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. The clauses exposed here do not contain the rewrite of clauses of an administrative nature – sections 216, 217, 226, 234, 234A, 250, 252 and 253 of ICTA. The scope of these provisions extends beyond companies within the charge to corporation tax. Consideration is still being given to their most appropriate location.

3. A number of the rewritten provisions apply for the purposes of corporation tax whereas their source provisions also relate to income tax. The structure and location of the related income tax material is still under consideration. The clauses therefore refer in a number of places to the "corresponding income tax provisions".

Chapter 1: Introduction

Clause 1: Overview of Part

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

5. 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.

6. 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 provides interpretation.

Q1. We welcome comments on the structure of the legislation.

Chapter 2: Matters which are distributions

Clause 2: Overview of Chapter

7. 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

8. 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.

Clause 4: Meaning of "distribution"

9. 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.

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

11. 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).

12. The clause also provides signposts to extensions to the meaning of distribution in clause 62 and clause 69.

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

13. 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.

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

Q2. 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

15. 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.

16. 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 23(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 23(2) and (3).

17. Section 209(6) is rewritten in clause 6(2) and clause 23(4). This ensures that the qualifications are located close to the rewritten provisions that they modify.

18. 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

19. 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.

20. 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.

21. 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: Securities issued otherwise than wholly for new consideration

22. 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"

23. 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.

24. 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

25. 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.

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

27. 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.

28. Clause 99(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.

29. 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.

30. 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: Modification of section 10 in cases where consideration exceeds amount of principal secured

31. 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.

32. 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.

33. 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

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

35. 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.

36. 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.

37. The second qualification is in clause 15.

Clause 13: Meaning of "qualifying index" in section 12

38. This clause defines "qualifying index". It is based on section 209A(3) of ICTA.

39. 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

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

41. 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

42. 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.

43. 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.

44. 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.

45. 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.

46. The definition of "hedging arrangements" is in clause 17.

Clause 16: Exception to section 15

47. 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.

48. 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).

49. 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.

50. 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.

51. 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 **and** 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,	YES	NO

overrides clause 12(1)		
Clause 15 applies – hedging arrangements	NO	YES
Clause 16 applies, overrides clause 15	YES	NO

Clause 17: Meaning of "hedging arrangements"

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

53. 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"

54. 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.

55. There are five sets of circumstances listed, corresponding as follows to the provisions in clause 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: Section 18: supplementary

56. This clause provides additional definitions for the purpose of clause 18. It is based on section 209(2), (3B), (9), (10) and (11) of ICTA.

57. *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.

58. *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.

59. *Subsections (3)* to *(7)* contain interpretation concerning equity notes, relevant to condition E in clause 18.

Clause 20: The principal secured: special securities

60. 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.

61. 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 21: Alternative finance arrangements

62. 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).

63. 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 22: Transfers of assets or liabilities treated as distributions

64. 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.

65. 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.

66. This clause is subject to the exceptions in clause 23.

Clause 23: Section 22 exceptions

67. This clause sets out two circumstances where clause 22 does not apply. It is based on section 209(5) to (7) of ICTA.

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

69. Note that if subsection (1) disapplies clause 22 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.

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

Clause 24: Bonus issues following repayment of share capital treated as distributions

71. 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.

72. The rules for a repayment of share capital following a bonus issue of shares are in clause 27.

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

Clause 25: Premiums paid on redemption of share capital

74. This clause and clause 26 work together to determine what is treated as a repayment of share capital. It is based on section 211(7) of ICTA.

75. 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 26.

76. The source legislation in section 211(7) of ICTA technically applied throughout ICTA, 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.

Q3.	**We welcome comments on the proposals to clarify the scope of the provision concerning premiums paid on the redemption of share capital?**

Clause 26: Share capital issued at a premium representing new consideration

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

78. 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.

79. For example, taking clauses 25 and 26 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.

80. 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 27: Distributions following a bonus issue

81. 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.

82. 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 103 for the definition).

83. 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.

84. Clause 28 contains a further qualification.

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

Clause 28: Cap on amount of distributions affected by section 27

86. This clause qualifies clause 27. It is based on section 211(1) and (3) of ICTA.

87. 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 29: Certain payments connected with exempt distributions

88. This clause affects clause 24 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.

89. Exempt distributions and chargeable payments are dealt with in clauses 70 to 93. Chargeable payments are charged to corporation tax by clause 83. The appropriate location for the equivalent income tax charge is still under consideration.

Chapter 3: Matters which are not distributions
Clause 30: Overview of Chapter

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

91. 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 31: Distributions in respect of share capital in a winding up

92. 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 32: Distribution as part of a cross-border merger

93. 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.

94. 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 33: Interest etc paid in respect of certain securities

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

96. 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.

97. 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.

Clause 34: Purchase by unquoted trading company of own shares

98. 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.

99. 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.

100. This clause is supplemented by clauses 35 to 48.

Clause 35: Requirements as to residence

101. 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 36: Requirement as to period of ownership

102. 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 37: Determining the period of ownership

103. 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.

104. 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.

105. 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 98.

Clause 38: Reduction of seller's interest as shareholder

106. 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.

107. 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 57 to 59.

108. The clause is qualified generally by clause 39 and clause 44, and by clauses 40 to 43 if the company making the purchase is a member of a group.

Clause 39: Section 38: effect of entitlement to profits

109. 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.

110. 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 40 where the company is a member of a group.

111. The clause refers to section 830(2) of the Companies Act 2006.

Clause 40: Requirements applicable where purchasing company is member of group

112. This clause supplements the requirements of clause 38 and clause 39 where the company is a member of a group. It is based on section 222(1), and (3) of ICTA.

113. 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.

114. There are further qualifications in clause 41 and clause 44.

Clause 41: Determining whether interests as shareholders in a group are substantially reduced

115. 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.

116. 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 42: Section 41: effect of entitlement to profits

117. 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 43: Other requirements

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

119. The definition of "connected" for this purpose is in clause 60.

Clause 44: Relaxation of requirements in certain cases

120. 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 45: Advance clearance of payments by Commissioners
121. This clause permits the company to apply to the Commissioners for Revenue and Customs for a decision on whether or not clause 34 will apply. It is based on section 225(1) of ICTA.

122. 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 46: Advance clearance: supplementary
123. This clause sets out time limits and further procedural rules in relation to the consideration of an application under clause 45. It is based on section 225(2) to (5) of ICTA.

Clause 47: Meaning of "group" and "51% subsidiary" in sections 34 to 47
124. 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 48: Sections 34 to 47: other interpretation
125. This clause contains definitions. It is based on section 229 of ICTA.

126. "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 49: Stock dividends
127. 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.

128. 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.

129. The clause is supplemented by clauses 50 and 51, and there are special rules in Schedule 2 for share capital issued before 6 April 1975.

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

Clause 50: Application of clause 49 where bonus share capital is converted etc
131. 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.

132. 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).*

133. Some bonus issues do not fall within the rules of the predecessors to clause 49, 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).

134. If this is the case, clause 49 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 51: "Bonus share capital" and "in lieu of a cash dividend"

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

Clause 52: Building society payments

136. 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.

137. 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 53: Industrial and provident societies: interest and share dividends etc

138. 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.

139. 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 54: Dividend or bonus relating to transactions with industrial and provident society

140. 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.

141. 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.

Clause 55: UK agricultural or fishing co-operatives: interest and share dividends etc

142. This clause provides the same treatment for payments made to members in the case of UK agricultural or fishing co-operatives as clause 53 provides for an industrial and provident society. It is based on section 486(1), (9) and (12) of ICTA.

Clause 56: Meaning of "UK agricultural or fishing co-operative"

143. This clause provides definitions for the purpose of clause 55. It is based on section 486(12) of ICTA.

144. 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 57: Associated persons

145. 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 37 the definition of persons "living together" has been brought directly into the legislation – see clause 98.

146. Further rules in clauses 58 and 59 extend the meaning in the case of trustees and personal representatives.

Clause 58: Associated persons: trustees

147. This clause supplements the definition of "associated person" in clause 57. It is based on section 227(5), (8) and (9) of ICTA.

Clause 59: Associated persons: personal representatives

148. This clause also supplements the definition of "associated person" in clause 57. It is based on section 227(6) and (9) of ICTA.

Clause 60: Connected persons

149. 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.

150. These rules are supplemented by clause 61.

Clause 61: Section 60: supplementary
151. This clause supplements the definitions in clause 60. It is based on section 228(6), (7) and (8) of ICTA.

Chapter 4: Special rules for distributions made by certain companies
Clause 62: Certain expenses of close companies treated as distributions
152. 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.

153. 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.

154. 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.

155. 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.

156. 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.

157. Clauses 63 and 64 set out two exceptions. Clause 65 contains supplementary material.

Clause 63: Exceptions for benefits treated as employment income etc
158. This clause sets out the first circumstance where clause 62 does not apply. It is based on section 418(3) of ICTA.

159. 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 64: Exception for certain transfers between UK resident companies.
160. This clause sets out the second exception to clause 62. It is based on section 418(5) and (6) of ICTA.

Clause 65: Extension of references to close companies and participators
161. 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.

162. 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.

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

Clause 66: Companies carrying on a mutual business
164. 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.

165. 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.

166. 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.

167. 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 67 Mutual businesses: distributions out of surpluses not charged to tax etc
168. 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 68: Companies not carrying on a business
169. 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.

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

Clause 69: Members of a 90% group
171. 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.

172. 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.

173. 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
174. This Chapter rewrites the provisions concerning exempt distributions and chargeable payments in sections 213, 214, 215 and 218 of ICTA.

175. The administrative provisions in sections 216 and 217 of ICTA will be rewritten separately as they place requirements on individuals as well as companies. The location for these provisions is under consideration.

Clause 70: Key terms etc
176. This clause provides signposts to the key terms used in this Chapter, and to the reference to chargeable payment in clause 29. It is new.

Clause 71: Purpose of provisions about demergers
177. 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.

178. Those provisions include the income tax rules relating to chargeable payments. The appropriate location for these rules in the income tax legislation is under consideration.

Clause 72: Exempt distributions
179. 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 73: Transfer of shares in subsidiaries to members
180. This clause defines the circumstances giving rise to the first type of exempt distribution. It is based on section 213(2) of ICTA.

181. Conditions A to D are in clause 78, conditions E and F are in clause 79, and conditions L and M are in clause 82.

Clause 74: Transfer by distributing company and issue of shares by transferee company

182. 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.

183. Conditions A to D are in clause 78, conditions G to K are in clause 80, and conditions L and M are in clause 82.

Clause 75: Division of business in a cross-border transfer

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

185. 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 76: "The distributing company"

186. This clause defines the term "the distributing company" for the purposes of clauses 77. It is based on section 213(3) and section 213A(3) of ICTA.

Clause 77: Meaning of "relevant company"

187. This clause defines the term "relevant company" for the purposes of clauses 73, 74 and 75. It is based on section 213(3) and section 213A(3) of ICTA.

Clause 78: General conditions

188. 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 73 and 74. It is based on section 213(4), (5), (10) and (11) of ICTA.

189. The clause is supplemented by clauses 79 and 80 which set out conditions that must be met in relation to specific types of exempt distribution.

Clause 79: Conditions for distributions falling within section 73(a)

190. This clause supplements clause 78 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.

191. *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.

192. 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 82 applies.

Clause 80: Conditions for distributions falling within section 74

193. This clause supplements clause 78 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.

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

195. Clause 81 further qualifies this clause.

Clause 81: Cases where condition K does not apply

196. This clause qualifies clause 80 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 82: Conditions to be met if the distributing company is a 75% subsidiary

197. This clause will apply instead of either condition F in clause 79 or condition K in clause 80 because the distributing company is itself a 75% subsidiary. It is based on section 213(12) of ICTA.

198. Without this clause a 75% subsidiary would not be able to meet the overarching requirement in clause 71(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.

199. 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).*

200. 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 71(1).

Clause 83: Chargeable payments connected with exempt distributions

201. This clause sets out how a chargeable payment is charged to corporation 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), (1B) and (6) of ICTA.

202. The appropriate location for the rules about charging to tax the recipient of a chargeable payment that is within the charge to income tax are still under consideration.

Clause 84: Chargeable payments not deductible in calculating profits

203. 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.

204. 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 83 – despite the treatment in the hands of the payer as a distribution.

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

Clause 85: Meaning of "chargeable payment"

206. 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.

207. This clause is supplemented by clause 86 if any company concerned in the exempt distribution is an unquoted company.

Clause 86: Meaning of "chargeable payment": unquoted companies

208. This clause expands the circumstances in which Condition A in clause 85 is met if a company concerned in an exempt distribution is an unquoted company. It is based on section 214(3) of ICTA.

Clause 87: Meaning of "company concerned in an exempt distribution"

209. 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.

210. This term is necessary to underpin the four conditions in clause 85 and the extension in clause 86.

Clause 88: Advance clearance of distributions
211. 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 90.

212. 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 89: Advance clearance of payments
213. 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 90: Requirements relating to the application
214. 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 91: Decision of the Commissioners or Special Commissioners
215. 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 92: Meaning of "unquoted company"
216. 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 93: Other definitions etc
217. This clause contains further interpretation. It is based on section 218(1), (2) and (3) of ICTA.

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

Chapter 6: Interpretation of Part
Clause 94: Arrangements between companies
219. 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.

Clause 95: "In respect of shares"
220. 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 96: "In respect of securities"
221. 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 97: "New consideration"
222. 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 98: References to married persons, or civil partners, living together
223. This clause contains the definition of "living together". It is based on section 1011 of ITA.

Clause 99: Other interpretation
224. 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 100: Overview of Chapter
225. This clause sets out the matters covered by the Chapter. It is new.

Clause 101 Tax credits for certain recipients of qualifying distributions
226. 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.

227. One of the conditions is that the distribution is a qualifying definition. This term is defined in clause 103.

228. *Subsection (3)* provides signposts to provisions that qualify this clause.

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

Clause 102 Meaning of "franked investment income"
230. This clause sets out the definition and computation of "franked investment income". It is based on section 832(1) of ICTA.

Clause 103 Meaning of "qualifying distribution"
231. 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
232. This Schedule inserts into ITTOIA income tax provisions that relate to the stock dividend rules. See the commentary on clauses 49 to 51.

Schedule 2: Transitionals and Savings

233. 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.

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ANNEX 1

Change 648: Company distributions: premium paid on redemption of share capital: clause 25
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.