets out the matters covered by the Chapter. It is new.

**Clause 123 Tax credits for certain recipients of qualifying distributions**

268. This clause sets out the conditions necessary for a company to be entitled to a tax credit in relation to a distribution that it receives. It is based on section 231 of ICTA.

269. One of the conditions is that the distribution is a qualifying distribution. This term is defined in clause 127.

270. *Subsection (3)* provides signposts to provisions that qualify this clause. Sections 231AA and 231AB of ICTA will be rewritten in Bill 6 - see draft clauses 22, 23 and 24 published with paper CC/SC (08) 20.

271. The equivalent provision for income tax is in section 397 of ITTOIA.

**Clause 124: Recovery of overpaid tax credit etc**

272. This clause enables an officer of Revenue & Customs to make assessments to recover tax and/or interest where a tax credit has been overpaid or a set-off of tax credit is excessive. It is based on section 252(1) and (2) of ICTA.

273. Schedule 1 inserts the equivalent income tax provisions into ITTOIA.

**Clause 125: Section 124: supplementary**

274. This clause provides further provisions relating to the recovery provisions in clause 124. It is based on section 252(3) and (5) of ICTA.

**Clause 126 Meaning of “franked investment income”**

275. This clause sets out the definition and computation of “franked investment income”. It is based on section 832(1) of ICTA.

**Clause 127 Meaning of “qualifying distribution”**

276. This clause provides the definition of what is and is not a qualifying distribution. It is based on section 14 and section 832(1) of ICTA.

**Schedule 1: Minor and Consequential Amendments**

277. This Schedule inserts into ITTOIA income tax provisions for the recovery of overpaid tax credit or underpaid tax due to excessive set-off of tax credit (equivalent to clauses 124 and 125 for corporation tax).

278. It also inserts income tax provisions that relate to the stock dividend rules. See the commentary on clauses 53 to 55.

**Schedule 2: Transitionals and Savings**

279. This Schedule contains a number of provisions where the source legislation contained a cut-off date before which the provisions did not apply, or applied in a different way. Typically these involve shares or securities issued either before a specified date or after a specified date, depending on the particular rule in question.

**ANNEX 1.**

**Change 648: Company distributions: premium paid on redemption of share capital: clause 26**

This change narrows the scope of the stipulation in section 211(7) of ICTA that premiums paid on redemption of share capital are not treated as repayments of share capital.

In the source legislation section 211(7) of ICTA is not limited in its application and therefore potentially applies across the entirety of ICTA. However it appears to have no practical application beyond Chapter 2 of Part 6 of ICTA, which sets out what is to be treated as a distribution.

This change therefore makes it explicit that this particular stipulation applies only to the question of what is to be treated as a distribution.

*This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect.*

**Change 608: Information: distributions that are not qualifying distributions: “reasonably requires”: clause 109**

This change expressly restricts certain particulars that an officer of Revenue and Customs may require to be provided in respect of a distribution that is not a qualifying distribution to those particulars which the officer may reasonably require.

Section 234(7) and (8) of ICTA enables an inspector to require a company to provide such information as the inspector may “reasonably require” in connection with a distribution that is not a qualifying distribution. Section 234(9) of ICTA allows the inspector to exercise the powers available under paragraphs 2 to 4 of Schedule 12 to FA 1989 for these purposes.

Paragraph 2 of Schedule 12 to FA 1989 does not limit the particulars that an inspector may request to those that may be “reasonably required”.

The opportunity has been taken in clause 109 to modernise this language and expressly impose the criterion of reasonableness. This is consistent with the way in which HMRC exercise the power in practice.

***This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.***

**Change 670: Company Distributions: duty to provide a tax certificate – interest that is not a qualifying distribution. Clauses 110 and 112.**

This change clarifies that section 234A of ICTA applies to a payment of interest only where interest is treated as a distribution, in whole or in part, and not to all payments of interest made by a company.

The origins of section 234A of ICTA lie in section 33 of FA 1924. The provision was introduced specifically to deal with what were known as “tax free dividends”, that is dividends paid by a company to its shareholders where the income tax had already been settled. It was felt that the shareholder should be given more detailed information about the amounts involved and the tax deducted. The provision was largely unchanged through the Income Tax Act 1952 (section 199) and the Income and Corporation Taxes Act 1970 (section 242).

It was amended by paragraph 19 of Schedule 24 to FA 1972 when the imputation system was introduced and the distinction between a qualifying and non-qualifying distribution was introduced. The amendment, which was described as consequential, made separate provision for the two different categories of distribution, and amended the requirements in relation to a qualifying distribution to refer to the tax credit attaching to such a distribution.

This became section 234 of ICTA, with the critical provisions being in section 234(3) and (4). Section 34 of the Finance (No 2) Act 1992 introduced section 234A of ICTA to deal with payments made directly into a bank account – section 234(3) and (4) of ICTA were repealed and were restated in section 234A, along with further provisions to cover direct payment into an account held by the recipient or a nominee.

Section 234A of ICTA applies where “dividend or interest is distributed” by a company – section 234A(1) – and this wording has been unchanged from the introduction of the provision in 1924. This carries the clear implication that the section only applies to distributions and not to ordinary payments of interest made by a company. This is reinforced by the penalty provision in section 234A(9) of ICTA (which refers to “distribution”), and by the commencement provision for section 32 of the Finance (No 2) Act 1992, which introduced section 234A (the new provision was applied to “distributions begun after the day on which this Act is passed”).

However, section 234A(6) refers to “interest which is not a qualifying distribution or part of a qualifying distribution”. The definition of a qualifying distribution is in section 14 of ICTA, and that definition covers the vast majority of distributions, with the exception of certain types of bonus issue of shares or securities. It is very difficult to see how a payment of interest could therefore fit within the scope of a distribution that is not a qualifying distribution. Section 234A(6) of ICTA could therefore be read

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as applying to all payments of interest made by a company, including banks, and not just those that are treated as distributions.

However, if that were true it would overlap with section 975 of ITA 2007, which is the provision under which banks, building societies and other payers of interest deliver tax deduction certificates, and would impose a penalty for failure to comply, whereas none is stipulated in the tax statute in the case of section 975 of ITA.

The origins of section 975 of ITA 2007 lie in section 50 of FA 1963. The Royal Commission on the Taxation of Profits and Income (the Radcliffe Committee) reported in 1955 in the following terms:

“though the law requires that a company’s dividend warrants shall be accompanied by statements giving particulars of the tax deductions made,.....there is no statutory obligation on a person who deducts tax from any interest....to furnish a similar certificate” (Cmd 9474).

The Commission clearly reported on the basis that section 199 of the Income Tax Act 1952, the precursor of section 234A(6) of ICTA 1988, did not apply to all payments of interest and that a new provision would therefore be desirable.

Published guidance and commentaries do not comment explicitly, but the prevailing practice is that certificates for the deduction of income tax from interest payments are delivered under section 975 of ITA 2007.

This change deletes section 234A(6) of ICTA as it appears to have no effect if confined to distributions, and there is evidence from the history of the provision that it was not intended to apply to all payments of interest made by companies.

The change therefore removes any argument that section 234A of ICTA could apply to all payments of interest made by a company, including banks, and could therefore lead to a penalty for failure to comply, as opposed to section 975 of ITA 2007 which is enforceable by the recipient of the payment and where no penalty is set down in the tax legislation.

***This change has no effect on any liability to tax. It is favourable to some taxpayers in principle by removing a requirement on them, and adverse to those who might have received certificates but will not now do so. But it is expected to have no practical effect as it is in line with current practice.***