

*Corporation Tax: Bill 6*  
*Losses on disposal of shares*  
*January 2008: Committee paper CC/SC (08) 04*

**Losses on disposal of shares**

**Overview**

1. This Chapter rewrites sections 573 to 576L of ICTA, forming Chapter 5A of Part 13 of that Act. Section 573 of ICTA provides that, if an investment company incurs an allowable loss for the purposes of corporation tax on chargeable gains on the disposal of ordinary shares in a qualifying trading company for which it has subscribed, it may claim to set off the loss against its income for corporation tax purposes. It is supplemented by sections 575 to 576L of ICTA.

2. Chapter 5A of Part 13 of ICTA is a product of the rewriting, in Chapter 6 of Part 4 of ITA, of section 574 of ICTA which provides for similar relief against income tax for allowable losses incurred by individuals. Section 574 of ICTA was, like section 573, supplemented by sections 575 and 576 of that Act.

3. Section 576(4) to (4B) of ICTA included provisions defining a “qualifying trading company” by cross-reference, with extensive modifications, to the provisions of Chapter 3 of Part 7 of ICTA (Enterprise investment scheme).

4. The enterprise investment scheme has been rewritten in Part 5 of ITA and at the same time the need to cross-refer so extensively to Part 5 of ITA has been reduced by replacing section 576(4) to (4B) of ICTA with provisions setting out in full the principal requirements for a company to be a qualifying trading company. These are in sections 134 and 137 to 146 in Chapter 6 of Part 4 of ITA for the purposes of relief against income tax and in sections 576A to 576K of ICTA inserted by Schedule 1 to ITA for the purposes of relief against income subject to corporation tax.

5. The commentary uses a number of abbreviations. They are listed below.

FA 1980	Finance Act 1980 (and similarly for other Finance Acts)
HMRC	Her Majesty’s Revenue and Customs
ICTA	the Income and Corporation Taxes Act 1988
ITA	the Income Tax Act 2007
TCGA	the Taxation of Chargeable Gains Act 1992

**Clause 1: Share loss relief**

6. This clause introduces share loss relief. It is based on sections 573(1) and 575(1) and (3) of ICTA.

7. *Subsection (1)* outlines the basic structure of the relief, namely that a company (“the investor company”) is eligible for share loss relief if the following conditions are met:

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- the investor company has “subscribed for” shares in another company (“the investee company”) (see the commentary on clause 6),
  - the investee company is a “qualifying trading company” (see the commentary on clause 11),
  - the investor company incurs an allowable loss for the purposes of corporation tax on chargeable gains on the disposal, and
  - the investor company meets the eligibility conditions (see the commentary on clause 2).
8. *Subsection (2)* provides that relief is only available if the disposal is of one of the kinds specified in paragraphs (a) to (d).
9. *Subsection (2)(a)* is based on section 575(1)(a) of ICTA which specifies as one of the kinds of disposal:
- a disposal by way of a bargain made at arm’s length for full consideration.
10. The words “for full consideration” have been omitted from section 131(3)(a) of ITA, rewriting section 575(1)(a) of ICTA for the purposes of relief against income tax, on the basis that they add nothing. *Subsection (2)(a)* of this clause also omits those words. See *Change 625* in Annex 1. Respondents to consultation on section 131 of ITA agreed with this change.

**Q1. We welcome comments on the proposal to omit the words “for full consideration” from clause 1(2)(a).**

**Clause 2: Eligibility conditions**

11. This clause sets out the conditions in relation to the investor company which must be met in order for the investor company to be eligible for share loss relief. It is based on section 573(1) and (5) of ICTA.
12. This clause provides that the investor company must be an investment company (as defined in clause 23) on the date of the disposal and for a continuous period ending on that date and must not be associated with the investee company or any member of its group.
13. Section 416 of ICTA, referred to in *subsection (5)*, is expected to be rewritten in this Bill.

**Clause 3: Entitlement to claim**

14. This clause deals with the making of a claim for share loss relief. It is based on section 573(2) and (3) of ICTA.

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15. Share loss relief is obtained by way of a deduction in calculating the investor company's income for corporation tax purposes.

16. *Subsection (3)* makes clear that the words "if the company was then an investment company" in section 573(2)(b) of ICTA require that the company is an investment company throughout the relevant accounting period.

**Clause 4: How relief works**

17. This clause explains how the loss is to be deducted from income. It is based on section 573(2) to (4A) of ICTA.

18. At Step 2 in *subsection (1)* the amount not deducted from income of the accounting period in which the loss is incurred may be deducted from the income of earlier accounting periods ending within the immediately preceding period of 12 months. The extent to which a deduction may be made at Step 2 from an accounting period which falls only partly within that period of 12 months is limited in accordance with clause 5.

19. The words "amounts which can be deducted from, set against or treated as reducing profits of any description" in *subsection (5)(c)* denote amounts which the legislation permits to be deducted from, set against or treated as reducing either income or capital profits, in contrast to share loss relief which can only reduce income. The terms "total profits", "net profits", "profits" and "profits of any description" are currently being considered in the context of this Bill as a whole. Accordingly the use of the words "profits of any description" in this clause should be regarded as provisional for the time being.

20. *Subsection (7)* is new. It has been included to make explicit that the balance of any allowable loss for which share loss relief is not obtained continues to be capable of being claimed as a deduction under TCGA.

**Clause 5: Limit on deduction if accounting period falls partly within 12 month period**

21. This clause applies where an accounting period ends within 12 months before the accounting period in which the loss is incurred but begins before the beginning of that 12 month period. It is based on section 573(3) of ICTA.

22. This clause ensures that a deduction can only be made at Step 2 in clause 4(1) from that part of the income of the accounting period that is proportionate to the part of the accounting period falling within the 12 month period.

**Clause 6: Subscription for shares**

23. This clause sets out the requirements relating to the subscription for shares in a qualifying trading company. It is based on sections 573(6) and 576K(3) of ICTA and includes a new provision relating to bonus shares.

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24. *Subsection (2)* provides that shares are subscribed for by the investor company if they have been issued to the investor company in consideration of money or money's worth.

25. The shares must form part of the ordinary share capital of the investee company. See the definition of "shares" in clause 23 and the commentary on that clause.

26. *Subsection (3)* is new and treats "corresponding bonus shares" issued in respect of shares which have been subscribed for as themselves having been subscribed for. This subsection is equivalent to section 135(4) of ITA and brings the provisions for share loss relief for investment companies back into line with the provisions for share loss relief for individuals. See *Change 635* in Annex 1. Respondents to consultation on section 135 of ITA agreed with the change in this subsection.

27. *Subsection (4)* is new and provides that corresponding bonus shares are treated as subscribed for at the same time as the original shares were subscribed for. See *Change 635* in Annex 1.

**Q2. We welcome comments on the proposal to legislate for share loss relief to be available in respect of corresponding bonus shares.**

**Clause 7: Disposals of new shares**

28. This clause denies or restricts share loss relief on the disposal of shares which are identified by virtue of section 127 of TCGA with other shares previously held by the investor company, unless certain conditions are met. It is based on section 575(2) and (4) of ICTA.

29. The reference to section 20(3) at the end of *subsection (2)* makes clear that this clause does not apply to an exchange of shares to which clause 20(1) applies. See the commentary on clause 20 and *Change 642* in Annex 1. This change is the same as that made in section 136(2) of ITA for the purposes of relief against income tax. Respondents to consultation on section 136 of ITA agreed with this change.

**Clause 8: Limits on relief**

30. This clause deals with the calculation of the amount of share loss relief. It is based on section 576(1) of ICTA.

31. Section 576(1) of ICTA provides that, if the investor company disposes of shares for which it has subscribed and which form part of a holding, the share loss relief in relation to those shares is not to exceed the sums which would have been allowable as deductions in computing the allowable loss for the purposes of corporation tax on chargeable gains if the shares had not formed part of the holding.

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32. Clause 8 refines the circumstances in which the provision applies in connection with the changes in clause 9 described in *Change 639* in Annex 1. See *Change 636* in Annex 1. This change is the same as that made in section 147 of ITA for the purposes of relief against income tax. Respondents to consultation on section 147 of ITA agreed with this change.

**Q3. We welcome comments on the proposals to refine the provisions of section 576(1) of ICTA set out in *Change 636* in Annex 1.**

33. *Subsection (8)* explains what is meant by shares “that are not capable of being qualifying shares” for the purposes not only of this clause but also of clause 9. *Change 637* in Annex 1 contains a detailed explanation of why a mixed holding is defined for the purposes of clause 9 in terms of a holding which includes such shares.

34. *Subsection (9)* extends this meaning for the purposes only of *subsection (5)* to cover reorganisations involving the issue of shares of a different class.

**Clause 9: Disposal of shares forming part of mixed holding**

35. This clause deals with the identification of shares disposed of where those shares form part of a “mixed holding”. It is based on section 576(1), (1C) and (1D) of ICTA, with a number of changes.

36. Section 576(1) of ICTA defines a mixed holding as one which comprises shares for which a person has subscribed and shares which the person has acquired otherwise than by subscription.

37. *Subsection (1)* provides that this clause applies to a holding in which some only of the shares are shares “that are not capable of being qualifying shares” (as defined in clause 8(8)). See *Change 637* in Annex 1 which contains a detailed explanation of why a mixed holding has been defined in terms of a holding which includes such shares. This change is the same as that made in section 148(1) of ITA for the purposes of relief against income tax. Respondents to consultation on section 148 of ITA agreed with this change.

**Q4. We welcome comments on the proposal to define a mixed holding as one which includes shares that are not capable of being qualifying shares and other shares.**

38. *Subsection (2)* provides that the clause applies for the purpose of determining the questions:

- whether the shares disposed of are qualifying shares (as defined in clause 8); and
- which of any qualifying shares acquired at different times are disposed of.

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39. This is a change from section 576(1) of ICTA, which is not expressed to apply for the purpose of determining which of any qualifying shares are disposed of. See *Change 638* in Annex 1. This change is the same as that made in section 148(2) of ITA for the purposes of relief against income tax. Respondents to consultation on section 148 of ITA agreed with this change.

**Q5. We welcome comments on the proposal to apply clause 9(2) for the purpose of determining which of any qualifying shares are disposed of.**

40. *Subsection (3)* introduces the rules for determining the questions in subsection (2), including in *subsection (4)* the application of the identification rules in sections 105 and 107 of TCGA. See *Change 639* in Annex 1.

**Q6. We welcome comments on the proposal to apply the identification rules in sections 105 and 107 of TCGA so far as those rules are capable of determining the questions in clause 9(2).**

41. *Subsection (7)* is new and puts on a statutory basis the practice under which questions which cannot be determined by the specific provisions of this clause are to be determined on a just and reasonable basis. This subsection will principally be required in cases where qualifying shares and shares which are not qualifying shares were acquired, or are treated as having been acquired, on the same day. See *Change 639* in Annex 1. This change is the same as that made in section 148(7) of ITA for the purposes of relief against income tax. Respondents to consultation on section 148 of ITA agreed with this change.

**Q7. We welcome comments on the proposal to legislate in clause 9(7) that questions not capable of being determined in accordance with the specific provisions of this clause are to be determined on a just and reasonable basis.**

42. *Subsection (8)* (defining “holding”) omits section 576(1D)(b) of ICTA, which applies subsection (4) of section 104 of TCGA. That subsection can apply only to employees and is, therefore, otiose in relation to an investment company.

**Clause 10: Section 9: supplementary**

43. This clause supplements clause 9. It is new.

44. *Subsection (1)* determines the time of acquisition for the purposes of clause 9 of shares issued in a reorganisation within the meaning of section 126 of TCGA to which section 127 of that Act applies. See *Change 640* in Annex 1. This change is the same as that made in section 149(2) of ITA for the purposes of relief against income tax. Respondents to consultation on section 149 of ITA agreed with this change.

**Q8. We welcome comments on the addition of clause 10(1) relating to the time of acquisition for the purposes of clause 9 of shares issued in a reorganisation within the meaning of section 126 of TCGA to which section 127 of that Act applies.**

45. *Subsection (2)* clarifies that shares held or disposed of by a nominee or bare trustee for a company are part of the company's holding for the purposes of clause 9. See *Change 641* in Annex 1. This change is the same as that made in section 149(3) of ITA for the purposes of relief against income tax. Respondents to consultation on section 149 of ITA agreed with this change.

**Q9. We welcome comments on the addition of clause 10(2) relating to shares held by nominees and bare trustees.**

**Clause 11: Qualifying trading companies**

46. This clause defines what is a qualifying trading company and introduces clauses 12 to 18, which set out six specific requirements to be met by a company if it is to be a qualifying trading company. It is based on section 576A of ICTA.

47. Four of the requirements are to be met on the date of the disposal or, subject to certain conditions, at a time which is not more than three years before that date (see *subsection (2)*) and for a continuous period ending on that date or, subject to those conditions, at that time (see *subsection (3)*).

48. Two of the requirements are to be met only at or around the time of issue of the shares in respect of which the share loss relief is claimed (see *subsection (4)*).

49. Section 576A of ICTA on which this clause is based and sections 576B to 576K on which clauses 12 to 21 respectively are based were introduced into ICTA by ITA and correspond to sections 134 and 137 to 146 of that Act.

50. In rewriting sections 576A to 576K of ICTA, no substantive change has been made (with the exceptions referred to in the commentary on clauses 14, 18, 20 and 21). In order to preserve consistency of style within ICTA, a small number of words and phrases are used in sections 576A to 576L which are different from but synonymous with the corresponding words or phrases used in sections 134 and 137 to 146 of ITA. Those words and phrases have been changed in this Bill to those used in ITA.

**Clause 12: The trading requirement**

51. This clause sets out the first of the four requirements to be met throughout the period mentioned in clause 11(3). It is based on section 576B of ICTA. See the commentary on clause 11.

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52. The definition of “research and development” in section 837A of ICTA, applied by *subsection (7)*, is expected to be rewritten in this Bill.

**Clause 13: Ceasing to meet trading requirement because of administration or receivership**

53. This clause supplements clause 12 and deals with the consequences for the trading requirement of administration, receivership or winding up. It is based on section 576C of ICTA. See the commentary on clause 11.

**Clause 14: The control and independence requirement**

54. This clause sets out the second of the four requirements to be met throughout the period mentioned in clause 11(3). It is based on section 576D of ICTA. See the commentary on clause 11.

55. In *subsection (4)* “transactions or series of transactions” has been added to the illustrative list of matters which are included within the term “arrangements”. The change from the source legislation is one of presentation rather than of substance.

56. It is intended that, in clauses such as this, the definition of “arrangements” will adopt this same form of words. We will in due course consider whether this definition of “arrangements” could be located at the end of this Bill so that it applies for the purposes of this Bill as a whole. If we adopt this course, then the specific definition of “arrangements” in this clause will be removed.

57. Section 416 of ICTA, referred to in the definition of “control” in *subsection (4)*, is expected to be rewritten in this Bill.

**Clause 15: The qualifying subsidiaries requirement**

58. This clause sets out the third of the four requirements to be met throughout the period mentioned in clause 11(3). It is based on section 576E of ICTA. See the commentary on clause 11.

**Clause 16: The property managing subsidiaries requirement**

59. This clause sets out the last of the four requirements to be met throughout the period mentioned in clause 11(3). It is based on section 576F of ICTA. See the commentary on clause 11.

**Clause 17: The gross assets requirement**

60. This clause sets out the requirement to be met only at the times mentioned in clause 11(4)(a). It is based on section 576G of ICTA. See the commentary on clause 11.

**Clause 18: The unquoted status requirement**

61. This clause sets out the requirement to be met only at the time mentioned in clause 11(4)(b). It is based on section 576H of ICTA. See the commentary on clause 11.

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62. In *subsection (3)* “transactions or series of transactions” has been added to the illustrative list of matters which are included within the term “arrangements”. The change from the source legislation is one of presentation rather than of substance.

63. It is intended that, in clauses such as this, the definition of “arrangements” will adopt this same form of words. We will in due course consider whether this definition of “arrangements” could be located at the end of this Bill so that it applies for the purposes of this Bill as a whole. If we adopt this course, then the specific definition of “arrangements” in this clause will be removed.

64. In *subsection (3)* “debenture” is defined by cross-reference to section 738 of the Companies Act 2006 which is expected to be in force before this Bill is enacted. The definition there is in the same terms as that in section 744 of the Companies Act 1985 which it will replace.

**Clause 19: Power to amend requirements by Treasury order**

65. This clause enables the requirements in clauses 12 to 18 to be amended by secondary legislation. It is based on section 576I of ICTA. See the commentary on clause 11.

**Clause 20: Relief after an exchange of shares for shares in another company**

66. This clause and clause 21 provide for continuity of the application of the requirements in clauses 12 to 18 in the case of certain reconstructions which result in the issue of shares in a new company in exchange for shares in another company but do not involve any change in ownership of the underlying business. This clause is based on section 576J of ICTA. See the commentary on clause 11.

67. *Subsection (3)(a)* is new and resolves the apparent conflict between clause 7 and this clause. See *Change 642* in Annex 1. This change is the same as that made in section 145(3) of ITA for the purposes of relief against income tax. Respondents to consultation on section 145 of ITA agreed with this change.

**Q10. We welcome comments on the inclusion of clause 20(3)(a).**

**Clause 21: Substitution of new shares for old shares**

68. This clause sets out the consequences for the application of the requirements in clauses 12 to 18 of an exchange to which clause 20 applies. It is based on section 576K of ICTA. See the commentary on clause 11.

69. The words “in relation to any subsequent disposal or other event” which appear in section 146(2) of ITA but were inadvertently omitted from section 576K(2) of ICTA have been included in *subsection (2)*.

**Clause 22: Deemed time of issue for certain shares**

70. This clause determines the time of issue of corresponding bonus shares for the purposes of the provisions listed in *subsection (1)*. It is new.

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71. *Subsection (2)* mirrors clause 6(3). See *Change 643* in Annex 1. This change is the same as that made in section 150 of ITA for the purposes of relief against income tax. Respondents to consultation on section 150 of ITA agreed with this change.

**Q11. We welcome comments on the addition of clause 22 relating to the time of issue of corresponding bonus shares for certain purposes.**

**Clause 23: Interpretation of Chapter**

72. This clause explains the meaning of expressions used in this Chapter. It is based on sections 130 and 576L of ICTA.

73. *Subsection (1)* includes the definition of “corresponding bonus shares”. *Subsection (2)* amplifies that definition. See *Change 635* in Annex 1.

74. The definition of “investment company” is set out in full in subsection (1) rather than by cross-referring to and modifying the definition in section 130 of ICTA. References to savings banks and banks for savings have been omitted. See *Change 647* in Annex 1. It is also proposed to substitute this definition of “investment company” for the definition in section 151 of ITA.

**Q12. We welcome comments on the omission of references to savings banks and banks for savings in the definition of “investment company” in clause 23 of this Bill and section 151 of ITA.**

75. *Subsection (7)* is new and clarifies that the date of disposal is the time when the disposal is made or treated as made for the purposes of corporation tax on chargeable gains. See *Change 644* in Annex 1. This change is similar to that made in section 151(8) of ITA for the purposes of relief against income tax. Respondents to consultation on section 151 of ITA agreed with the change.

**Q13. We welcome comments on the proposal to specify the time at which the disposal occurs.**

**ANNEX 1: CHANGES IN THE LAW**

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**Change 625: Share loss relief, community investment tax relief and the corporate venturing scheme: omit the words “for full consideration”: clauses 1 and [CITR] and Schedule 1 (paragraph 46(2)(a) of Schedule 15 to FA 2000)**

This change deletes the words “for full consideration” which qualify “by way of a bargain made at arm’s length”. It removes words which are not in practice applied to impose any additional requirement.

There are three places in the Tax Acts where the words “by way of a bargain made at arm’s length” are qualified by the words “for full consideration”. These are:

- section 575(1)(a) of ICTA (relief for losses on unquoted shares in trading companies);
- paragraph 29(4)(a) of Schedule 16 to FA 2002 (community investment tax relief); and
- paragraph 46(2)(a) of Schedule 15 to FA 2000 (the corporate venturing scheme).

Paragraph 46(2)(a) of Schedule 15 to FA 2000 is also applied for the purposes of paragraph 67 of that Schedule by paragraph 67(3).

All these provisions apply for corporation tax purposes only. Prior to ITA, section 575(1)(a) and paragraph 29(4)(a) of Schedule 16 to FA 2002 also applied for income tax purposes.

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Section 575(1)(a) of ICTA and paragraph 67 of Schedule 15 to FA 2000 are concerned with the circumstances in which an allowable loss incurred on a disposal of shares may be claimed as a relief in calculating taxable income. The phrase “for full consideration” has not caused practical difficulty in relation to the application of either of those provisions.

Case law (Berry v Warnett (1982), 55 TC 92 HL<sup>1</sup> and Bullivant Holdings Limited v CIR (1998), 71 TC 22 ChD<sup>2</sup>) confirms that a bargain may be made at arm’s length if a full and fair price is paid. Whether the price is full and fair is to be determined by reference to the circumstances of the disposal and it is clear that the price paid may be full and fair notwithstanding that it is substantially below open market value.

If the words “for full consideration” mean no more than that a full and fair price is paid in the circumstances of the disposal, the words are otiose. If they have independent meaning, this may require that the price paid is not less than market value, if market value is greater than the amount which is a full and fair price in the circumstances of the disposal. But in practice no such requirement is imposed.

Accordingly the words “for full consideration” have been omitted from section 131(3)(a) of ITA rewriting section 575(1)(a) of ICTA for income tax purposes. See Change 20 in Annex 1 to the Explanatory Notes to ITA.

This Bill similarly omits those words from clause 1(2)(a) of this Bill rewriting section 575(1)(a) of ICTA for corporation tax purposes and amends Schedule 15 to FA 2000 so that the words do not apply for the purposes of paragraph 67 of that Schedule (see below).

Paragraph 29 of Schedule 16 to FA 2002 and paragraph 46 of Schedule 15 to FA 2000 are concerned with the withdrawal or reduction of tax relief previously obtained.

These paragraphs contrast with the only other provisions in the Tax Acts dealing with the withdrawal or reduction of investment reliefs, namely:

- section 299(1)(a) and (b) of ICTA and section 209(2) and (3) of ITA (withdrawal or reduction of EIS relief); and
- section 266(2) and (3) of ITA (withdrawal or reduction of VCT relief).

In those provisions, the words “by way of a bargain made at arm’s length” appear without any qualification.

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<sup>1</sup> [1982] STC 396

<sup>2</sup> [1998] STC 905

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In practice, the provisions for the withdrawal or reduction of CITR are operated on the same basis as the similar provisions relating to EIS relief and VCT relief - see paragraph 7020 of HMRC's Community Investment Tax Relief Manual (CITM 7020).

The words "for full consideration" have accordingly been omitted from section 361(4)(a) in Part 7 of ITA rewriting Schedule 16 to FA 2002 for income tax purposes. See Change 20 in Annex 1 to the Explanatory Notes to ITA.

This Bill similarly omits those words from:

- clause [ ] rewriting paragraph 29(4)(a) of Schedule 16 to FA 2002 for corporation tax purposes and
- paragraph 46(2)(a) of Schedule 15 to FA 2000 (see Schedule 1).

The effect of this change is to conform provisions in each of the venture capital schemes dealing with the same issues, by removing from some of them words which are either otiose or apply a test which in practice is not required to be met.

***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 635: Share loss relief: corresponding bonus shares: clauses 6 and 23**

This change legislates the practice that corresponding bonus shares are qualifying shares for share loss relief.

The change in clause 6(3) is equivalent to that made in section 135(4) of ITA and brings the provisions for share loss relief for investment companies back into line with the provisions for share loss relief for individuals. See Change 23 in Annex 1 to the Explanatory Notes to ITA.

When shares are issued by way of bonus they are not issued for consideration. Bonus shares do not, therefore, meet the requirements of section 573(6) of ICTA (rewritten as clause 6(2)) that the company has subscribed for the shares in consideration of money or money's worth.

In practice, where ordinary shares in the same company, of the same class and carrying the same rights as shares for which the company has subscribed are issued by way of bonus, claims for relief on the disposal of the shares issued by way of bonus are accepted.

Accordingly, clause 6(3) has been included to provide that, where a company which has subscribed in consideration of money or money's worth for shares in a qualifying

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trading company is issued with bonus shares in that company which are of the same class and carry the same rights (corresponding bonus shares), the company is treated as having also subscribed for the corresponding bonus shares in consideration of money or money's worth.

This means that the corresponding bonus shares are shares which have been subscribed for by the company for the purposes of clause 1(1).

Clause 6(4) has been added to make clear that the corresponding bonus shares are treated as subscribed for at the time the original shares were subscribed for in actual consideration of money or money's worth. This is principally for the purposes of clause 2(2)(a), which has no equivalent in Chapter 6 of Part 4 of ITA.

The definitions of bonus shares and corresponding bonus shares are in clause 23(1) and (2).

The effect of this change is to put on a statutory basis an existing practice which is favourable to taxpayers.

***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 636: Share loss relief: restrictions on the amount of share loss relief: clause 8**

This change refines and extends the provision in section 576(1) of ICTA which restricts the amount of share loss relief available in a case where qualifying shares forming part of a holding are disposed of.

This change is the same as that made in section 147 of ITA for the purposes of relief against income tax. See Change 26 in Annex 1 to the Explanatory Notes to ITA.

Section 576(1) of ICTA provides that, if a company disposes of qualifying shares forming part of a holding, the amount of relief must not exceed the sums which would be allowed as deductions in computing the allowable loss if the shares had not been part of the holding.

For the purposes of corporation tax on chargeable gains, where shares are pooled in a section 104 holding (see section 104 of TCGA) or a 1982 holding (see section 109 of TCGA), the total consideration given for all the shares in the pool is averaged across the shares. This means that, when there is a part disposal of shares out of the holding, a proportion of this consideration is deducted in computing the chargeable gain pro-rata to the number of shares disposed of over the total number of shares in the pool. This may result in an allowable loss on the disposal of such shares being greater than it would have been if the shares had not been pooled.

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This provision is designed to limit the share loss relief available in such cases to no more than what would have been the amount allowable as a deduction in calculating the loss if the shares had not been pooled. Ignoring incidental costs of acquisition and disposal, this will equate in most cases to the amount subscribed for the shares. It is a general rule, but is of special relevance to the case where some of the shares in the pool are not qualifying shares.

In connection with the changes in clause 9 described in *Change 639* in Annex 1, clause 8 refines the circumstances in which the provision applies as follows:

- where the qualifying shares disposed of form part of a section 104 holding or a 1982 holding at the time of the disposal or formed part of such a holding at any earlier time (subsections (1) and (2));
- where both qualifying shares and shares which are not capable of being qualifying shares are acquired or disposed of on the same day and are treated by virtue of section 105(1)(a) of TCGA for the purposes of corporation tax on chargeable gains as acquired or disposed of by a single transaction (subsections (3) and (4)); and
- where the qualifying shares in a company are treated for the purposes of corporation tax on chargeable gains by virtue of section 127 of TCGA as the same asset as other shares in the same company which are not capable of being qualifying shares or as debentures of the same company (subsections (5) and (6)).

The clause has the following effects:

- Subsections (1) and (2) rewrite the provision in section 576(1) with two changes.
- The first change is that subsection (2) only applies to shares which are pooled in a section 104 holding or a 1982 holding. It requires the allowable deductions for the qualifying shares to be re-calculated as if the qualifying shares did not form part of the section 104 holding or the 1982 holding. But it does not affect the calculation of the allowable deductions in any other way. For example, if there has been an issue of corresponding bonus shares in respect of original qualifying shares, the re-calculated allowable deductions will be apportioned in the usual way across the original shares and the corresponding bonus shares.
- The second change is that subsection (2) expressly applies if the company disposes of all the shares in the section 104 holding or the 1982 holding and at some time those shares and other shares which have been disposed of earlier formed part of the same holding (see subsection (1)(b)(ii)). This deals with the effect on the allowable cost of the shares in the pool where the other shares

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were acquired at a different price from that of the shares now being disposed of. It is a clarification of the scope of the provision in section 576(1) of ICTA.

- Subsections (3) to (6) are new. They are limited to mixed holdings (see the commentary on clause 9 and *Change 637*) and deal with the residual situations where the cost of shares which are not within a section 104 holding or a 1982 holding is also subject to averaging.
- Subsections (3) and (4) deal with the circumstances where the cost of qualifying shares and shares which are not capable of being qualifying shares acquired on the same day are subject to averaging.
- Subsections (5) and (6) ensure that the limit is calculated separately in relation to the qualifying shares in the case of a reorganisation, such as a rights issue, involving qualifying shares and shares which are not capable of being qualifying shares or debentures. In those circumstances, the allowable deductions by reference to which the limit is to be calculated in accordance with this subsection are likely to differ from the cost of acquisition of the qualifying shares calculated in accordance with section 129 of TCGA.

Subsection (8) explains what is meant by “shares that are not capable of being qualifying shares” for the purposes not only of this clause but also clause 9. See *Change 637* for a detailed explanation of why a mixed holding has been defined in terms of a holding which includes such shares. Subsection (9) extends this meaning for the purposes only of subsection (5) to cover re-organisations involving the issue of shares of a different class.

The effect of this change is mainly clarificatory. In particular the reference in clause 8(1)(b)(ii) to the shares having formed part of such a holding [that is a section 104 holding or a 1982 holding] at an earlier time prevents the taxpayer claiming an amount of relief greater than the actual cost of the qualifying shares disposed of by advancing an argument that the restriction on the amount of share loss relief does not apply on the disposal of the whole of a holding.

***This change is adverse to some taxpayers in principle and in practice. But the numbers affected and the amounts involved are likely to be small.***

**Change 637: Share loss relief: meaning of a mixed holding: clause 9**

This change substitutes for the meaning of a mixed holding in section 576(1) of ICTA a new definition of a mixed holding.

This change is the same as that made in section 148(1) of ITA for the purposes of relief against income tax. See Change 27 in Annex 1 to the Explanatory Notes to ITA.

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Section 576(1) of ICTA contains a rule for identifying shares disposed of by a person out of a holding which comprises:

- (a) shares for which he has subscribed (“qualifying shares”); and
- (b) shares which he has acquired otherwise than by subscription.

This distinction has remained unchanged since the introduction of this provision by section 37 of FA 1980. At that time and at the time of its consolidation in 1988 as section 576(1) of ICTA, the wording was adequate to distinguish between shares which would qualify for share loss relief and those which would not.

Following the changes to the definition of qualifying trading company made by FA 1998 and FA 2001, the fact that this is the distinction made by section 576(1) of ICTA has become less evident.

At the time of a disposal of shares from a holding, those or other shares in the holding may be known to be incapable of ever being qualifying shares, even though they were subscribed for. This can be because:

- the company failed to meet either the gross assets requirement or the unquoted status requirement at the time of issue of the shares; or
- the company has failed to meet the condition that it has carried on its business wholly or mainly in the United Kingdom in relation to the shares. If the failure in relation to those shares was only during a period that ended more than 12 months before other shares in the holding were issued, it will not cause the other shares to be incapable of being qualifying shares.

Clause 9(1), accordingly, provides that a mixed holding is one which, at the time of the disposal in question, includes shares that are not capable of being qualifying shares and “other shares”, that is shares which at that time may or may not qualify for relief on their disposal.

Shares that are not capable of being qualifying shares are defined in clause 8(8) as not only shares acquired otherwise than by subscription, but also shares in relation to which the gross assets requirement or the unquoted status requirement or the requirement as to the carrying on of business wholly or mainly in the United Kingdom has not been met.

The effect in principle of this change will depend on whether the rule as amended results in different shares being identified as disposed of by the taxpayer from those identified under the rule in the source legislation. Identification of different shares may in principle result in the amount of share loss relief available on the disposal in question being less, more or the same and may also affect the relief available on a subsequent disposal. But in practice mixed holdings are treated as including all

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holdings of shares in a company some of which qualify for share loss relief and some of which do not qualify (see paragraph 47010 of HMRC's Venture Capital Manual).

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

**Change 638: Share loss relief: identification of which shares are disposed of: clause 9**

This change legislates the practice that, if the identification rule in section 576(1) of ICTA identifies that some but not all of the qualifying shares in the mixed holding are disposed of, the rule is also applied to determine which of those shares are disposed of.

This change is the same as that made in section 148(2) of ITA for the purposes of relief against income tax. See Change 28 in Annex 1 to the Explanatory Notes to ITA.

It is stated explicitly in clause 9(2)(b) that the rule as amended by *Change 637* so applies.

The effect in principle of this change will depend on whether the rule as amended results in different shares being identified as disposed of by the taxpayer from those identified under the rule in the source legislation. Identification of different shares may in principle result in the amount of share loss relief available on the disposal in question being less, more or the same and may also affect the relief available on a subsequent disposal. But in practice the qualifying shares disposed of and the proportion of the loss attributable to those shares is determined on a just and reasonable basis. This will normally give the same result as the rewritten legislation (see paragraph 47150 of HMRC's Venture Capital Schemes Manual).

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

**Change 639: Share loss relief: identification of shares disposed of out of a mixed holding: clause 9**

This change expands and clarifies the rules for identifying the shares disposed of, in cases where the company disposes of some only of the shares in a mixed holding. As to what constitutes a mixed holding, see *Change 637*.

Section 576(1) of ICTA sets out a general rule that, where shares are disposed of out of a mixed holding, the shares disposed of are to be identified on a last in first out (LIFO) basis.

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This rule is modified by section 576(1C) of ICTA in the case of a mixed holding which includes shares to which investment relief within the meaning given by Schedule 15 to FA 2000 (corporate venturing scheme) is attributable.

Shares forming a section 104 holding or a 1982 holding are regarded for the purposes of corporation tax on chargeable gains as indistinguishable parts of a single asset. Thus, the consideration given for the shares in the holding is spread evenly across the shares and there is no need for the purposes of corporation tax on chargeable gains to identify the specific shares disposed of.

The LIFO identification rule is, however, necessary for the purposes of section 573 of ICTA to identify whether, on the disposal of some only of the shares out of such a holding consisting partly of shares that are not capable of being qualifying shares, the shares disposed of are qualifying shares.

Shares of the same class held by the company in the same capacity will normally constitute a section 104 holding or a 1982 holding (see sections 104 and 109 of TCGA). Section 107 of TCGA, however, provides special rules for identifying shares where there are acquisitions and disposals within a ten day period. Where some but not all of the shares acquired within a ten day period are disposed of within that period, section 107 of TCGA identifies the shares disposed of on a first in first out (FIFO) basis.

Section 105 of TCGA contains rules in relation to shares acquired on the same day. In practice, if some but not all of the shares of the same class acquired on the same day are shares that are not capable of being qualifying shares and if some only of the shares acquired on that day are disposed of, the question whether and to what extent the shares disposed of are qualifying shares is determined for the purposes of section 573 of ICTA on a just and reasonable basis; normally pro rata to the number of shares acquired on that day.

In rewriting the rule in section 576(1) of ICTA, the approach taken in clause 9 is to ensure that the identification rules for share loss relief are wholly consistent with the identification rules for corporation tax on chargeable gains, so that:

- so far as the rules in sections 105 and 107 of TCGA serve conclusively to identify whether and to what extent the shares disposed of out of a mixed holding are qualifying shares, those rules are explicitly applied (see subsections (3)(a)(i) and (4));
- so far as shares acquired on different days are included in a section 104 holding, the LIFO rule in section 576(1) of ICTA is applied separately to the shares in the section 104 holding (see subsections (3)(a)(ii) and (5)); and

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- so far as shares acquired on different days are included in a 1982 holding, the LIFO rule in section 576(1) of ICTA is applied separately to the shares in the 1982 holding (see subsections (3)(a)(ii) and (5)).

In a case where the mixed holding includes shares to which investment relief is attributable, subsections (3)(a), (4) and (5) are displaced by subsections (3)(b) and (6).

In some cases those rules do not conclusively determine whether and to what extent the shares disposed of are qualifying shares. They may, for example, identify that some only of shares of the same class acquired on the same day are disposed of. In that case it will be necessary to determine whether any of the shares disposed of are shares that are not capable of being qualifying shares. Subsection (7) legislates existing practice by providing an explicit rule that the determination is to be made on a just and reasonable basis.

This change will only have any effect on taxpayers in the rare circumstances of the disposal at a loss of qualifying shares being some only of a number of shares acquired at separate times not earlier than nine days before the date of the disposal. The change will apply a FIFO rule rather than a LIFO rule. The effect may be adverse or favourable depending on whether the shares identified as disposed of are or are not qualifying shares and, if qualifying shares were subscribed for at different times, the respective amounts subscribed for the qualifying shares. In all other circumstances, it will have no effect for taxpayers.

***This change is adverse to some taxpayers and favourable to others in principle and in practice. But the numbers affected and the amounts involved are likely to be small.***

**Change 640: Share loss relief: shares to which section 127 of TCGA applies: clause 10**

This change makes explicit the time at which, among others, corresponding bonus shares are treated as issued for the purposes of clause 9. It is, in part, consequential on the inclusion of clause 6(3) (see *Change 635*) which treats corresponding bonus shares as subscribed for by the company.

This change is the same as that made in section 149(2) of ITA for the purposes of relief against income tax. See Change 31 in Annex 1 to the Explanatory Notes to ITA.

The time at which such shares are treated as issued to or acquired by the company claiming relief needs to be ascertained for a number of purposes. See clause 22 and *Change 643*.

The time at which corresponding bonus shares are treated as issued to or acquired by the company claiming relief also needs to be ascertained for the purpose of

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determining which shares are disposed of in accordance with the identification rules in section 576(1) and (1C) of ICTA, rewritten in clause 9.

Clause 10(1) has been included for this purpose. A different approach from that in clause 22(2) has been adopted. Clause 9 applies where the holding includes shares to which investment relief within the meaning given by Schedule 15 to FA 2000 (corporate venturing scheme) is attributable. In cases where it so applies, clause 9 applies the rules in paragraph 93 of Schedule 15 to FA 2000. For consistency, clause 10(1) follows the wording in paragraph 93(7) of that Schedule.

Clause 10(1) and paragraph 93(7) of Schedule 15 to FA 2000 do not apply only to issues of corresponding bonus shares. They also apply to allotments of shares for payment, for example by way of rights, which meet the requirements of section 126(2)(a) of TCGA and to which section 127 of that Act applies.

This ensures that, if investment relief is not attributable to the shares in the existing holding or the new shares, new shares issued by way of rights within section 126(2)(a) of TCGA are treated for the purposes of clause 9 as acquired at the same time as the shares in the existing holding.

But if investment relief is attributable to the shares in the existing holding or to new shares allotted for payment, clause 10(1) does not apply to the allotment. This is because paragraph 81 of Schedule 15 to FA 2000 provides that, if there is such an allotment for payment and investment relief is attributable either to the shares in the existing holding or to the allotted shares, section 127 of that Act does not apply.

In addition to making the necessary provision consequent on the explicit treatment of corresponding bonus shares as being subscribed for, this change has the effect, for the purposes of clause 9, of treating rights issue shares as issued earlier than the date on which they are actually issued, except as described in the preceding paragraph.

If the rights issue shares form part of a mixed holding and some only of the shares in the mixed holding are disposed of, the effect of this change is to prevent the taxpayer from claiming a greater amount of relief or from obtaining relief earlier than would be the case under generally accepted practice (see paragraphs 47400 and 48350 of HMRC's Venture Capital Schemes Manual), by advancing an argument that the rights issue shares are to be identified as being among the shares disposed of by reference to the actual date of their issue.

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

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**Change 641: Share loss relief: nominees and bare trustees: clause 10**

This change makes clear that, if shares of the same class are held as to some directly by the company and as to the others by a nominee or bare trustee for it, all the shares are included in a single holding of the company for the purposes of clause 9.

This change is the same as that made in section 149(3) of ITA for the purposes of relief against income tax. See Change 32 in Annex 1 to the Explanatory Notes to ITA.

A company which has subscribed for shares may subsequently wish to transfer the shares into the name of a nominee or bare trustee for it. On a disposal of the shares on behalf of the company by the nominee or bare trustee, the allowable loss for the purposes of corporation tax on chargeable gains and the entitlement to relief under section 573 of ICTA is that of the company not that of the nominee or bare trustee.

The effect of this change is to prevent the taxpayer from claiming a greater amount of relief or obtaining relief earlier than has hitherto been the case in practice, by advancing an argument that, where a company has beneficial holdings of shares one of which is held directly and the other of which is held through a nominee or bare trustee, the provisions of clause 9 should be applied separately.

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

**Change 642: Share loss relief: resolution of conflicting provisions: clauses 7 and 20**

This change makes clear that the provisions of clause 7 do not apply to an exchange of shares to which clause 20 applies. It resolves an apparent conflict between section 304A of ICTA, rewritten by ITA as sections 576J and 576K of ICTA, and section 575(2) of ICTA, rewritten in clause 7, which arises from the way in which section 575(2) of that Act achieves its purpose.

This change is the same as that made in sections 136(2) and 145(3) of ITA for the purposes of relief against income tax. See Change 24 in Annex 1 to the Explanatory Notes to ITA.

Section 575(2) of ICTA is an anti-avoidance provision. Its purpose is to prevent a person from obtaining share loss relief in respect of shares that are not capable of being qualifying shares in a company (“Oldco”) by swapping them for shares in another company (“Newco”) that are capable of being qualifying shares, except to the extent that the person gives additional consideration for the shares in Newco. For example, the shares in Oldco may not be capable of being qualifying shares because they were purchased from another shareholder. This provision has existed since the introduction of share loss relief in 1980.

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Section 304A of ICTA was first applied for the purposes of share loss relief as part of the changes to the meaning of “qualifying trading company” made by FA 1998. It deals with the continuity of the requirements to be met by Newco following an exchange of qualifying shares in Oldco for qualifying shares in Newco without change of ownership.

Section 575(2) of ICTA applies to the issue of ordinary shares (“new shares”) by Newco in an exchange or scheme of reconstruction within section 135 or 136 of TCGA relating to shares (“old shares”) in Oldco. The new shares are in these circumstances “issued in consideration of ... money’s worth”, that is the transfer or cancellation of the old shares. Accordingly, if Newco is a qualifying trading company in relation to the disposal of the new shares, the new shares disposed of will be qualifying shares (see section 573(6) of ICTA rewritten in clause 6(2)). This is the case whether or not the old shares are capable of being qualifying shares.

Section 575(2)(a) of ICTA operates to prevent share loss relief being obtained on the disposal of the new shares where the old shares were not themselves capable of being qualifying shares by requiring the following assumptions to be made:

- first, that section 127 of TCGA does not apply to the exchange or scheme of reconstruction, so that there is a disposal of the old shares for the purposes of corporation tax on chargeable gains; and
- second, that on that assumed disposal an allowable loss would have been incurred for those purposes.

Section 575(2)(a) of ICTA then requires that share loss relief would have been obtainable on the assumed disposal on the basis that it was a disposal by way of a bargain made at arm’s length. This is a consequence of the express reference in section 575(2)(a) of ICTA to the allowable loss being incurred “in disposing of [the old shares] as mentioned in subsection (1)(a) above”. Section 575(1) of ICTA sets out the categories of disposal in respect of which a claim for share loss relief may be made, including in paragraph (a) a disposal “by way of a bargain made at arm’s length for full consideration”. This requirement is rewritten in clause 1(2)(a). See the commentary on clause 1 and *Change 625* in Annex 1.

Unless, on the assumptions described, share loss relief would have been obtained on the assumed disposal of the old shares, share loss relief may not be obtained on the disposal of the new shares, except to that extent that any “new consideration” has been given for the new shares (see section 575(2)(b) of ICTA rewritten in clause 7(4) and (5)).

Section 304A of ICTA is one of the provisions applied by section 576(4A) of that Act with modifications for the purposes of defining a qualifying trading company by reference to the requirements of section 293 of ICTA. Section 304A of ICTA has been rewritten by ITA with the required modifications, in sections 145 and 146 of ITA for

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the purposes of relief against income tax and in sections 576J and 576K of ICTA for the purposes of relief against income subject to corporation tax. See the commentary on sections 145 and 146 of, and Schedule 1 to, ITA in the Explanatory Notes to that Act.

Section 304A of ICTA relates to an exchange of securities within section 135 of TCGA affecting old shares which are qualifying shares. The type of exchange to which section 304A of ICTA applies is one which involves no change of ultimate ownership. It typically occurs when a new holding company is placed above a previously loss making company as one of the steps in obviating difficulties arising under company law in relation to distributable profits.

The effect of section 304A of ICTA as modified and applied by section 576(4A) of that Act is that, if the exchange meets the requirements of section 304A(1) of ICTA, the new shares are capable of being qualifying shares and the requirements for Newco to be a qualifying trading company are to be applied as if Oldco and Newco were one and the same company. In particular, the unquoted status requirement in section 293(1A) of ICTA (rewritten in section 143 of ITA and section 576H of ICTA) and the gross assets requirement in section 293(6A) of ICTA (rewritten in section 142 of ITA and section 576G of ICTA) are to be met only at the time of issue of the old shares by Oldco.

But if the assumptions required by section 575(2)(a) of ICTA are to be applied to an exchange falling within section 304A(1) of that Act, the requirement that the assumed disposal arises by way of a bargain made at arm's length is unlikely to be capable of being met. This would prevent a claim for share loss relief on the disposal of the shares in Newco and render nugatory the application of section 304A of ICTA for the purposes of share loss relief.

Change 24 in Annex 1 to the Explanatory Notes to ITA resolves that apparent conflict, for the purposes of relief against income tax, by providing in section 145(3)(a) of ITA that nothing in section 136(2) of that Act applies to an exchange falling within section 145(1) and cross-referring to that provision in section 136(2) of that Act.

But it was not within the scope of ITA, an income tax rewrite Bill, to make the equivalent changes in sections 575(2) and 576J of ICTA for the purposes of relief under section 573 of that Act against income subject to corporation tax. It is within the scope of a corporation tax rewrite Bill to make them and this change accordingly does so.

The effect of this change is to ensure that the legislation no longer contains an apparent conflict between provisions. The conflict is apparent in the sense that it arises in principle but has no effect in practice.

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*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 643: Share loss relief: time of issue of corresponding bonus shares: clause 22**

This change inserts an explicit provision determining the time at which corresponding bonus shares are treated as issued to a company. It is consequential on the inclusion of clause 6(3) (see *Change 635* which treats corresponding bonus shares as subscribed for by the company).

This change is the same as that made in section 150(3) of ITA for the purposes of relief against income tax. See Change 34 in Annex 1 to the Explanatory Notes to ITA.

The time at which such shares are treated as issued to the company claiming relief needs to be ascertained for the purposes of determining:

- the beginning of the period during which the qualifying trading company must carry on its business wholly or mainly in the United Kingdom (clause 11(5)(a));
- the time at which the gross assets requirement is to be met (clause 17(1)(a) and (2)(a));
- the time at which the unquoted status requirement is to be met (clause 18(1)); and
- if clause 20 applies, the time at which the new shares are to be treated as having been issued for the purposes of clause 21(2)(b).

This change is a necessary direct consequence of the inclusion, to the advantage of taxpayers, of the explicit treatment of corresponding bonus shares as being subscribed for.

*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 647: Investment company: omission of reference to savings bank and bank for savings: clause 23 and Schedule 1 (section 151 of ITA)**

This change results in certain savings banks and banks for savings no longer falling within the definition of “investment company” for the purposes of share loss relief in Chapter [X] of Part [Y] of this Bill and Chapter 6 of Part 4 of ITA.

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Section 576L(1) of ICTA and section 151(1) of ITA apply the definition of investment company in section 130 of ICTA, with modification, for the purposes of share loss relief under section 573 of ICTA and Chapter 6 of Part 4 of ITA.

The definition of “investment company” in section 130 of ICTA, which applies for the purposes of Part 4 of ICTA, is as follows:

“investment company”, means any company whose business consists wholly or mainly in the making of investments and the principal part of whose income is derived therefrom, but includes any savings bank or other bank for savings except any which, for the purposes of the Trustee Savings Bank Act 1985 is a successor or a further successor to a trustee savings bank.

The principal use of the term in Part 4 of ICTA was for the purposes of section 75 of ICTA (expenses of management: investment companies). FA 2004 repealed that section in relation to accounting periods beginning on or after 1 April 2004 and replaced it with the current provisions in sections 75 to 75B of ICTA (to be rewritten in Bill 5, see Committee Paper CC/SC (07) 07). The current provisions apply to “companies with investment business” the definition of which inserted in section 130 by FA 2004 is as follows:

“company with investment business” means any company whose business consists wholly or partly in the making of investments.

The notes on clauses to the Finance Bill 2004 state in relation to that definition that:

the reference to savings banks has now been removed on the grounds that it is obsolete.

The definition of “investment company” was retained in section 130 of ICTA for the reasons given in the notes on clauses to Finance Bill 2004:

26. The current definition of an “investment company” has not been repealed. The definition of an “investment company” will remain relevant for the purposes of:
- section 573 ICTA (where it helps identify the companies entitled to relief against income in respect of losses on unquoted shares in trading companies); and
  - the transitional rules in Clause 43.

This change proposes that the cross reference to and modification of the definition of “investment company” in section 576L(1) of ICTA and section 151(1) of ITA be replaced by a stand alone definition in clause 23(1) of this Bill and section 151(1) of ITA in the following terms:

“investment company” means a company—

- (a) whose business consists wholly or mainly in the making of investments, and
- (b) which derives the principal part of its income from the making of investments,

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but does not include the holding company of a trading group.

The omission of the reference to “any savings bank or other bank for savings except any which, for the purposes of the Trustee Savings Bank Act 1985 is a successor or a further successor to a trustee savings bank” will apply only in relation to the disposal on or after the date on which this Bill comes into force of shares issued on or after that date. It has two effects.

First, no such savings bank or bank for savings will be eligible for share loss relief under clause 1 of this Bill on such a disposal as it will no longer meet the requirement that the investor is an investment company.

This is potentially adverse to taxpayers in principle and in practice, but we are not aware that any such bank carries on business in the United Kingdom which includes the making of investments in shares in companies capable of being qualifying trading companies.

Second, the requirements in clause 11(2)(b) and (3)(b) of this Bill and section 134(2)(b) and (3)(b) of ITA, that to be a qualifying trading company the company must not be an investment company at the times mentioned, will be capable of being met by a company that is such a savings bank or bank for savings in relation to a disposal to which the new definition applies.

This is potentially favourable to taxpayers in principle but will have no effect in practice, as it is also a requirement of clause 11(2)(b) and (3)(b) of this Bill and section 134(2)(b) and (3)(b) of ITA that the company is not at those times a trading company (as defined in clause 23(1) of this Bill and section 151(1) of ITA). Such a bank will be a trading company within that definition, notwithstanding that it may be a mutual trader and the profits of its trade are not within the charge to tax under Case I of Schedule D.

*This change has an effect which is adverse to some taxpayers in principle and in practice. But the numbers affected and the amounts involved are likely to be small. It also has an effect which is in taxpayers’ favour in principle but which is not expected in practice to alter the position for taxpayers.*

**Change 644: Share loss relief: time of disposal: clause 23**

This change makes explicit the accounting period in which the disposal is to be treated as occurring for the purpose of share loss relief.

The availability of share loss relief is dependent upon an allowable loss being incurred for the purposes of corporation tax on chargeable gains and this can only be incurred on a disposal within the meaning given in TCGA.

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*January 2008: Committee paper CC/SC (08) 04*

The provisions of TCGA which determine when a disposal occurs, including in particular section 28 of that Act, do not apply to Chapter 5A of Part 13 of ICTA. But in practice “the accounting period in which the loss was incurred” referred to section 573(2) of ICTA is taken to be the accounting period in which the disposal is made or treated as made for the purposes of corporation tax on chargeable gains in accordance with TCGA.

Clause 23(8) contains explicit provision to this effect. This change is similar to that made in section 151(8) of ITA for the purposes of relief against income tax. See Change 35 in Annex 1 to the Explanatory Notes to ITA.

*Although this change in principle affects the timing of relief and could be favourable to some taxpayers and adverse to others, it is entirely in line with generally accepted practice and so will have no practical effect.*