

## **Part 1: Companies with investment business**

### **Overview**

1. Expenses of management (generally known as “management expenses”) are designed to give relief for the cost of managing investments on broadly the same basis as relief for trading expenses or expenses of a property business.
2. Originally relief was given for expenses “disbursed” but changes in 2004 brought the relief (and the recovery of relief) more closely into line with the treatment of the corresponding items in a company’s accounts. So, for instance, clauses 8 and 14 rely on the concept of “generally accepted accounting practice”.

### **Chapter 1: Introduction**

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

3. This clause introduces the Part. It is new.
4. This Bill does not rewrite section 76 of ICTA (expenses of insurance companies). For companies carrying on life assurance business, but not charged under Schedule D Case I, this Part does not apply. Instead, the rules in section 76 apply.

#### **Clause 2: “Company with investment business” and “investment business”**

5. This clause sets out which companies are within the rules in this Part of the Bill. It is based on sections 75(4) and 130 of ICTA.
6. *Subsection (1)* defines a “company with investment business”.
7. *Subsection (2)* rewrites the rule in section 487(4) of ICTA about credit unions.
8. The rule applies for the purposes of this Part of the Bill. So there is no possibility of a charge on a credit union under clause 35 on a FISMA repayment. See *Change 1* in Annex 1.

<p><b>Q1. We propose to make clear that a charge on a FISMA repayment cannot be made on a credit union. We welcome comments on this proposed rewrite change.</b></p>
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9. *Subsection (3)* is a signpost to clause 3(2) which restricts the application of this Part of the Bill to the part of the company’s business which is an investment business. But that restriction does not affect the basic definition of a “company with investment business”.
10. Schedule 1 to this Bill amends section 18 of CAA so that “managing the investments of a company with investment business” in section 15(1)(g) of CAA is defined by reference to clauses 2 and 3 of the Bill. So there is no need for a separate

rule to the effect that a credit union is not a company with investment business for the purposes of CAA 2001.

## **Chapter 2: Management expenses**

### **Clause 3: Expenses of management of a company's investment business**

11. This clause sets out what are “expenses of management”. It is based on section 75 of ICTA.

12. There is no explicit definition of “expenses of management” either in the source legislation or in this Bill. Instead, the limits of the expression are set by:

- case law, in which the expression (retained in this Bill) has been considered;
- general exclusions set out in this clause;
- specific reliefs set out in Chapter 3 of this Part of the Bill; and
- specific restrictions set out in Chapter 4 of this Part of the Bill.

13. *Subsection (1)* ties the expenses to the company's investment business (defined in clause 2).

14. *Subsection (2)(a)* restricts the application of the section to the part of the company's business which is an investment business. This rule is needed because, unlike under the pre-2004 rules, relief for management expenses may be available to a company that undertakes other significant activities, such as carrying on a trade. Paragraph (b) excludes expenses in connection with investments held for an unallowable purpose (see subsection (5)). The exclusion restricts the company's investment business.

15. Both restrictions in subsection (2) apply for the purposes of this Part of the Bill (see clause 2).

16. *Subsection (3)* restricts the application of this Part of the Bill to the part of the company's business which is an investment business. This rule is needed because, unlike under the pre-2004 rules, relief for management expenses may be available to a company that undertakes other significant activities, such as carrying on a trade.

17. The clause uses the expression “a deduction is allowed”, following the words of the trading income clauses. HMRC guidance (see paragraph 8580 of the Company Taxation Manual) suggests that the deduction of management expenses is mandatory. But this amounts to the same thing. Management expenses are referable to a particular accounting period. They can be deducted only for the period to which they are referable (or to which they are carried forward under clause 6).

18. *Subsection (3)* excludes capital expenditure, in terms that follow closely the trading income rule. It also prevents a deduction as management expenses for anything that is otherwise allowable for tax purposes.

19. *Subsection (4)* is a link to clause 7, which determines the timing of the deduction.

20. *Subsection (5)* explains the expression “unallowable purpose” used in subsection (2)(b). Examples are shares in a football club held because a director is a supporter and shares in a company that owns a yacht which is available for shareholders’ use. And investments held for activities that are outside the charge to corporation tax are excluded.

21. In practice (see paragraph 8230 of the HMRC Company Taxation Manual), activities are not treated as outside the charge to corporation tax just because they generate no profits charged to corporation tax.

22. *Subsection (6)* allows an apportionment on a just and reasonable basis.

23. *Subsection (7)* is a signpost to the rule about non-chargeable income.

#### **Clause 4: Amounts treated as expenses of management**

24. This clause makes clear the relationship between two of the rules in clause 3 and rules elsewhere in this Part of the Bill. It is based on section 75 of ICTA.

25. The rule in clause 3(3)(a) which excludes capital expenditure is not applied to a rule that treats an amount as an expense of management.

26. Similarly, the rule in clause 3(2) that expenses must be “in respect of” the company’s investment business is not applied to a rule that makes an amount deductible as an expense of management. See *Change 2* in Annex 1.

**Q2. We propose to clarify the relationship between the rules in sections 75(2) and (4) and other rules that treat an expense as an expense of management. We welcome comments on this proposed rewrite change.**

#### **Clause 5: Income from a source not charged to tax**

27. This clause requires non-taxable income to be set off against management expenses. It is based on section 75(6) of ICTA.

28. *Subsection (1)* identifies the income of a UK resident company to which the clause applies.

29. *Subsection (2)* identifies the income of a non-resident company to which the clause applies.

30. *Subsection (3)* is the rule that the non-taxable income is to be deducted from the management expenses that would otherwise be deductible.

**Clause 6: Carrying expenses forward**

31. This clause allows excess management expenses to be carried forward. It is based on section 75(8) and (9) of ICTA.

32. *Subsection (1)* sets the scene: the company has more management expenses than can be set off against its profits.

33. *Subsection (2)* makes clear that the management expenses in question include any brought forward from the previous accounting period.

34. *Subsection (3)* is the rule that the excess management expenses are carried forward.

35. Section 75(8)(b) of ICTA deals with “charges” paid for the purpose of the company’s investment business. “Charges” comprise only charitable payments. If such payments are made “for the purpose of the company’s investment business” they are management expenses within clause 3 anyway. So they are excluded from “charges” by section 338A(3) of ICTA. This Bill does not rewrite section 75(8)(b) of ICTA. See *Change [Redundant material]* [not in this print].

**Clause 7: Accounting period to which expenses are referable**

36. This clause introduces the timing rules for management expenses. It is based on section 75A of ICTA.

37. *Subsection (2)* makes clear that the general rules in this Chapter may be overridden by a specific timing rule elsewhere.

**Clause 8: Accounts conforming with GAAP**

38. This clause gives the timing rule in the two most common cases. It is based on section 75A of ICTA.

39. *Subsection (1)* deals with the first most common case. The management expenses are “referable to” the accounting period for which accounts are drawn up in accordance with generally accepted accounting practice (GAAP). GAAP is defined in section 50(1) of FA 2004:

(a) in relation to the affairs of a company or other entity that prepares accounts in accordance with international accounting standards (“IAS accounts”), generally accepted accounting practice with respect to such accounts;

(b) in any other case, UK generally accepted accounting practice.

40. UK generally accepted accounting practice is defined in section 50(4) of FA 2004:

generally accepted accounting practice with respect to accounts of UK companies (other than IAS accounts) that are intended to give a true and fair view

41. *Subsection (2)* deals with the second most common case. GAAP accounts are drawn up. But the period of the accounts does not coincide with the company's accounting period. The expenses are apportioned.

42. *Subsection (3)* sets out the basis of apportionment. It retains the words "it appears that" because they may make the test easier to meet than an apparently objective test ("if the method would work unreasonably ..."). But the second "appears" in section 75A(5) of ICTA ("such other method ... as appears just and reasonable") is dropped as it adds nothing. So the wording here is consistent with other "just and reasonable" apportionments in the Bill. The same point arises in connection with clause 12(6).

#### **Clause 9: Accounts not conforming with GAAP**

43. This clause gives the timing rule if accounts are not GAAP compliant. It is based on section 75A(6) of ICTA.

44. The rule is that the management expenses are "referable to" the accounting period into which they would have fallen if the accounts had been GAAP compliant.

#### **Clause 10: Accounts not drawn up**

45. This clause gives the timing rule if there are no accounts. It is based on section 75A(7) and (8) of ICTA.

46. The rule is that the management expenses are "referable to" the accounting period into which they would have fallen if the GAAP accounts had been drawn up.

47. There are alternative definitions of GAAP in section 50 of FA 2004. The international standard applies if the company "prepares accounts in accordance with international accounting standards". In any other case (including the case where no accounts are prepared), the United Kingdom standard (UK GAAP) applies.

48. The combined effect of section 50(1) and (4) of FA 2004 must be taken to be that in section 75A(8) GAAP means UK GAAP. A similar point arises in clause 14. In each case the clause specifies UK GAAP.

#### **Clause 11: Credits that reverse debits**

49. This clause explains that the credits in accounts with which clauses 12 and 13 are concerned include repayments and amounts never paid. It is based on section 75B(11) of ICTA.

**Clause 12: Claw back of relief**

50. This clause charges tax on credits in accounts that reverse management expenses. It is based on section 75B(3) of ICTA.

51. *Subsection (1)* looks at the credits in accounts and identifies them with previously allowed management expenses. In the case of management expenses carried forward the identification is with the expenses originally deductible (under clause 3) rather than with the amount allowed in a later period.

52. *Subsections (3) and (4)* tax the “reversal amount” by:

- reducing any available management expenses; or
- charging it to tax.

53. *Subsection (5)* provides for any necessary apportionment of the company’s accounts to accounting periods.

54. *Subsection (6)* sets out the basis of apportionment. It retains the words “it appears that” because they may make the test easier to meet than an apparently objective test (“if the method would work unreasonably ...”). But the second “appears” in section 75B(6) of ICTA (“such other method ... as appears just and reasonable”) is dropped as it adds nothing. So the wording here is consistent with other “just and reasonable” apportionments in the Bill. The same point arises in connection with clause 8(3).

**Clause 13: Meaning of “reversal amount”**

55. This clause calculates the reversal amount. It is based on section 75B(3) of ICTA.

56. The calculation is set out in a method statement that excludes from the credit in the accounts:

- anything that does not relate to management expenses previously allowed; and
- anything that has already been taxed.

**Clause 14: Absence of accounts**

57. This clause sets out what happens if there are no accounts. It is based on section 75B(9) and (10) of ICTA.

58. The reversal amount is the amount that would have been credited to GAAP accounts for the company’s accounting period.

59. There are alternative definitions of GAAP in section 50 of FA 2004. The international standards apply if the company “prepares accounts in accordance with

international accounting standards”. In any other case (including the case where no accounts are prepared), UK GAAP applies.

60. The combined effect of section 50(1) and (4) of FA 2004 must be taken to be that in section 75B(10) GAAP means UK GAAP. A similar point arises in clause 10. In each case the clause specifies UK GAAP.

### **Chapter 3: Amounts treated as expenses of management**

#### **Clause 15: Chapter applies to amounts not otherwise relieved**

61. This clause is a priority rule. It is based on section 75(2) of ICTA.

62. If an expense fall within the general rule for management expenses in clause 3(1) that clause takes priority over the rules in this Chapter. And if an expense is otherwise deductible for tax purposes the rules in this Chapter do not apply to it.

#### **Clause 16: Excess capital allowances**

63. This clause gives a deduction for some capital allowances. It is based on section 75(7) of ICTA.

64. A company with an investment business carries on a “qualifying activity” (see section 15(1)(g) of CAA). The rule in section 253 of CAA is that capital allowances are to be deducted in calculating the profits of the business. But, if there is an excess of allowances, the excess is treated as management expenses and can be set against profits generally.

### **Clauses 17 to 28**

#### ***Overview***

65. The following 12 clauses are equivalent to trading income clauses.

66. Generally there are no timing rules in the clauses. So a deduction is made in the accounting period to which it is “referable” in accordance with clause 7. There are two exceptions, in the redundancy payment rules: if the business ceases, the deduction is made in the final accounting period of the business.

#### **Clause 17: Payments for restrictive undertakings: expenses of management**

67. This clause allows a company to deduct certain amounts paid to employees for restrictive undertakings. It is based on section 73(3) of FA 1988.

#### **Clause 18: Employees seconded to charities and educational establishments: expenses of management**

68. This clause allows a company carrying on a trade to deduct the cost of an employee seconded to a charity or educational establishment. It is based on section 86(1) of ICTA.

69. The rule in section 86 of ICTA is that the cost of the employee “shall continue to be deductible in the manner and to the like extent” as if the employee continued to

work in the employer's business. This clause allows the employer to deduct *all* costs attributable to the seconded employee during the period of the secondment, regardless of whether those costs would have been allowed if the employee had not been seconded.

**Q3. We welcome comments on the proposal to carry Change 16 in ITTOIA across to management expenses.**

70. The "to the like extent" rule in section 86 of ICTA clearly brings in the "nine months rule" in section 44 of FA 1989: if the costs are not paid within nine months of the end of the accounting period they are not allowed until they are paid.

71. For income tax the rule in section 86 of ICTA was rewritten in section 70 of ITTOIA. That is a "relevant permissive rule" for the purpose of section 31 of ITTOIA. The rule in section 43 of FA 1989 (the trading income equivalent of section 44 of ICTA) was rewritten in section 36 of ITTOIA. That is a "relevant prohibitive rule" for the purpose of section 31 of ITTOIA. So the "nine months rule" does not affect the deduction currently allowed by section 70 of ITTOIA. But, for corporation tax (both trading income and management expenses), the rewritten rule follows the source legislation. Schedule 1{j2} of this Bill amends section 31 of ITTOIA to bring the income tax code into line.

**Clause 19: Payroll deduction schemes: expenses of management**

72. This clause allows an employer a deduction for expenses incurred in operating the payroll deduction scheme. It is based on section 86A of ICTA.

**Clause 20: Counselling and other outplacement services: expenses of management**

73. This clause gives a deduction for certain expenses of counselling provided for employees. It is based on section 589A of ICTA.

**Clause 21: Retraining courses: expenses of management**

74. This clause gives a deduction for certain expenses of retraining provided for employees. It is based on section 588 of ICTA.

75. The clause does not rewrite section 588(3)(b) of ICTA. That provision makes a deduction as a management expense conditional on the employee's exemption under section 311 of ITEPA in respect of the expenditure in question. This condition is not consistent with the similar provision rewritten in clause 20 and does not serve any material purpose.

**Q4. We welcome comments on the proposal to carry Change 17 in ITTOIA across to management expenses.**

**Clauses 22 to 26: Redundancy payments etc**

76. These five clauses are based on sections 90, 579 and 580 of ICTA. The parts of the rules that deal with the employee’s liability are in section 309 of ITEPA.

***Timing***

77. In clauses 23(4) and 25(4) there is a special timing rule for management expenses. For trading income the Bill adopts a “person-based” approach. So the corresponding trading income rules refer to a “payment ... made after the employer has permanently ceased to carry on the trade [or part of the trade]”.

78. In these clauses the rules refer a payment “referable to ... an accounting period beginning after the business [or the part of the business] has [permanently] ceased to be carried on”. This produces the same result as the trading income clauses, without the need to explain the rule for businesses carried on in partnership.

79. If an investment business ceases, paragraph (iii) of the second sentence of section 90(1) and section 579(3A) of ICTA make the payments referable to the “accounting period ending on the last day on which the ... business was carried on”. These clauses specify instead “the last accounting period in which the business was carried on”. See *Change 3* in Annex 1.

**Q5. We welcome comments on the proposal to clarify the timing rule for redundancy payments if an investment business ceases.**

***Just and reasonable apportionment***

80. Clause 24(2) requires a “just and reasonable” apportionment. Section 579(5) of ICTA does not specify the basis of apportionment.

**Q6. We welcome comments on the proposal to carry Change 14 in ITTOIA across to management expenses.**

***Part of a business***

81. Clause 25 applies to payments in connection with the cessation of *part* of a business in the same way as it applies to payments in connection with the cessation of a whole trade.

**Q7. We welcome comments on the proposal to carry Change 18 in ITTOIA across to management expenses.**

***Devolution***

82. Clause 26(2)(b) reflects the effect of the devolution settlements.

**Q8. We welcome comments on the proposal to carry Change 19 in ITTOIA across to management expenses.**

**Clause 27: Contributions to local enterprise organisations or urban regeneration companies: expenses of management**

83. This clause allows deductions for contributions to local enterprise agencies, training and enterprise councils (TECs), local enterprise companies in Scotland, business links and urban regeneration companies. It is based on sections 79, 79A and 79B of ICTA.

84. *Subsection (3)* is an anti-avoidance rule. It prevents a company using the clause to obtain a deduction for non-commercial expenditure, such as funding the training of a member of a shareholder's family, by passing funds through one of these bodies. The source legislation disallows any deduction if there is a benefit to the company (or a connected person). This clause merely restricts the deduction by the value of the benefit.

**Q9. We welcome comments on the proposal to carry Change 20 in ITTOIA across to management expenses.**

85. *Subsection (6)* of this clause invokes the definitional clauses in the trading income Part [not in this print].

86. If a disqualifying benefit is later received it is charged to tax by clause 34.

**Clause 28: Payments to Export Credits Guarantee Department: expenses of management**

87. This clause allows a company to deduct the cost of certain payments to the Export Credits Guarantee Department (ECGD). It is based on section 88 of ICTA.

**Clause 29: Levies under FISMA 2000: expenses of management**

88. This clause allows a deduction for certain payments arising from the Financial Services and Markets Act 2000 (FISMA). It is based on section 76B of ICTA.

89. A company carrying on investment business may be called upon to make payments in connection with FISMA. The payments are of two sorts:

- a "levy" to meet the running costs of the schemes set up by FISMA; and
- "costs" which may be awarded at the conclusion of a hearing of a complaint.

90. Section 76B of ICTA allows as a management expense both sorts of payment. But there is a difficulty with one sort of levy. So some changes are made in this clause and in the trading income clause [not in this print] to ensure that all the payments under FISMA qualify for a deduction. Schedule 1 to this Bill makes a corresponding relaxation in section 155 of ITTOIA. See *Change 4* in Annex 1.

**Q10. We propose to extend the relief in sections 76A and 76B of ICTA to all payments of levies and costs under FISMA. We welcome comments on this proposed rewrite change.**

#### **Chapter 4: Rules restricting deductions**

##### **Clause 30: Introduction**

91. This clause introduces the Chapter. It is new.

92. *Subsection (2)* lists rules outside this Part of the Bill that affect the calculation of management expenses. All these rules in the source legislation are drafted in wide terms (for instance, “for the purpose of calculating profits or other income charged to corporation tax”). The rules apply to the calculation of management expenses because that is part of the calculation of profits charged to corporation tax.

93. In some cases the application of the rewritten rules is restricted so that they do not apply in calculating the profits of a trade or property business. That is because there is an equivalent rule in the trading income Part (which applies also to property income).

94. The permissive rules for management expenses in Chapter 3 of this Part say that expenses are “treated for the purposes of Chapter 2 as expenses of management”. The restrictive rules in this Chapter “restrict the expenses of management under section 3” (which is in Chapter 2). So it is clear that the restrictive rules have priority.

95. This is the reverse of the position for trading income, where the general rule is that the permissive rules have priority. But, in the unusual cases where it is possible for the rules to overlap, the result is the same.

96. *Subsection (3)* draws attention to section 196A of FA 2004. This rule about pension scheme contributions does not itself restrict management expenses. But it gives HMRC power to make regulations that may make such a restriction.

##### **Clause 31: Unpaid remuneration: companies with investment business**

97. This clause delays a deduction for employees’ (or an office-holder’s) pay if it is paid late. The clause is based on section 44 of FA 1989.

98. *Subsection (5)* of this clause invokes the supporting trading income clause [not in this print] .

##### **Clause 32: Car or motor cycle hire: companies with investment business**

99. This clause restricts the amount that a company can deduct in respect of the cost of hiring certain cars or motor cycles with a retail price (when new) of more than £12,000. The clause is based on sections 578A and 578B of ICTA.

100. Under section 75B(3) of ICTA any recovery of the hire charge is restricted to the reversal of “so much of the debit as represents the expenses of management.” *Subsection (4)* makes this restriction explicit and mirrors the trading income rule [not in this print]. See *Change 5* in Annex 1.

**Q11. We welcome comments on the proposal to clarify the restriction to the recovery charge in cases where section 578A(4) of ICTA applies.**

101. *Subsection (7)* of the clause invokes the supporting trading income clauses [not in this print]. So the definition of “qualifying hire car or motor cycle” includes a car or motor cycle where ownership passes without the exercise of an option to purchase.

**Q12. We welcome comments on the proposal to carry Change 11 in ITTOIA across to management expenses.**

#### **Chapter 5: Companies with investment business: receipts**

##### **Clause 33: Industrial development grants: companies with investment business**

102. This clause deals with the treatment of certain grants under the Industrial Development Act 1982 or the corresponding provision in Northern Ireland. It is based on section 93 of ICTA.

103. Under section 93(1) of ICTA the payment of a grant is “taken into account as a receipt in computing [the company’s] profits under Case VI of Schedule D”. Under section 70(1) of ICTA the basis of assessment for Schedule D is the “profits gains or income arising” in an accounting period. But there is no explicit rule to say into which accounting period the grant falls.

104. Clause 36 gives a basis of assessment: it is the amount arising in the accounting period.

##### **Clause 34: Contributions to local enterprise organisations or urban regeneration companies: disqualifying benefits**

105. This clause sets out what happens if a company (or a connected person) receives a benefit in connection with a contribution to a local enterprise organisations or urban regeneration company (see clause 27). The clause is based on sections 79(9), 79A(4) and 79B(4) of ICTA.

106. Section 79(9) of ICTA refers to relief having been given “under subsection (1) above”. Strictly, relief for management expenses is given under subsection (2) by reference to a “deduction under subsection (1)”. But it is clear in the context of the section that the recovery under subsection (9) is intended to apply to management expenses as it applies to a trading deduction. The same analysis applies to the corresponding provisions in sections 79A and 79B of ICTA. This clause clarifies the position.

107. The charge is restricted to the amount of the “disqualifying benefit”. That expression is explained in clause 27(5).

**Q13. We welcome comments on the proposal to carry Change 20 in ITTOIA across to management expenses.**

**Clause 35: Repayments under FISMA 2000**

108. This clause charges tax on a repayment made to a company under the Financial Services and Markets Act 2000 (FISMA). It is based on section 76B of ICTA.

109. Under section 76B(2) of ICTA the repayment is “charged to tax under Case VI of Schedule D”. Under section 70(1) of ICTA the basis of assessment for Schedule D is the “profits gains or income arising” in an accounting period. But there is no explicit rule to say in which accounting period the repayment falls.

110. Clause 36 gives a basis of assessment: it is the amount arising in the accounting period.

**Clause 36: Income charged**

111. This clause gives an explicit basis of assessment for the industrial development grants and FISMA repayments charged to tax by clauses 33 and 35. It is based on section 70 of ICTA.

112. These receipts will usually “arise” when they are paid. But this clause allows the accounts treatment to be followed.

**Q14. We welcome comments on the proposal to provide a more explicit basis of assessment for industrial development grants and FISMA repayments.**

**Chapter 6: Supplementary**

**Clause 37: Meaning of some accounting terms**

113. This clause provides definitions of some accounting terms used in this Part of the Bill. It is based on sections 75A and 75B of ICTA.

114. *Subsection (1)* deals with the concept of management expenses being “debited in accounts”. This expression is used in the rules which determine to which accounting period expenses are referable.

115. *Subsection (2)* deals with the concept of an amount being “brought into account”. This expression is used in the rule that deals with the claw back of relief. There is no reason why the expression should be defined differently in sections 75A(10) and 75B(8) of ICTA. So this clause adopts the fuller words of section 75A(10).

116. *Subsection (3)* removes a small inconsistency between sections 75A(10) and 75B(12) of ICTA by referring to a debit that increases *or creates* a loss.

## ANNEX 1

### **Change 1: Expenses of management: credit unions: clause 2**

This change makes clear that a credit union cannot be the subject of a charge to tax on a FISMA repayment or an industrial development grant under the Part of the Bill dealing with companies with investment income.

Section 487(4) of ICTA provides that a credit union is not a company with investment business *for the purpose of section 75 of ICTA*. As a result, such a company cannot have expenses of management deducted under section 75. And it follows that there can be no charge on a “reversal amount” under section 75B of ICTA.

But the charge under section 76B of ICTA on a repayment under FISMA is not dependent on there having been a previous deduction under section 75. It is arguable that the rule in section 487(4) of ICTA is not wide enough to remove the possibility of a charge under section 76B.

In the unlikely event that a credit union receives an industrial development grant it is similarly arguable that section 487(4) of ICTA does not remove the charge under section 93(1) of ICTA.

Clause 2(3) takes credit unions completely outside the rules in the Part of the Bill dealing with companies with investment income. So there can be no charge under the rules in Chapter 5 of that Part.

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

### **Change 2: Expenses of management: clause 4**

This change clarifies the relationship between:

- the rules in section 75(4) of ICTA that an expense must be “in respect of ... the company’s investment business” and not for an unallowable purpose; and
- other rules that expenses are to be treated as expenses of management.

In the case of expenses that are to be treated as expenses of management, there is a distinction between:

- rules that simply treat expenditure as an expense of management; and
- rules that go to on to say that expenditure is, as a result, *deductible under section 75*.

The rules in the first category leave the expenditure to meet the tests in section 75(4) of ICTA. Clause 4 preserves this position for rules such as that in clause 27 (rewriting section 79 of ICTA).

The rules in the second category apparently override the rules in section 75(4) of ICTA. Clause 4(2) and (3) make this clear.

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

### **Change 3: Expenses of management: cessation of business: clauses 23 and 25**

This change clarifies the timing rule in cases where an investment business ceases.

Before the FA 2004 changes a company claiming management expenses had to be one “whose business consists wholly or mainly in the making of investments” (part of the definition of “investment company” in section 130 of ICTA, used in section 75(1) of ICTA). So it was likely that when the business ceased to be carried on there would be an end of an accounting period in accordance with section 12(3)(e) of ICTA.

The timing rules in sections 90(1)(iii) and 579(3A) of ICTA make the payments referable to the “accounting period ending on the last day on which the ... business was carried on”. If an accounting period ends on that day, the rule is straightforward.

Since 2004 management expenses are available to a company with investment business. Such a company may carry on other activities, such as a trade. So it is not necessarily the case that the cessation of the investment business triggers the end of an accounting period.

These clauses cater for the possibility that an accounting period does not end with the cessation of the investment business: they refer to the accounting period *in which* the investment business ceases. If an accounting period does in fact end with the cessation of the investment business, there is no change in the law.

*This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.*

### **Change 4: Allow all FISMA levies and costs: clause 29 and Schedule 1**

This change ensures that all payments of levies and costs under the Financial Services and Markets Act 2000 (“FISMA”) are allowed as deductions.

### *Trading income*

Section 76A of ICTA allows a deduction for “any sum expended ... in paying a levy”. “Levy” is defined in section 76A(2) by listing the sorts of payment that may be required under FISMA.

- The first sort of payment relates to the legal assistance scheme in connection with hearings before the Financial Services and Markets Tribunal (see sections 134 to 136 of FISMA).
- The second sort of payment relates to the Financial Services Compensation Scheme. A levy in connection with this scheme may be made on an “authorised person” (see section 31 of FISMA) by the “scheme manager” (see section 212 of FISMA). The power to do this is in section 213(3)(b) of FISMA.
- The third sort of payment relates to the ombudsman scheme (see sections 225 to 234 of FISMA). The expenses of the scheme are funded by a payments required from authorised persons by the Financial Services Authority under section 234 of FISMA.
- The fourth sort of payment relates to the ombudsman’s “compulsory jurisdiction” (see section 226 of FISMA). Under paragraph 15 of Schedule 17 to FISMA the scheme operator may require a respondent (defined in section 226(1) to mean the person complained of) to pay a fee.
- The fifth sort of payment relates to the ombudsman’s “voluntary jurisdiction” (see section 227 of FISMA). Under paragraph 18 of Schedule 17 to FISMA the scheme operator sets “standard terms” for dealing with complaints dealt with under the voluntary jurisdiction. Paragraph 18(3) of Schedule 17 allows the standard terms to require the making of payments to the scheme operator (paragraph (a)) and to include the award of costs (paragraph (b)).

The first four sorts of payment may be described as contributions towards the costs of running the schemes that are set up by FISMA. And, within the fifth sort of payment, the payments to the scheme operator also have the character of a contribution to running costs (in that case, of the voluntary jurisdiction).

It is clear that the contributions to running costs are allowable. But the position of “costs” is unclear. Section 76A(2)(e) excludes payments “other than an award which is not an award of costs under costs rules”. “Costs rules” are defined in subsection (6) as rules made under section 230 of FISMA (which are not relevant to the voluntary jurisdiction) and rules contained in the “standard terms” for the voluntary jurisdiction. The standard terms published by the Financial Standards Authority do not distinguish between:

- the levies to be paid on the same basis as those for the compulsory jurisdiction; and
- the costs that may be awarded against a respondent.

### ***Management expenses***

Section 76B of ICTA allows a deduction for “any sums paid ... by way of a levy or as a result of an award of costs under the costs rules”. The definitions of “levy” and “costs rules” are imported from section 76A.

As with the trading income rule, it is clear that the contributions to running costs are allowable. But, unlike in the trading income rule, all “costs” are also allowable.

### ***What the Bill does***

If section 76A(2)(e) of ICTA means that some costs are not allowable as a trading deduction it is difficult to explain why this is the case. So the trading income rule [not in this print] is brought into line with the management expenses rule.

Section 76A of ICTA applies only to an “authorised person”. But section 76B apparently applies more widely. It is conceivable that an unauthorised person may make a payment within section 76A. There is no reason why such a person should not have a trading deduction. So clause 147 is not restricted to authorised persons.

Section 76A of ICTA does not apply to an “investment company”. This rule was not changed when most of the rules about investment companies were amended to refer to companies with investment business. The rule applies only to give a deduction under Schedule D Case I. In the rare case of an investment company carrying on a trade there is no reason why it should not have a trading deduction. So clause 147 does not exclude investment companies.

Amendments to section 155 of ITTOIA (see Schedule 1) keep the income tax and corporation tax codes in line.

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

### **Change 5: Car or motor cycle hire: clause 32 and Schedule 1**

This change clarifies the operation of section 578A of ICTA in three areas.

#### ***Corporation tax: expenses of management***

Two rules, which partly overlap, restrict the amount that can be charged to tax when the amount of a deduction for management expenses has been reduced under section 578A(3) of ICTA and a credit reversing the expenses is later brought into account.

If there is a rebate or release of a debt, the “reversal amount” within section 75B of ICTA is “so much of the debit as represents the expenses of management”. The amount which “represents the expenses of management” is restricted under section 578A(3) of ICTA. So the amount treated as the “reversal amount” under section 75B cannot exceed that restricted amount (£75 in the example below).

Section 578A(4) seems to duplicate this restriction. It also imposes a stronger restriction in a case where a rebate represents only part of the original deduction (see below). But in the context of management expenses, section 578A(4) applies only in relation to rebates, not releases of debts.

It is not entirely clear how section 578A(4) should be reconciled with the competing rule given by section 75B.

Clause 32(4) makes clear that the restriction is the same as the one made under clause 32(2). The clause also makes clear what happens if the rebate or release of a debt represents only part of the original deduction.

**Example**

Car hire charge	100
Restricted (by 25%) to	75
Rebate	60

It is clear that the charge on the rebate should be restricted by 25% to 45.

***Income tax: receipt of a “rebate”***

Section 578A(4) of ICTA applies if there is:

- a rebate; or
- a release of a debt,

in connection with an expense that has been restricted under the section. The trading income clause [not in this print] rewrites the rule for corporation tax. But section 48(4) of ITTOIA seems to apply only to the release of a debt: although the introductory words of subsection (4) refer to a rebate, the main part of the rule refers only to debts released. Schedule 1 to this Bill amends section 48(4) of ITTOIA so that it applies also to rebates (which are brought into account as a receipt of the trade without a special rule).

***Income tax: “corresponding provisions”***

Section 578A of ICTA applies to:

- a trading deduction;

- a management expense; and
- an expense of an insurance company.

A rebate or release of a debt is restricted under subsection (4) however the original deduction was given. The trading income clause [not in this print] and clause 32(3) and (5) make this clear by referring to a “corresponding provision”. But section 48(4) of ITTOIA deals only with the case where the original deduction (as a trading expense) was restricted under that section. Schedule 1 of this Bill amends section 48(3) of ITTOIA, and introduces a new subsection (4A), so that it applies also to deductions previously given as a management expense or as an expense of an insurance company.

***Summary***

The corporation tax change merely clarifies the law. The income tax changes restrict a charge to tax in cases where ITTOIA may not give the restriction.

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