

**Schedule []: Sale and lease-back etc: new Part 12A of ITA 2007**

**Part 12A of ITA: Sale and lease-back etc**

*Overview*

1. This Part rewrites sections 779 to 785 of ICTA (sales and leasebacks) for the purposes of income tax.
2. Sections 779 and 781 to 785 of ICTA first appeared as sections 17 to 19 of, and Schedule 7 to, FA 1964. Section 780 of ICTA first appeared as section 80 of FA 1972. There have been numerous changes to the taxation of leasing since 1972, but sections 779 to 785 of ICTA are still capable of applying.
3. The four main operative sections of the source legislation – sections 779, 780, 781 and 782 of ICTA – have been rewritten in separate Chapters. Within each Chapter, the detailed provisions have been laid out in sections arranged in a rational order. The legislation is also being split between the corporation tax and income tax codes.
4. This Part has the following structure.
  - Chapter 1 (payments connected with transferred land) is based on section 779 of ICTA.
  - Chapter 2 (new lease after assignment or surrender) is based on section 780 of ICTA.
  - Chapter 3 (leased trading assets) is based on sections 782 and 785 of ICTA.
  - Chapter 4 (leased assets: capital sums) is based on sections 781, 782(1) and 783 to 785 of ICTA.
5. Chapters 1 and 2 apply to certain transactions in land. Chapters 3 and 4 apply to certain transactions in assets other than land.
6. If Chapter 1 or Chapter 3 applies, tax relief for lease rental (or similar) expenditure is deferred (and may in certain circumstances be denied).
7. If Chapter 2 or Chapter 4 applies, a capital sum is taxed as income.
8. This Part largely replicates Part [] of Bill 6, which makes similar provision for the purposes of corporation tax. See the draft commentary on that Part.
9. As far as possible, the income tax provisions and the corporation tax provisions are drafted in the same terms. The drafting differs in the following respects.

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- Part [] of Bill 6 refers to corporation tax; Part 12A of ITA refers to income tax.
  - Companies may in certain circumstances be liable to income tax, but persons other than companies are not liable to corporation tax. Accordingly, the corporation tax provisions use “company” to denote the person liable where the corresponding income tax provisions use “person”.
  - Part [] of Bill 6 refers to provisions which are specific to corporation tax; Part 12A of ITA refers to provisions which are specific to income tax.
  - Part [] of Bill 6 does not refer to companies carrying on professions or vocations; Part 12A of ITA refers to persons carrying on professions and vocations. See clause [9][j313] of Bill 6, with the draft commentary thereon, and section 681CA.
10. Consequential amendments, repeals and any savings and transitional provisions will be drafted in due course.
11. Since the changes to the law of income tax will be made by a different Bill from the changes to the law of corporation tax, they will be acknowledged in Annex 1 to the explanatory notes on a different Bill. Accordingly, separate Change Notes are presented for them in this draft commentary.

### **Chapter 1: Payments connected with transferred land**

#### ***Overview***

12. This Chapter is based on section 779 of ICTA. It counters certain avoidance devices based on arrangements for the sale and leaseback of land or on analogous arrangements, such as arrangements for sale of land with reservation of a rentcharge. It restricts tax relief for lease rental expenditure.

13. This Chapter corresponds to Chapter 1 of Part [] of Bill 6, which makes similar provision for the purposes of corporation tax. It has the following structure.

- Section 681A summarises the Chapter.
- Sections 681AA and 681AB say when the Chapter applies.
- Section 681AC restricts income tax relief and section 681AD carries forward relief which has been denied.
- Sections 681AE to 681AG make supplementary provision about payments under the lease or rentcharge etc.
- Sections 681AH to 681AM are interpretative.

**Section 681A: Overview**

14. This section summarises this Chapter. It is new.

**Section 681AA: Transferor or associate becomes liable for payment of rent**

15. This section sets out the conditions for the Chapter to apply in a case involving the payment of rent. It is based on section 779(1) and (3) of ICTA.

16. *Subsection (1)* is the main operative provision; it lists the conditions which must be met.

17. The words “rent” and “lease” appear for the first time in this Chapter in subsection (1)(c). They are defined in section 681AK.

18. Subsection (1)(d)(i) puts on a clear statutory footing the practice of spreading lease rental expenditure in accordance with generally accepted accounting practice (GAAP) before applying section 779 of ICTA. This is a minor change in the law, in favour of the taxpayer. See *Change 703* in Annex 1. The same change is made in section 681AB(1)(d)(i).

19. Section 681CB makes the same change in rewriting section 782 of ICTA.

**Q1. We welcome comments on the proposal to put on a clear statutory footing, in sections 681AA, 681AB and 681CB, the practice of applying GAAP before applying section 779 or, as the case may be, section 782 of ICTA (Change 703).**

20. *Subsection (2)* explains what is meant in subsection (1)(a) by “transferring” an estate or interest in land.

21. *Subsection (3)* explains what is meant in subsection (1)(b) by the “transferor”.

22. *Subsections (4) and (5)* explains what is meant in subsection (1)(b) by becoming “liable” to make a payment.

**Section 681AB: Transferor or associate becomes liable for payment other than rent**

23. This section sets out the conditions for the Chapter to apply in a case involving a payment other than rent. It is based on section 779(2) and (3) of ICTA. It is very similar in structure to section 681AA. See the draft commentary on that section.

24. If, in a given case, the reader is satisfied that at least one of the conditions in section 681AA is not met and at least one of the conditions in this section is not met, the reader can conclude that as this Chapter does not have effect there is no need to read any further in it.

25. *Subsection (1)(d)(i)* brings the law into line with practice. See the draft commentary on section 681AA and Change 703 in Annex 1.

**Section 681AC: Income tax deduction not to exceed commercial rent**

26. This section restricts income tax relief for payments falling within section 681AA or 681AB. It is based on section 779(1), (2) and (4) of ICTA.

27. For the purpose of comparing items in *subsections (1)* and *(3)*, “commercial rent” is defined in section 681AI.

28. For the purpose of comparing items in *subsections (2)* and *(3)*, “commercial rent” is defined in section 681AJ.

**Section 681AD: Carrying forward parts of payments**

29. This section permits amounts which have been disallowed under section 681AC to be carried forward to a later period (and thus, potentially, relieved). It is based on section 779(5) and (6) of ICTA.

30. *Subsections (1)* to *(3)* specify the conditions which must be met if this section is to apply.

31. The expression “a deduction by way of relevant income tax relief” appears for the first time in *subsection (2)*. It is defined in section 681AH.

32. *Subsection (4)* is the main operative provision.

33. *Subsection (5)* permits the section to be applied repeatedly.

**Section 681AE: Aggregation and apportionment of payments**

34. This section is concerned with the aggregation and apportionment of payments under the lease or rentcharge etc. It is based on section 779(6) of ICTA.

**Section 681AF: Exclusion of service charges etc**

35. This section is concerned with service charges and the like. It is based on section 779(6) and (12) of ICTA.

36. Leases commonly provide for the tenant to pay the landlord not only rent but also service charges and the like, and these may be paid in a single sum; the definitions of “commercial rent” in sections 681AI and 681AJ do not include service charges etc and so this section correspondingly excludes them from the amount with which the commercial rent is compared.

37. *Subsections (3)* and *(4)* prevent the taxpayer escaping this Chapter by agreeing to pay an excessive amount by way of service charge. They include a minor change in the law to bring it into line with Self Assessment. See Change 702 in Annex 1.

**Q2. We welcome comments on the proposal to bring section 779(6)(d) of ICTA into line with Self Assessment in section 681AF of ITA (Change 702).**

38. The source legislation uses the term “asset”, which is defined to exclude land and interests in land. It is thought that many readers are likely to find this counter-intuitive. *Subsection (2)(b)* therefore refers to “relevant assets”. The term “relevant asset” is defined in *subsection (5)*. Chapters 3 and 4 of this Part also use the term “relevant asset”, for the same reason. See sections 681CJ and 681DO.

**Section 681AG: Payments made for later periods**

39. This section prevents the taxpayer escaping this Chapter by labelling the bunched-up payments as payments *for* later periods. It is based on section 779(7) of ICTA.

**Sections 681AH: Relevant income tax relief**

40. This section lists, for the purposes of this Chapter, the deductions by way of “relevant income tax relief”. It is based on section 779(13) of ICTA.

41. Schedule A is currently being rewritten in Bill 5. The square brackets in *paragraph (a)* flag the need to monitor the meaning of “UK property business”.

**Section 681AI: Commercial rent: comparison with rent under a lease**

42. This section defines “commercial rent” for the purpose of comparison with rent under a lease. It is based on section 779(8) of ICTA.

43. Commercial rent is the rent payable under a hypothetical lease. Under *subsection (2)(d)*, the hypothetical lease provides for rent to be payable “at an appropriate rate”. This expression is defined in *subsection (3)*.

**Section 681AJ: Commercial rent: comparison with payments other than rent**

44. This section defines “commercial rent” for the purpose of comparison with payments other than rent. It is based on section 779(9) and (12) of ICTA.

45. Commercial rent is the rent payable under a hypothetical lease. Under *subsection (2)(b)*, the hypothetical lease is “a tenant’s repairing lease”. This expression is defined in *subsection (3)*.

46. Under *subsection (2)(c)*, the hypothetical lease is “of an appropriate duration”. The rules for determining whether a lease is of an appropriate duration are laid down in *subsection (4)*.

**Section 681AK: Lease and rent**

47. This section defines “lease” and “rent” for the purposes of this Chapter. It is based on section 779(10) and (12) of ICTA.

**Section 681AL: Associated persons**

48. This section defines “associated persons” for the purposes of this Chapter. It is based on section 779(11) of ICTA.

**Section 681AM: Land outside the UK**

49. This section explains how expressions in this Chapter relating to interests in land in the United Kingdom and their disposition are to be interpreted in cases involving land outside the United Kingdom. It is based on section 779(12) of ICTA.

**Chapter 2: New lease after assignment or surrender**

**Overview**

50. This Chapter is based on section 780 of ICTA. It deals with the situation where the existing occupier of premises incurs additional rental liability in return for the payment of a lump sum.

51. In form, the lump sum is the consideration received for assigning the lease, usually to a charity or a pension fund, and the leaseback is at an increased rent.

52. In substance, however, the lump sum is a loan and the additional rent represents the repayment of principal and interest.

53. Where the Chapter applies, a proportion of the lump sum is to be treated as income of the recipient.

54. The Chapter corresponds to Chapter 2 of Part [] of Bill 6, which makes similar provision for the purposes of corporation tax. It has the following structure.

- Section 681B summarises the Chapter.
- Section 681BA states when the Chapter applies.
- Sections 681BB and 681BC tax some or all of the consideration as income.
- Section 681BD concerns relief for rent under the new lease.
- Sections 681BE to 681BI deal with cases in which the new lease is deemed to end.
- Section 681BJ deals with a case in which a lease is varied to provide for increased rent.
- Sections 681BK to 681BM are interpretative.

**Section 681B: Overview**

55. This section summarises this Chapter. It is new.

56. The word “lease” appears in *subsection (1)* for the first time in this Chapter. On the meaning of “lease” in this Chapter, see section 681BM.

**Section 681BA: New lease after assignment or surrender**

57. This section states when this Chapter applies. It is based on section 780(1), (7) and (8) of ICTA.

58. *Subsection (1)* provides that four conditions must be met if the Chapter is to apply. If, in a given case, the reader is satisfied that at least one of these conditions is not met, the reader need read no further in this Chapter.

59. *Subsection (2)* specifies condition A, concerning the original lease.

60. The word “lessee” appears in subsection (2)(a) for the first time in this Chapter. On the meaning of “lessee” in this Chapter, see section 681BM.

61. The expression “a deduction by way of relevant income tax relief” appears in subsection (2)(b) for the first time in this Chapter. It is defined in section 681BK.

62. *Subsection (3)* specifies condition B, concerning the assignment or surrender of the original lease. Section 1008 of ITA provides that in Scotland “assignment” means assignation, and thus gives effect to the application of section 24(5) of ICTA by section 780(8) of that Act. Section 1008 of ITA also provides that in Scotland “surrender” includes renunciation.

63. *Subsection (4)* specifies condition C, concerning the new lease.

64. *Subsection (5)* specifies condition D, concerning the relationship between the new lease and the original lease.

65. *Subsection (6)* warns the reader that “lessee” in subsection (4)(a) has a wider scope than “lessee” in subsections (2) and (3). A similar warning is given in each of the other sections of this Chapter which uses “lessee” in the extended sense given by section 681BL.

**Section 681BB: Taxation of consideration**

66. This section taxes, as if it were income, some or all of the consideration received by the lessee. It is based on section 780(1), (3) to (3C), (7) and (8) of ICTA.

67. *Subsection (1)* requires an “appropriate amount” of the consideration to be found.

68. Subsection (1)(a) refers to the assignment of the original lease. Section 1008 of ITA provides that in Scotland “assignment” means assignation, and thus gives effect to the application of section 24(5) of ICTA by section 780(8) of that Act. Section 1008 of ITA also provides that in Scotland “surrender” includes renunciation.

69. *Subsection (2)* provides that the appropriate amount is not to be treated as a capital receipt.

70. *Subsection (3)* defines the appropriate amount if the term of the new lease is not more than one year. *Subsection (4)* defines the appropriate amount if the term of the new lease is more than one year.

71. In a case in which the term of the new lease (a) exceeds one year and (b) is not for a whole number of years, the formula in section 780(3) of ICTA does not expressly say how to deal with parts of years. *Subsection (5)* makes it clear that, in such a case, a part of a year is to be taken as an appropriate proportion of a year.

72. *Subsection (6)* provides that the way in which the appropriate amount is treated depends on whether certain specified conditions are met.

73. If these conditions are met, *subsection (7)* treats the appropriate amount as a receipt of a trade, profession or vocation.

74. If the conditions in *subsection (6)* are not met, *subsection (8)* treats the appropriate amount as chargeable to income tax.

75. *Subsection (9)* quantifies the amount charged, specifies the person liable and treats the amount charged as income.

**Section 681BC: Position where new lease does not include all original property**

76. This section deals with the position where the new lease does not include all the original property. It is based on section 780(4) of ICTA.

**Section 681BD: Relief for rent under new lease**

77. This section makes it clear that the normal rules for tax relief apply to rent under the new lease. It is based on section 780(1) of ICTA.

78. The source provision for *subsection (3)* refers to “the provisions of this Act [ie ICTA] providing for deductions or allowances by way of tax relief in respect of payments of rent”. ITTOIA rewrote the provisions of ICTA about Schedule A for income tax purposes. In rewriting Schedule A for corporation tax purposes, Bill 5 will consequentially amend ICTA. The square brackets in *subsection (3)* flag the need to check whether ICTA, as amended, will still include any residual provisions about tax relief for rent. No particular comments are sought at this stage on the words in square brackets in *subsection (3)*.

**Section 681BE: New lease treated as ending**

79. This section introduces three sections which treat the new lease as ending in certain circumstances. It is based on section 780(2) of ICTA.

80. *Subsection (2)* is a tie-breaker rule. Section 780(2) of ICTA indicates that if section 780(2)(a) and (2)(b) could both apply then only one of them applies, namely the one that produces the earlier date. However, section 780(2)(b) might on its own produce different dates, and it seems to take section 780(2)(b)(i) and (ii) separately (see “as the case may be”) without expressly providing which prevails. But it would be anomalous if section 780(2) included a tie-breaker rule for some but not all of the possible cases, or if it had different tie-breaker rules for different cases. *Subsection (2)* therefore makes it clear that the earliest date prevails in all cases.

**Section 681BF: Position where rent reduces**

81. This section deals with the position where the rent is reduced. It is based on section 780(2) and (8) of ICTA.

82. *Subsection (1)* uses the expressions “rent for a relevant period” and “following comparable period”. *Subsection (2)(a), (b) and (c)* define “relevant period”, “following comparable period” and “rent for a period” respectively.

83. *Subsection (2)(a)* uses the expressions “rental period” and “fifteenth anniversary [of the new lease]”. These expressions are defined in *subsection (2)(d)* and *(e)* respectively.

84. *Subsection (3)* supplements the definition of “rental period” in *subsection (2)(d)*.

**Section 681BG: Position where lease may be ended**

85. This section deals with the position where the lease makes provision for early termination. It is based on section 780(2) and (7) of ICTA.

**Section 681BH: Position where lease may be varied**

86. This section deals with the position where the lessee has the power to vary the terms of the lease in the lessee’s favour. It is based on section 780(2) and (7) of ICTA.

**Section 681BI: Lease treated as ending: rentcharge**

87. This section supplements the previous three; it deals with rentcharges. It is based on section 780(2) and (7) of ICTA.

**Section 681BJ: Lease varied to provide for increased rent**

88. This section deals with a case in which a lease is varied to provide for increased rent. It is based on section 780(6) of ICTA.

89. *Subsection (1)* provides that four conditions must all be met if this section is to apply.

90. *Subsection (2)* specifies condition A, concerning the original lease.

91. *Subsection (3)* specifies condition B, concerning the variation of the lease.

92. *Subsection (4)* specifies condition C, concerning the increase in the rent.
93. *Subsection (5)* specifies condition D, concerning the period within which the increased rent is to be paid.
94. *Subsection (6)* is the main operative provision. Condition A in subsection (2) is the same as condition A in section 681BA. In consequence of subsection (6)(a), condition B in that section is met. In consequence of subsection (6)(b), conditions C and D in that section are met. Accordingly, if conditions A to D in this section are met, conditions A to D in that section are met and this Chapter therefore has effect.

**Section 681BK: Relevant income tax relief**

95. This section defines deductions by way of relevant income tax relief. It is based on sections 779(13) and 780(1) of ICTA.
96. Schedule A is currently being rewritten in Bill 5. The square brackets in *paragraph (a)* flag the need to monitor the meaning of “UK property business”.

**Section 681BL: Lessee includes partners and associates**

97. This section extends the meaning of “lessee” in certain specified contexts in this Chapter. It is based on section 780(7) of ICTA.

**Section 681BM: Lease, lessee, lessor and rent**

98. This section concerns the meaning of “lease”, “lessee”, “lessor” and “rent”. It is based on sections 24(1) and (6) and 780(8) of ICTA.
99. *Subsection (3)* says that “lease” does not include a mortgage. This is based on section 24(1) of ICTA as applied by section 780(8) of ICTA. In fact, section 24(1) of ICTA says that a lease includes neither a mortgage nor a heritable security. A “heritable security” is the Scottish equivalent of a mortgage, although post-1970 heritable securities take the form of a standard security. *Subsection (7)*, which is new, states that in the application of the section to Scotland, “mortgage” includes the Scottish equivalents. Accordingly, subsection (3) has to be read as if it said that a lease includes neither a mortgage nor the Scottish equivalents. Subsection (3) therefore achieves the same effect as the source legislation. This is considered to be the case even though subsection (7) is a definition of the Scottish equivalents that contains more detail than the words “mortgage or heritable security” in section 24(1) of ICTA. The approach is the same as that already taken for income tax purposes when the definition of “lease” in section 24(1) of ICTA was rewritten to sections 364(1) and 879(1) of ITTOIA.

**Chapter 3: Leased trading assets**

***Overview***

100. This Chapter is based on sections 782 and 785 of ICTA.

101. This Chapter applies where a person carrying on a trade, profession or vocation pays rent under a lease of an asset other than land or buildings and at any time before the lease was created the asset was used either (a) in that trade, profession or vocation or (b) in another trade, profession or vocation carried on by the person who then or later was carrying on the first trade, profession or vocation and, in either case, when so used was owned by the person carrying on the trade, profession or vocation in which it was used.

102. If this Chapter applies, it provides that in computing the profits and gains of the trade, profession or vocation the deduction in respect of a payment under the lease shall not exceed the commercial rent of the asset for the period for which the payment was made.

103. This Chapter corresponds to Chapter 3 of Part [] of Bill 6, which makes similar provision for the purposes of corporation tax. It has the following structure.

- Section 681C summarises the Chapter.
- Sections 681CA to 681CC state when the Chapter applies.
- Section 681CD restricts income tax relief and section 681CE carries forward relief which has been denied.
- Sections 681CF and 681CG make supplementary provision about payments under the lease.
- Sections 681CH to 681CJ are interpretative.

**Section 681C: Overview**

104. This section summarises this Chapter. It is new.

105. The word “lease” appears in this clause for the first time in this Chapter. It is defined in section 681CI.

**Section 681CA: Professions and vocations**

106. This section applies the Chapter not only to trades but also to professions and vocations. It is based on section 782(10) of ICTA. There is no corresponding provision in Chapter 3 of Part [] of Bill 6, which omits all references to companies carrying on professions or vocations. See the draft commentary on clause [9][j313] of Bill 6 and Change 634 in Annex 1 to the draft commentary on that Bill.

**Section 681CB: Leased trading assets**

107. This section states when this Chapter applies. It is based on section 782(1) of ICTA.

108. *Subsection (1)* introduces the three conditions relating to the application of this Chapter and explains their logical relationship.

109. *Subsection (2)* specifies condition A, concerning the payment.

110. In particular, under subsection (2)(a) the payment must be made under the lease of a “relevant asset”. The expression “relevant asset” appears in subsection (2)(a) for the first time in this Chapter. It is defined in section 681CJ.

111. *Subsection (2)(c)* brings the law into line with practice. See the draft commentary on section 681AA and Change 703 in Annex 1.

112. *Subsections (3) and (4)* specify conditions B and C. These are two alternative conditions concerning the use to which the leased asset was put before it was leased.

**Section 681CC: Long funding finance leases**

113. This section makes an exception for long funding finance leases. It is based on section 782(1A) of ICTA.

**Section 681CD: Tax deduction not to exceed commercial rent**

114. This section restricts income tax relief. It is based on section 782(2) of ICTA.

**Section 681CE: Carrying forward parts of payments**

115. This section carries forward relief which has been denied. It is based on section 782(3) and (4) of ICTA.

116. *Subsection (1)* provides that two conditions must be met if relief is to be carried forward.

117. *Subsection (2)* specifies condition A, concerning restriction of relief under section 681CD.

118. *Subsection (3)* specifies condition B, that the payment for which relief has been restricted is not the last payment made by the person under the lease.

119. If conditions A and B are met, *subsection (4)* prescribes how the relief is carried forward.

120. *Subsection (5)* permits the section to be applied repeatedly.

**Section 681CF: Aggregation and apportionment of payments**

121. This section deals with the aggregation and apportionment of payments. It is based on section 782(4) of ICTA. As far as possible, it is drafted in the same terms as section 681AE.

**Section 681CG: Payments made for later periods**

122. This section prevents the taxpayer escaping this Chapter by labelling bunched-up payments as payments *for* later periods. It is based on section 782(5) of ICTA. It is drafted in the same terms as section 681AG.

**Section 681CH: Commercial rent**

123. This section defines “commercial rent” for the purpose of making comparisons under section 681CD. It is based on the definition of “commercial rent” in section 782(6) of ICTA.

**Section 681CI: Lease**

124. This section defines “lease” for the purposes of this Chapter. It is based on the definition of “lease” in section 785 of ICTA.

**Section 681CJ: Relevant asset**

125. This section defines “relevant asset” for the purpose of this Chapter. It is based on the definition of “asset” in section 785 of ICTA.

126. The source legislation uses the term “asset”, which is defined to exclude land and interests in land. It is thought that many readers are likely to find this counter-intuitive. This section therefore uses the new term “relevant asset”.

**Chapter 4: Leased assets: capital sums**

*Overview*

127. This Chapter is based on sections 781, 783 and 784 of ICTA.

128. It deals with cases such as that of a taxpayer who, having had tax relief in respect of a payment under a lease of an asset other than land or buildings, receives or has received at any time a capital sum in respect of the lessee’s interest in the lease.

129. If the Chapter applies, income tax is charged on (broadly speaking) the amount on which relief has been obtained or, if less, on the capital sum.

130. This Chapter corresponds to Chapter 4 of Part [] of Bill 6, which makes similar provision for the purposes of income tax. It has the following structure.

- Section 681D summarises the Chapter.
- Sections 681DA to 681DC state when the Chapter applies.
- Sections 681DD to 681DF concern the charge to income tax.
- Sections 681DG to 681DI deal with obtaining the capital sum.
- Sections 681DJ and 681DK are about apportionment.

- Sections 681DL to 681DQ are interpretative.

**Section 681D: Overview**

131. This section summarises this Chapter. It is new.

132. The expressions “capital sum” and “lease” appear in this section for the first time in this Chapter. They are defined in sections 681DM and 681DN respectively.

**Section 681DA: Application of the Chapter**

133. This section introduces the five conditions relating to the application of this Chapter and explains their logical relationship. It is based on section 781(1) of ICTA.

**Section 681DB: Payment under lease**

134. This section specifies a necessary condition for the Chapter to apply, namely that a tax-deductible payment is made under a lease of a relevant asset. It is based on sections 781(1) and 782(1) of ICTA.

135. The expressions “relevant asset” and “relevant tax relief” appear in *subsection (1)(a)* and *(b)* respectively for the first time in this Chapter. They are defined in sections 681DO and 681DP respectively.

136. The person entitled to a deduction by way of tax relief under section 781(1)(a) of ICTA is not necessarily the person obtaining the capital sum and charged to tax under that subsection. It follows that, if the person obtaining the capital sum is charged to income tax, the person entitled to a deduction by way of tax relief is not necessarily an income tax payer. Subsection (1)(b) of this section therefore refers to “relevant tax relief”, rather than “relevant income tax relief”.

137. *Subsection (2)* stipulates that if Chapter 3 of this Part applies to the payment then condition A is not met (and, therefore, this Chapter does not apply to the payment). For that reason, Chapter 3 appears in this Part before this Chapter, reversing the order of the source legislation.

138. *Subsection (3)* similarly stipulates that if Chapter 3 of Part [] of Bill 6 applies to the payment then condition A is not met (and, therefore, this Chapter does not apply to the payment). Subsection (3) is unlikely to apply in practice, but omitting it would change the law to the taxpayer’s disadvantage.

**Section 681DC: Sum obtained**

139. This section specifies four alternative additional conditions for the Chapter to apply. It is based on sections 781(1) and (9) and 783(3) of ICTA.

140. All four of the conditions concern the obtaining of a capital sum by a person of the description specified in the condition. In particular, the person obtaining the capital sum need not be the person making the tax-deductible payment.

141. In conditions B and C in *subsections (1) and (2)*, the capital sum is obtained in respect of the lessee's interest in the lease. In condition B, the capital sum is obtained by the person making the payment. In condition C, the capital sum is obtained by an associate of that person.

142. Subsection (1)(a) is the first provision in this Chapter which refers to obtaining a sum in respect of an interest in a lease and, specifically, to obtaining a sum in respect of the lessee's interest in a lease. The former expression is defined in section 681DG. The latter expression is defined in section 681DH.

143. The word "associate" appears in subsection (2) for the first time in this Chapter. It is defined in section 681DL.

144. In conditions D and E in *subsections (3) and (4)*, the capital sum is obtained in respect of the lessor's interest in the lease, or of any other interest in the asset. In condition D, the capital sum is obtained by an associate of the person making the payment. In condition E, the interest belongs to an associate of that person and the capital sum is obtained by an associate of that associate.

145. *Subsection (5)* makes it clear that, for the purposes of this section, it is irrelevant when the payment is made.

146. *Subsections (6) and (7)* relate to hire-purchase agreements for plant and machinery. Subsection (6) makes an exception to conditions B and C. Subsection (7) makes an exception to conditions D and E.

**Section 681DD: Charge to income tax**

147. This section imposes the charge to income tax on the person obtaining the capital sum. It is based on section 781(1) to (2) and (6) of ICTA.

148. Under *subsection (1)* there is a charge to income tax for the tax year in which the sum is obtained.

149. *Subsection (2)* measures the income thus charged.

150. *Subsection (3)* introduces four subsections limiting the effect of subsections (1) and (2).

151. *Subsection (4)* caps the amount charged.

152. To prevent double taxation, *subsections (5) and (6)* ensure that once a payment (or part of a payment) has been taken into account in making a charge under this Chapter it cannot be taken into account in making a further charge in respect of another sum.

153. *Subsection (7)* is a timing rule supplementing subsections (5) and (6).

**Section 681DE: Hire-purchase agreements**

154. This section concerns hire-purchase agreements. It is based on section 784 of ICTA.

155. This section may be in point if section 681DC(6) and (7) (sum obtained: exceptions for hire-purchase agreements) do not prevent this Chapter from applying. If this Chapter applies, *subsection (1)* states the conditions for this section to apply.

156. *Subsection (2)* requires the total to be found of:

- non-tax-deductible payments under the lease; and
- if the lessee's interest in the lease was assigned to the person before it obtained the capital sum in respect of that interest, any capital payment made by the person as consideration for the assignment.

157. Under section 1008 of ITA, the references to assignment in section 681DE(2) will be read in relation to Scotland as references to assignation, thus making explicit what is merely implicit in section 784(2)(b).

158. The total found in subsection (2) is then compared with the capital sum. If it is equal to or greater than the capital sum, then under *subsection (3)* the capital sum is treated for the purposes of section 681DD(4) as £nil. If the total found under subsection (2) is less than the capital sum, then under *subsection (4)* it is deducted from the capital sum in applying section 681DD(4).

159. *Subsection (5)* covers the special case in which the capital sum is the consideration for part only of the lessee's interest in the lease.

160. Section 784(4) of ICTA provides that:

"the amount to be deducted ... shall be such proportion of the capital expenditure which is still unallowed *as is reasonable*" (emphasis added).

161. Rewriting this, subsection (5)(a) requires the unallowed amount to be reduced to a proportion which is not only reasonable but also just. This is a minor change in the law: see *Change 704* in Annex 1.

**Q3. We welcome comments on the proposal to require the unallowed amount in section 681DE(5)(a) to be reduced to a proportion which is not only reasonable but also just (Change 704).**

162. To prevent double relief, *subsections (6) and (7)* ensure that if a payment has been taken into account under subsection (2) in respect of a capital sum it cannot be taken into account in respect of another capital sum.

163. *Subsection (8)* is a timing rule supplementing subsections (6) and (7).

**Section 681DF: Adjustments where sum obtained before payment made**

164. This section provides for adjustments to be made if a capital sum is obtained as mentioned in section 681DC and later a payment is made as mentioned in section 681DB. It is based on section 781(7) to (8A) of ICTA.

**Section 681DG: Sum obtained in respect of interest**

165. This section is concerned with the meaning, in this Chapter, of “a sum obtained in respect of an interest in a lease of an asset”. It is based on section 783(1) and (2) of ICTA.

**Section 681DH: Sum obtained in respect of lessee’s interest**

166. This section is concerned with the meaning, in this Chapter, of “a sum obtained in respect of the lessee’s interest in a lease of an asset”. It is based on section 783(1) and (2) of ICTA.

**Section 681DI: Disposal of interest to associate**

167. This section determines the amount which a company is deemed to obtain if it disposes of an interest in an asset to a person who is the company’s associate. It is based on sections 781(1) and 783(4) and (5) of ICTA.

**Section 681DJ: Apportionment of payments made and of sums obtained**

168. This section provides for apportionments to be made of payments made and sums obtained. It is based on section 783(6) to (8) of ICTA.

169. *Subsection (3)* requires apportionments to be not only just but also reasonable. This is a minor change in the law. See *Change 704* in Annex 1.

**Q4. We welcome comments on the proposal to require apportionments under section 681DJ to be not only just but also reasonable (Change 704).**

170. Although section 783(6) and (8) of ICTA refer to vocations carried on in partnership (as well as to trades and professions carried on in partnership), it is considered that vocations cannot be carried on in partnership: see, for example, the explanatory notes on section 847 of ITTOIA. Accordingly, *subsections (2), (4) and (5)* do not refer to vocations.

**Section 681DK: Manner of apportionment**

171. This section provides for apportionments to be made by the tribunal in certain circumstances. It is based on section 783(9) of ICTA.

172. This section anticipates the amendments to section 783(9) of ICTA which are to be made by the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2008. This Order has been published in draft for consultation and is currently

available at <http://www.hmrc.gov.uk/finance-bill2008/draft-tribunals-inquiries.pdf>. It is envisaged that this Order will come into force in 2009. The square brackets in *subsection (2)* flag the need to monitor the progress of this Order.

**Section 681DL: Associates**

173. This section defines “associates” for the purposes of this Chapter. It is based on section 783(10) and (11) of ICTA.

**Section 681DM: Capital sum**

174. This section defines “capital sum” for the purposes of this Chapter. It is based on the definition of “capital sum” in section 785 of ICTA.

**Section 681DN: Lease**

175. This section defines “lease” for the purposes of this Chapter. It is based on the definition of “lease” in section 785 of ICTA.

**Section 681DO: Relevant asset**

176. This section defines “relevant asset” for the purposes of this Chapter. It is based on the definition of “asset” in section 785 of ICTA.

177. The source legislation uses the term “asset”, which is defined to exclude land and interests in land. It is thought that many readers are likely to find this counter-intuitive. This section therefore uses the new term “relevant asset”.

**Section 681DP: Relevant tax relief**

178. This section defines “relevant tax relief” for the purposes of this Chapter. It is based on section 781(4) of ICTA.

179. *Paragraph (a)* omits references to a profession and to a vocation where the source legislation refers to the carrying on by a company of a trade, profession or vocation. This is a minor change in the law. See *Change 734* in Annex 1.

**Q5. Change 734 in section 681DQ reproduces Change 2[jc310] in Bill 5 and so brings this provision back into line with the provisions being rewritten in Bill 5. We welcome comments on the proposal to carry Change 2[jc310] in Bill 5 through into Bill 7.**

180. *Paragraph (b)* refers to section 834A of ICTA, which is being inserted by Bill 5, and clause [j4551rm] of Bill 6, which is based on section 396 of ICTA. See section 31[j4551rm] in CC/SC (07) 38 (loss relief).

181. *Paragraph (d)* refers to section [j2000] of Bill 5, which is based on section 75 of ICTA. See section 1143[j2000] of the draft Bill published for consultation in February 2008.

**Section 681DQ: Meaning of “hire-purchase agreement”**

182. This section defines “hire-purchase agreement”. It is based on section 784(6) of ICTA. This section, although needed for interpreting the Chapter, has been generalised with a view to being inserted among the general interpretative sections in Part 20 of ITA.

**Possible repeals**

183. Sections 782(7) and (9) of ICTA are not rewritten in the draft sections. We are considering whether this Bill needs to rewrite either or both of these subsections. To the extent that it does, the draft sections will be amended. To the extent that it does not, the draft commentary will explain why not.

**Repeals**

184. Repeals arising from the rewrite of sections 779 to 785 of ICTA will be drafted in due course. Meanwhile, the opportunity is being taken to note here a number of provisions which will be repealed without replacement.

***Sections 779(13)(f), 781(4)(e), 781(5)(a) and 785 of ICTA: references to “woodlands”***

185. Following the repeal of Schedule B in 1988, the references to woodlands in sections 779(13)(f), 781(4)(e), 781(5)(a) and 785 of ICTA are obsolete.

***Section 781(5) of ICTA***

186. Following the introduction of Income Tax Self Assessment, section 781(5) of ICTA is spent. It catered for cases in which, under the superseded rules about a trade ceasing, there could be periods whose profits were not brought into account in assessing the amounts on which income tax was charged.

**Annex 1**

**Change 703: sales and leasebacks: restriction of excessive lease rentals: relationship with accounting practice: Schedule [] (sections 681AA, 681AB and 681CB of ITA)**

This change puts on a statutory basis HMRC’s published practice on the interaction between section 779 of ICTA (sale and lease-back: limitation on tax reliefs) and the accounting treatment for finance lease rentals.

The Inland Revenue set out in Statement of Practice 3/91 (SP 3/91) its view on the timing of deductions for rentals payable by lessees under finance leases. Generally speaking, the effect of SP 3/91 is that tax relief is given for finance lease rentals in the period in which they are charged in calculating the lessee’s accounting profit or loss. The Inland Revenue published an article supplementing SP 3/91 in the *Tax Bulletin*, February 1995 (TB15). The material in SP3/91 and TB15 is substantially reproduced in paragraphs 61105 to 61185 of HMRC’s Business Income Manual (BIM 61105 to 61185).

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Generally speaking, the effect of SP 3/91 is that tax relief is given for finance lease rentals in the period in which they are charged in calculating the lessee's accounting profit or loss. If a lessee makes a payment under a lease, and the economic benefit of the payment extends over several periods of account, then (broadly speaking) the accounting treatment will be to charge the payment as expenditure in the periods of account to which the payment in economic substance relates. Thus under SP 3/91 tax relief is not necessarily given in the period in which the finance lease rental payment is made; tax relief may be deferred to later periods.

Section 779 of ICTA is an anti-avoidance provision restricting tax relief for excessive rentals paid under sales and leasebacks of land. If it applies to a payment, tax relief for that payment is deferred (and may in certain circumstances be denied altogether). Section 782 of that Act (leased assets: special cases) is a similar provision applying to transactions involving assets other than land. Sections 779 and 782 of that Act apply for the purposes of both income tax and corporation tax.

HMRC's practice, as published in TB15 and BIM 61105, is to apply SP 3/91 before making any adjustments under section 779 of ICTA (see BIM 61105). Depending on the facts, this may mean that there is no need for any adjustments to be made under section 779 of ICTA.

FA 1998 introduced specific legislation which (broadly speaking) is to the same effect as SP 3/91, but goes further. Section 42 of FA 1998 has been rewritten for the purposes of income tax and corporation tax in, respectively, section 25 of ITTOIA 2005 and section [47][j030301] of [the Corporation Tax Act 2009] (use of generally accepted accounting practice in calculating trade profits). Section 272 of ITTOIA 2005 and section [203][j050202] of [the Corporation Tax Act 2009] apply, respectively, section 25 of ITTOIA 2005 and section [47][j030301] of [the Corporation Tax Act 2009] in calculating profits of a property business.

Under section 25 of ITTOIA and section [47][j030301] of [the Corporation Tax Act 2009], trade profits are calculated in accordance with generally accepted accounting practice (GAAP), subject to adjustments required or authorised by law. These provisions operate by reference to receipts and expenses to be brought into account, not by reference to payments made. But sections 779 and 782 of ICTA do not acknowledge GAAP. And they assume that tax relief is given for payments made rather than expenses brought into account. So there is a conflict. Schedule [], inserting new sections 681AB, 681B and 681CB of ITA, resolves this conflict in this way.

- It acknowledges that a calculation for tax purposes is made in accordance with GAAP.
- It provides that if –
  - (a) an expense is to be brought into account in accordance with GAAP, and

- (b) the expense is constituted by a payment for which a deduction is allowed,

the deduction is reduced as required by the law currently contained in section 779 or 782 of ICTA.

*This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.*

**Change 702: sales and leasebacks: exclusion of service charges etc to be on just and reasonable basis: Schedule [] (section 681AF of ITA)**

This change requires that, in calculating the amount of a payment for which income tax relief is restricted under section 779 of ICTA, a just and reasonable amount must be excluded from the rent or other payment in respect of services or the use of relevant assets or rates usually borne by the tenant.

Section 779 of ICTA is an anti-avoidance provision which restricts tax relief for excessive payments of rent (and similar charges) in respect of land. Section 779(6)(d) provides that:

- in calculating the amount subject to restriction it is necessary to exclude so much of any payment as is in respect of services or the use of assets or rates usually borne by the tenant; and
- in determining the amount to be so excluded provisions in any lease or agreement fixing the payments or parts of payments which are in respect of services or the use of services may be overridden.

But section 779 of ICTA does not indicate either what considerations would justify such an override or what criterion should be used instead. In 1964, when this anti-avoidance provision was first introduced, it was natural to envisage that the decision to override the lease or agreement would be taken by the Inland Revenue. But that does not sit easily with Self Assessment.

Section 681AF of ITA, inserted by Schedule [], therefore replaces the overriding provision of section 779(6)(d) of ICTA with a requirement to exclude so much of the payment as is just and reasonable.

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

**Change 704: Requiring an apportionment, or a reduction, to be just and reasonable: Schedule [](sections 681DE and 681DJ of ITA)**

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

In some cases where there is an apportionment under legislation rewritten in this Act, the apportionment is required by the source legislation to be made on a just and reasonable basis. In other cases, it is required to be made only on a just basis or only on a reasonable basis, or there are no requirements. In new tax legislation it is now the practice to require an apportionment to be just and reasonable. For example, before it was replaced by ITEPA, section 140B(4) of ICTA (inserted by FA 1998) required a just and reasonable apportionment to be made of any consideration given partly in respect of one thing and partly in respect of another. There is no reason why an apportionment should not be on a just and reasonable basis. And it is desirable that all apportionments should be made on the same basis.

Similarly, section 784(4) of ICTA provides that “the amount to be deducted ... shall be such proportion of the capital expenditure which is still unallowed as is reasonable” (rather than such proportion as is just and reasonable).

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

- Section 783(8) of ICTA (leased assets: capital sums) requires apportionments to be just. As rewritten in new section 681DJ of ITA (inserted by Schedule []), it requires apportionments to be not only just but also reasonable.

[Other instances, not reproduced here.]

Similarly, new section 681DE(5)(a) of ITA (inserted by Schedule []), which is based on section 784(4) of ICTA, requires the unallowed amount to be reduced to a proportion which is not only reasonable but also just.

The same change was made in ITTOIA to provide a uniform expression of the basis on which apportionments are to be made.

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

**Change 734: Trading income: omission of references to a company carrying on a profession or a vocation: Schedule [](section 681DQ of ITA)**

This change omits references to a profession and to a vocation where the source legislation refers to the carrying on by a company of a trade, profession or vocation.

The change is reflected in numerous sections in Part 3 of [Bill 5] (trading income). It is included in the origins of the main provisions affected, where it is acknowledged as Change 2[jc310]. It is carried through into new section 681DQ of ITA (inserted by Schedule []).

### **The meaning of “company”**

“Company” in the Tax Acts means “any body corporate or unincorporated association but does not include a partnership, a local authority or a local authority association” (section 832(1) of ICTA). This note accordingly looks at corporate bodies and then at unincorporated associations.

The definition in section 832(1) of ICTA is subject to:

- some qualifications that deal with particular topics; and
- a general proviso that the definition “does not apply where the context otherwise requires because some other definition of “company” applies”.

Both the qualifications and the general proviso are in section 832(2) of ICTA. They do not affect the discussion in this note.

### **Corporate bodies and professions**

“Profession” is not defined for tax purposes. As long ago as 1919 Scrutton L J said:

it seems to me as at present advised that a “profession” in the present use of language involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production, or sale, or arrangements for the production or sale of commodities. The line of demarcation may vary from time to time. The word “profession” used to be confined to the three learned professions - the Church, Medicine and Law. It has now, I think, a wider meaning. It appears to me clear that a journalist whose contributions have any literary form, as distinguished from a reporter, exercises a “profession”; and that the editor of a periodical comes in the same category. CIR v Maxse (1919), 12 TC 41 CA on page 61.

The question whether or not a corporate body can carry on a profession for the purposes of corporation tax is one of interpretation of the corporation tax legislation. This is apparent from the general rules under which the acts of individuals are attributed to corporate bodies.

A wide variety of acts performed by individuals are in law attributed to corporate bodies under rules derived from the constitutions of the bodies, from company law and from general principles which also operate between individuals, such as agency and vicarious liability. These rules of attribution enable the rights and liabilities of corporate bodies arising out of the acts of individuals to be defined.

Under these principles many acts carried out by a corporate body’s agents in conducting its business may be treated as acts of the body for the purposes, for instance, of liability in contract or tort. But an act that is treated as an act of the

corporate body for one purpose would not necessarily be treated as the body's act for another purpose. For example, a corporate body generally has no criminal liability for the acts of its agents.

The rules of attribution are of little help when considering whether a corporate body is capable of carrying on a profession for the purposes of corporation tax. To begin with, the question is not obviously one of attribution. What is in doubt is not whether particular activities should be attributed to the corporate body, but whether a particular activity carried on by the body (namely the carrying on of a business consisting of the provision of professional services) should be classified as trading or as a profession. The principles of agency are not designed to answer questions such as whether a principal may carry on a profession by virtue of the fact that the principal's agent carries on a profession. And because it is arguable that the language of the corporation tax legislation implicitly excludes the application of the rules about professions to companies (see below), the question must in any case be approached as one of interpretation.

There are two main grounds for arguing that there are no acts which would, for the purposes of corporation tax, constitute the carrying on of a profession by a corporate body. The first is based on the nature of a profession. The second is based on internal evidence in the corporation tax legislation.

Before turning to those arguments this note looks briefly at some decided cases.

#### *Case law*

HMRC know of no case in which it was necessary to decide whether a corporate body can carry on a profession for tax purposes.

William Esplen, Son and Swainston Ltd v CIR (1919) 2 KB 731 concerned a corporate body whose shareholders and directors were three naval architects who had previously carried on their profession in partnership. Their activities had not changed in any way since incorporation.

There was an exception from Excess Profits Duty for:

Any profession, the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on ...

Rowlatt J said in his judgment that the company was not carrying on a profession for the purpose of that provision. But his reasoning was that "profession" in that provision means a profession the profits of which are mainly dependent on the personal qualifications of the person who carries it on, and only an individual can have professional qualifications. In CIR v Peter McIntyre Ltd (1926), 12 TC 1006 CS on page 1014 the Lord President (Clyde) explained Rowlatt J's decision as follows:

It follows from what has been said that the profits of a profession may, or may not, fall within the statutory exemption, according as the person who carries it on is an individual on the one hand, or a

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corporate person on the other hand. For a professional business may be carried on by a company as well as by an individual; but, if by a company, it is difficult to see how the profits can be dependent on the company's personal qualifications, for the simple reason that a company is incapable of personal qualifications. That is all, as I understand, that was decided by Mr. Justice Rowlatt in *William Esplen, Son and Swainston, Ltd. v The Commissioners of Inland Revenue*, (1919) 2 K.B. 731, and I respectfully think his decision was right.

The decision in the *Esplen* case was referred to by Scrutton L J in *Brighton College v Marriot* (1925), 10 TC 213 HL. He said on page 226:

It is clear that a private schoolmaster would be assessed as carrying on a profession, but it has been decided in *Esplen's* case, (1919) 2 K.B. 731, that a limited company employing professional men to do professional work does not carry on a profession; it must be assessed, if at all, as carrying on a trade.....

And on page 227:

The question then is: Do the Company in carrying on the school carry on a trade? In my view, when any person habitually and as a matter of contract supplies money's worth for full money payment, he "trades" within the meaning of Schedule D.

But his interpretation of that decision appears to go too wide and should probably not be given much weight.

So these cases contribute little to the question whether a corporate body can carry on a profession for the purposes of corporation tax.

***The nature of a profession***

A profession is carried on by a person who uses his or her professional skills, knowledge and training to carry on the distinctive work of the profession, whether it is sculpting, school teaching, the work of an architect etc. Although a professional person can delegate some of his or her work, it is never the case that the possession of knowledge, or the carrying on of activities, by one individual can constitute the carrying on of a profession by another individual. There is no reason why the position should be any different between a company and an individual.

Since the person who has the skills and knowledge and does the professional work must be an individual, it appears that only an individual can carry on a profession. This conclusion is founded on ordinary notions of what is involved in carrying on a profession, and coincides with the instinct that a person who carries on the profession of architecture must be the person who is by qualification an architect (and similarly with other professions).

This suggests that the starting point ought to be that a company cannot carry on a profession for the purposes of corporation tax legislation. But there is a contrary argument. The view is sometimes taken that a business of supplying professional services may be equated with a profession. On this view it is proper to say that a person who carries on such a business carries on a profession even if that person does not personally provide the professional services.

Since references to carrying on a profession may be used either in the strictest sense, or in a looser sense to include a business of providing professional services, the first argument based on the nature of a profession is not conclusive.

***“Profession” in the corporation tax legislation***

The second argument that there are no acts which would, for the purposes of corporation tax, constitute the carrying on of a profession by a corporate body is based on internal evidence in the corporation tax legislation.

***FA 1965***

The drafters of FA 1965 proceeded on the basis that a corporate body cannot carry on a profession.

It is true that section 53 of FA 1965 (see now section 9 of ICTA) provided that:

.... any income shall for purposes of corporation tax be computed in accordance with income tax principles, all questions as to the amounts which are or are not to be taken into account as income, or in computing income ... being determined in accordance with income tax law and practice....

....

(3) Accordingly, for purposes of corporation tax income shall be computed, and the assessment shall be made, under the like Schedules and Cases as apply for the purposes of income tax ...

Therefore, if a corporate body were to have profits from carrying on a profession those profits could be calculated and taxed under Schedule D Case II as applied for corporation tax purposes.

Case II: tax in respect of any profession or vocation not contained in any other Schedule (section 18(3) of ICTA)

But it is significant that professions are not anywhere catered for explicitly in the corporation tax code introduced by FA 1965.

So, for example, the following provisions of FA 1965 did not cater for professions:

- Section 50 brought non-UK resident companies within the charge to corporation tax, but only if they carried on a trade in the United Kingdom through a branch or agency. (See now section 11 of ICTA.)
- Section 51 set out the rules for determining when a company’s accounting period begins and ends.
- Subsection (3)(c) provided that an accounting period ends on “the company beginning or ceasing to carry on a trade, or to be, in respect of a trade, within the charge to tax”. (See now section 12(3)(c) of ICTA.)

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- Subsection (5) set out the rule that applies if “a company carrying on more than one trade makes up accounts of any of them to different dates”. (See now section 12(5) of ICTA.)
- Section 54(2) provided that “where a company begins or ceases to carry on a trade, or to be within the charge to corporation tax in respect of a trade” the profits computation was on the basis that the trade commenced or ceased. (See now section 337(1) of ICTA.)
- Section 56(2) dealt with capital allowances to be made “in taxing a trade”. They were to be treated “as a trading expense”. (See now sections 247 and 251 of CAA where the income tax and corporation tax rules are combined.)
- Sections 58 and 59 set out the loss relief rules, wholly in terms of trades. The special rule for “trade charges” in section 58(8) referred to “payments made wholly and exclusively for the purposes of a trade”. (See now sections 393 and 393A of ICTA.) This carries through to group relief as a result of the reference to section 393A in section 403ZA of ICTA.
- Section 61 provided for continuity in the case of a company reconstruction without change of ownership - “The trade shall not be treated as permanently discontinued”. (See now section 343(2) of ICTA.)

Section 89 (see now section 6(4)(b) of ICTA) provides that in the provisions discussed above:

“trade” includes “vocation”, and includes also an office or employment...

but there is no general extension to include professions.

If the corporation tax code was intended to cover professions it is extraordinary that the references to trades in these key provisions were not extended to professions. Nor is there any mention of professions in the 1965 Notes on Sections.

In line with the apparent intentions of the 1965 legislation, it has long been the Inland Revenue/HMRC view that a corporate body cannot carry on a profession for corporation tax purposes. Where a corporate body carries on a business consisting of the provision of professional services the practice is to treat it as carrying on a trade.

***References to “profession” in the current corporation tax legislation***

A significant number of references to “profession” in the current legislation (some two dozen or more) arise as a result of the ITTOIA split of income tax from corporation tax. Where the source legislation applied to both income tax and corporation tax and concerned professions the reference to profession was maintained in the corporation tax only rule. This was done on the basis that if companies cannot

carry on professions the references do no harm, and because the issue was seen as one to address in the context of the rewrite of corporation tax.

A slightly smaller number appear in provisions that apply to both income tax and corporation tax. They are clearly needed until these provisions are split into income tax and corporation tax rules.

A dozen or so are concerned with partnerships that might be made up of both income and corporation taxpayers. If a partnership consists of an individual and a corporate body and exists to exploit the professional services of the individual it may well be correct to regard the individual as carrying on the profession but the company as carrying on a trade.

A small number cannot be explained in any of the above ways.

#### ***Corporate bodies and professions - conclusions***

There are three conclusions:

- the nature of a profession and some comments in the case law suggest that corporate bodies cannot carry on a profession for corporation tax purposes – when they provide professional services they are trading;
- consistent with that, the 1965 corporation tax code made no explicit provision for professions; and
- references in the current legislation arise for a mixture of reasons, are inconsistent and therefore shed no great light on the issue.

So there are strong grounds for concluding that for the purposes of the charge to corporation tax under Schedule D Case II there are no activities that should be taken to constitute the carrying on of a profession by a corporate body.

#### **Corporate bodies and vocations**

##### ***The nature of a vocation***

“Vocation” is not defined for tax purposes.

According to the Oxford English Dictionary a vocation is:

- the fact or feeling of being called to undertake some specific career, function or occupation;
- a strong feeling of fitness or suitability for a particular career;
- a mode of life or employment regarded as requiring dedication.

The thread that ties all of these definitions together is that the exercise of a vocation requires a personal commitment to a particular activity.

Corporate bodies are artificial persons. They are not animated by callings. They do not have careers, still less can they be said to have feelings of fitness and suitability as regards a particular set of activities. Nor do they have a mode or a way of life and they do not engage in activities out of a sense of dedication.

That being the case it does not appear possible for a corporate body to carry on a vocation.

### ***FA 1965***

Section 89(2)(j) of FA 1965 provided that “trade” includes “vocation” for the purpose of Part 4 of the Act (taxation of companies and of company distributions). (See now section 6(4)(b) of ICTA.) Notes on Sections explain that this is because:

an old Court decision suggests that a bookmaking business may have to be considered as a vocation rather than a trade in the strict sense.

That decision is found in Partridge v Mallandaine 2 TC 179. That case was heard in the High Court in 1886. Today there is little doubt that a company carrying on a bookmaking business is trading.

### ***Corporate bodies and vocations – conclusions***

There are two conclusions:

- corporate bodies cannot carry on a vocation; and
- although the 1965 corporation tax code makes explicit provision for vocations this is the result of an excess of caution for reasons that are no longer relevant.

### **Unincorporated associations**

#### ***The meaning of “unincorporated association”***

In Conservative and Unionist Central Office v Burrell (1981), 55 TC 671 CA on page 699 Lawton LJ considered the meaning of “unincorporated association” for the purposes of s.832(1) of ICTA:

It is sufficiently like a “company” for it to be put in the charging section within the ambit of that word. The interpretation section makes it clear that the word “company” has a meaning extending beyond a body corporate but not as far as a partnership or a local authority. I infer that by “unincorporated association” in this context Parliament meant two or more persons bound together for one or more common purposes, not being business purposes, by mutual undertakings, each having mutual duties and obligations, in an organisation which has rules which identify in whom control of it and its funds rests and on what terms and which can be joined or left at will. The bond of union between the members of an unincorporated association has to be contractual.

The HMRC view of unincorporated associations differs from this in two main respects. These are that the union between the members need not be legally

enforceable and that there is no reason why an unincorporated body should not have trading or business objectives or carry on significant commercial activities.

***Unincorporated association or partnership?***

In the case of Blackpool Marton Rotary Club v Martin (1989), 62 TC 686 CA the club argued that it fell within the definition of a partnership because it was an association of persons “carrying on a business in common with a view of profit” (section 1 of the Partnership Act 1890). This was rejected by the Commissioners and their decision was confirmed by Hoffman J. He contrasted the position of partners, who are individually entitled to some proportion of profits, with the members of the club, who were not individually entitled to share in any profits which might arise from its activities. Their entitlement was to whatever privileges were conferred upon them by the rules of the club and no more.

***Unincorporated associations and professions***

The Blackpool case shows that if individuals come together to carry on a profession and are entitled to share the profit as it arises the arrangement will be a partnership liable to income tax rather than an unincorporated association liable to corporation tax.

HMRC are not aware of any instance of an unincorporated association being assessed to corporation tax as carrying on a profession.

***Unincorporated associations and vocations***

HMRC are not aware of any instance of an unincorporated association being assessed to corporation tax as carrying on a vocation.

***Unincorporated associations – conclusions***

The corporation tax charge under Schedule D Case II on the profits of a profession or vocation of an unincorporated association does not have any practical effect.

It is theoretically possible that the application of trading income rules to activities that a company could argue is a profession or a vocation could lead to a change in the measure of taxable profits.

***This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.***