

Tax Law Rewrite

Responses to the draft

Corporation Tax Bill

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22 August 2008

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Introduction

Purpose of this document

1. This document's purpose is to provide details of the substantive technical points made by respondents, to set out our analysis of them and to say what changes to the drafting of clauses, if any, we will be making as a result.

The draft Bill

2. The draft Corporation Tax Bill was published for consultation on 22 February 2008. It contained:

- the basic corporation tax provisions including the charge to tax, accounting periods and provisions relating to company residence;
- provisions relating to trading and property income and income from other sources;
- special provisions for companies affecting the computation of income, such as those for loan relationships, derivative contracts and intangible fixed assets; and
- provisions governing particular types of expenditure, for example, expenditure on research and development and films.

3. The Bill will be complemented by a second and final corporation tax Bill due to be published in draft form early in 2009. Together, the Acts based on the two corporation tax Bills will take the place of ICTA as the main corporation tax Acts.

4. The draft Bill brought together material previously published for consultation in 14 committee papers. The clauses in the draft Bill incorporated revisions made in the light of comments made by respondents to those consultations.

Respondents

5. We received detailed written responses from the following:

- The Chartered Institute of Taxation
- The Confederation of British Industry
- The Institute of Chartered Accountants in England and Wales
- John Jeffrey-Cook.

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6. In addition, as part of the consultation process, the project held a series of workshops to consider specific aspects of the draft Bill. Those taking part in this form of detailed consultation included representatives from:

- The British Bankers' Association
- Deloitte & Touche LLP
- Ernst & Young LLP
- The International Swaps and Derivatives Association, Inc
- Linklaters LLP
- The London Investment Banking Association.

7. Respondents to earlier consultation on draft clauses whose contributions were taken into account in the draft Bill included, in addition to those already mentioned:

- Alma Consulting Group
- The Law Society
- The London Society of Chartered Accountants
- KPMG LLP
- PricewaterhouseCoopers LLP
- Several individuals.

8. We are grateful for all the comments and contributions made, many of which were detailed, and we appreciate the time and effort taken by respondents. Their efforts are assisting us greatly in improving the clarity and accuracy of the clauses. We have sent each respondent a copy of this response document.

General

9. This response document broadly follows the format of the draft Bill. It covers substantive technical points made but does not include minor points, such as suggestions to improve punctuation or to correct obvious minor errors. However, all such suggestions have been carefully considered.

10. In the explanatory notes published with the draft Bill we asked a number of specific questions. These related to new proposed Annex 1 entries for suggested

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minor changes in the law and to other matters on which we were especially keen to receive views. We also invited comments generally.

11. If no mention is made of responses to particular questions, it is because respondents either supported the proposal or made no comment. Similarly, if a particular clause is not mentioned, either we received no comments on that clause, or the comments were minor in nature.

12. We published two papers in October 2007 containing draft clauses and explanatory notes where the draft clauses closely followed the source legislation. This was in response to a recommendation from the Consultative Committee that such clauses should be published in an informal way before publication of the draft Bill so that consultees could decide whether to comment on both the earlier and draft Bill presentation of clauses, or only on the latter.

13. The relevant papers were:

- Paper CC/SC (07) 32 Bill 5: Intangible fixed assets; and
- Paper CC/SC (07) 33 Bill 5: Film production and sound recordings.

14. Where responses were received to these papers in time to make changes to the clauses presented in the draft Bill, relevant changes were made.

15. This response document includes responses to those papers where relevant, but some comments related to clauses affected by the Corporation Tax (Implementation of the Mergers Directive) Regulations 2007 (SI 2007/3186). Those clauses were not included in the draft Bill and so are not discussed here.

Provisions to be included subsequent to publication of the draft Bill

16. Not all the provisions that will be included in the Bill were presented in the draft Bill. Since its publication, the project has published three further committee papers which include draft clauses and explanatory notes for consultation. These are:

- Paper CC/SC (08) 25 Bill 5: Relationships treated as loan relationships etc: OEICs, unit trusts and offshore funds;
- Paper CC/SC (08) 26 Bill 5: Intellectual property: know-how and patents; and
- Paper CC/SC (08) 27 Bill 5: Loan relationships, derivative contracts and intangible fixed assets: provisions affected by the European Mergers Directive.

17. The closing date for comments on these papers is 19 September 2008.

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18. In addition, since the draft Bill was published, FA 2008 has been put onto the statute book. Provisions affected by the Act will be presented to the committees shortly.

19. Work is continuing on consequential amendments to other legislation, transitionals, savings and repeals.

Policy suggestions

20. We received several policy suggestions for reform. Such issues are outside the remit of the project but we have passed them to the relevant specialists for consideration. A list of these suggestions will be presented in a separate paper to our Committees.

21. In response to earlier publication of draft clauses on loan relationships and derivative contracts legislation, some respondents raised strategic questions about whether the provisions should be rewritten and, if so, when and where. These issues were discussed by the project's Steering Committee who reaffirmed their support for the inclusion of both loan relationships and derivative contracts provisions in the Bill.

22. Where respondents commented on this specific issue, the response was positive. One respondent who had previously raised questions wrote:

Whilst we are aware that their inclusion has attracted some criticism, the lengthy loan relationships and derivative contracts provisions do now appear to fit appropriately within Bill 5.

Glossary

23. In this document we use a number of abbreviations. These are listed below.

ABI	the Association of British Insurers
HMRC	Her Majesty's Revenue and Customs
FA 1989	the Finance Act 1989 (and similarly for other Finance Acts)
ICTA	the Income and Corporation Taxes Act 1988
ITA	the Income Tax Act 2007
ITEPA	the Income Tax (Earnings and Pensions) Act 2003
ITTOIA	the Income Tax (Trading and Other Income) Act 2005
R&D	research and development
TCGA	the Taxation of Chargeable Gains Act 1992
TMA	the Taxes Management Act 1970
VAT	value added tax

Part 1: Introduction

Clause 1: Overview of Act

In clause 1(1)(a), within the brackets, are the words ‘in the sense of’ appropriate?

24. These words were intended to make a link to the references in paragraph (b) to income and chargeable gains.

25. *We will amend the clause.*

Part 2: Charge to corporation tax: basic provisions

Clause 5: Application of charge to corporation tax on income

It appears from the draft explanatory notes that this clause is intended to form the essential link between the basic charging provision in clause 2 and the rules which define “income” for this purpose. As such it is important that this clause, more than almost any other, should be clearly expressed.

In fact, however, it is an excellent example of “old style” drafting at its worst. Its meaning is almost completely opaque even to the informed reader, let alone to the less experienced users for whose benefit the rewrite is intended. We consider that something much closer to the existing section 9(1), which is admirably clear and succinct, should be reinstated.

We had great difficulty trying to make sense of subsection (1). We would suggest that some urgent attention be given to this provision.

Subsection (2) is not much clearer. Even when sense is made of subsection (2), it begs the question why there should be some provisions which have the effect of applying the charge to corporation tax on income without saying so explicitly.

26. As one of the respondents points out in relation to another clause, section 9(1) of ICTA interprets the reference to “income” in section 6 ICTA, the charging provision for corporation tax. The Bill will complete the split between income tax and corporation tax and the formulation in section 9(1) of ICTA is no longer apposite since its wording is adapted to the circumstances of applying one body of tax law (income tax principles) for the purposes of another tax (corporation tax).

27. The effect of section 9 of ICTA is that the scope of the charge to income tax determines what is income for corporation tax purposes (except as otherwise provided by the Tax Acts). Income tax, though primarily a charge to tax on things which would be regarded as income in its ordinary sense, is not exclusively a charge on such things. Section 9(4) provides that anything that is within the charge to income tax is within the charge to corporation tax on income “whether expressed to be income or not and whether an actual amount or not”.

28. So the effect of section 9 of ICTA is that (subject to the provisions of the Corporation Tax Acts) the charge to corporation tax on income is driven by the particular heads of the charge to income tax.

29. The purpose of this clause is to achieve an equivalent effect, so that the charge to corporation tax on income is driven by the particular heads of the charge to corporation tax on income.

30. But we accept that expressing the charge on income as being determined by the provisions that apply the charge is a difficult and unfamiliar concept.

31. Instead of including this as a separate clause, we will expand clause 2 to include an appropriate link between the charge on income and the provisions that have the effect of defining its application.

32. Instead of reproducing clause 5(2), we will make it clearer that provisions that deem an amount to be income involve an application of the charge to corporation tax on income. For example we will amend clause 1179 so that it states that “the payment is treated as an amount to which the charge to corporation tax on income applies”.

33. *We will amend clause 2 and will make other amendments to make the Bill clearer.*

Saving for section 9(1) of ICTA

34. We are inserting into Schedule 2 of the Bill a saving provision for income tax case law.

35. The case law to which the saving is relevant is the case law relating to the construction of source legislation rewritten in the Bill whose application for corporation tax purposes depended on section 9(1) of ICTA (which applies income tax principles for corporation tax purposes).

Clause 6: Territorial scope of charge

Subsection (3) refers to subsection (2) applying. This presumably means “the company carrying on a trade in the UK through a permanent establishment” even though subsection (2) does not expressly use the word “applying”. To avoid any doubts, could subsection (3) instead repeat some of the words from subsection (2)?

36. We agree that the reference to subsection (2) applying does not explain the relationship between subsections (2) and (3) in a helpful way.

37. *We will amend the clause.*

Clause 9: How tax is charged and assessed

The wording of sub-clause (5) does not, strictly, cater for the case of an accounting period which falls wholly within one financial year but (being less than 12 months in length) does not coincide with that year.

38. ***We agree and will substitute “falls within more than one financial year” for “does not coincide with a financial year”.***

Clause 19: Chargeable profits

Subsection (2) is confusing because of the juxtaposition of two paragraphs which have completely different functions. Paragraph (a) is concerned with the type of profits which are chargeable to corporation tax and the reader expects paragraph (b) to contain additional qualitative conditions whereas it is actually concerned with quantification. Paragraph (b) does not seem to be needed at all since one can read directly on from clause 19 to clause 20, but if retained it should be redrafted as a separate subsection.

39. Paragraphs (a) and (b) are united by their relevance to the definition of “chargeable profits”. It does not matter that they are neither both qualitative nor both quantitative.

40. Paragraph (b) is crucial as to whether profits fall within the definition of “chargeable profits”. The remaining clauses in the Chapter are about determining how far clause 19(2)(b) is satisfied in a given case. Since those clauses all hinge on that provision we consider that it would be wrong to omit it.

41. ***We do not consider that an amendment is necessary here.***

We do not accept HMRC’s reasoning in paragraphs 155 to 163 [of the explanatory notes] as to why section 18(1)(a)(iii) of ICTA should not be rewritten. It rests on the proposition that section 18 of ICTA is not itself a charge. This is, at least historically, incorrect. Before corporation tax was introduced the Schedules were independent charging provisions each with its own computational and territorial rules. Corporation tax was charged in accordance with income tax principles and under the same cases and Schedules in accordance with section 9 of ICTA. That provision makes no sense unless it imports all the rules of the schedular system. If and to the extent that the rule in section 11(2) is not supported by a specific charging provision it bites on air.

42. The Inland Revenue were advised by their solicitor shortly after the introduction of corporation tax in 1965 that corporation tax is not charged under the Schedules of the Income Tax Acts. Section 18, in the solicitor’s opinion, deals with the computation of the income rather than the charging of the income. HMRC abides by this opinion.

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Response document: Part 2: Charge to corporation tax: basic provisions

We would be interested to know the basis for the statement in paragraph 158 [of the explanatory note] that “the wider scope given in section 11 is generally accepted”. Has anyone ever been assessed on that basis? The only authority cited is a footnote from Bramwell, which is in fact expressed in terms which strongly suggest the authors do not think that the proposition they are putting forward is either certain or generally recognised.

43. The quoted words will be removed from the explanatory notes. The quotation from *Bramwell* does not, in our view, carry the adverse connotations implied. It is normal HMRC practice to assess non-resident companies trading in the United Kingdom through a permanent establishment on income attributable to the permanent establishment even if that income arises outside the United Kingdom.

The background to section 70 which is put forward in the commentary as supporting HMRC’s case actually appears to prove the opposite. The draftsman of the 1965 legislation clearly understood that in order to give what is now section 11(2) of ICTA its full effect he needed to modify the Schedule to match it, and that is what section 70(3) does in relation to Case IV and V. There is no corresponding modification of Case I (or Case VI) and apparently no suggestion in the 1965 Notes on Clauses of any intention to extend the territorial scope of Case I. This can only mean either that there was no intention to apply corporation tax to trading profits outside the UK but attributable to the UK branch or agency or, more probably, that there was thought to be no need for legislation to achieve that result because if such profits existed they would necessarily have an overseas source which would bring them within Case V. We would accept the latter argument and for that reason agree that the decision not to rewrite section 18(1)(a)(iii) of ICTA does not change the law so far as trading profits are concerned.

44. The explanatory notes did not specifically refer to trading profits arising outside the United Kingdom which are attributable to the branch or agency although in principle such profits could be so attributable. However there is no disagreement that the decision not to rewrite section 18(1)(a)(iii) of ICTA does not change the law.

45. *Apart from the removal of quoted words we do not consider that a change is necessary to the explanatory notes.*

Part 3: Trading income

Clause 60: Patent royalties

This clause needs a signpost to the rules under the intangible fixed assets regime that may give a deduction for patent royalties.

46. This suggestion is similar to one made in response to the trading and property income clauses published in June 2006. In our subsequent response document we agreed a signpost would be helpful and undertook to consider how best to deal with the suggestion.

47. Clause 696(5) (expenditure written off as it is incurred) highlights and clarifies, in the provisions themselves, the relationship between clause 60 and the intangible fixed asset provisions. We think the best way of signposting from clause 60 is by way of the explanatory notes.

48. *We will include in the commentary on clause 60 a signpost to the intangible fixed asset provisions in Part 9 of the Bill and, in particular, to clause 696(5).*

Clause 70: Employees seconded to charities and educational establishments

The original draft clause (published in June 2006) provided for educational establishments in Scotland to be approved by Scottish Ministers. Why does the draft Bill provide instead for approval by the Secretary of State?

49. Approval by Scottish Ministers was proposed because it was mistakenly understood that the power is exercised in practice by Scottish Ministers. In fact, the power is exercised in practice by the Secretary of State. So the part of Change 15 relating to this clause is withdrawn.

50. *We believe that the clause correctly states the law and will not be amending it.*

Clause 79: Additional payments

Despite paragraphs 139 to 141 of the response document published in April 2007 (when this clause was numbered 62), the clause has not been amended to clarify what happens when there is a cessation of part of a trade carried on in partnership.

51. We agree that the draft clause does not work as intended. A similar point arises in connection with section 79(2) of ITTOIA. We will change both that section and this clause.

52. *We will amend the clause to meet this point.*

Clause 81: Contributions to local enterprise organisations or urban regeneration companies

Why does Schedule 2 (transitionals and savings etc) not provide that clause 81 is inapplicable to any contribution to an urban regeneration company before 1 April 2003?

53. It is expected that the Bill will apply for accounting periods ending after 31 March 2009 (see clause 1252(a) of the draft Bill). It is not plausible that a company would claim a deduction in an accounting period to which the Bill applies for a contribution made before 1 April 2003. So the transitional rule which was necessary in ICTA is not reproduced.

54. *We will not include this transitional rule.*

Clause 88: Expenses connected with patents

Clause 89: Expenses connected with designs or trade marks

These clauses should draw attention to the fact the a deduction is usually available under the intangible fixed assets regime .

55. Please see the comments in paragraphs 46 and 47 of this document.

56. *We will include a signpost in the commentary.*

Clause 92: Capital receipts

This clause needs a signpost to the significant rules elsewhere in the Bill (for instance, the intangible fixed assets regime) that impose a charge on capital receipts.

57. Please see the comments in paragraphs 46 and 47 of this document. The same principles apply to other regimes that impose a charge to tax.

58. *We will include a signpost in the commentary.*

Clause 118: Section 117: sale for reasons outside farmer's control

Integrate clauses 118 and 120.

59. As a general rule we preserve where appropriate a consistency of drafting between ITTOIA and this Bill. Clauses 118 and 120 correspond to sections 121 and 123 of ITTOIA. It would not be desirable in this case to depart from the arrangement of the material in the corresponding income tax provisions.

60. *We disagree and will not integrate these two clauses.*

Clause 155: Valuation of trading stock on cessation

The reference to a company within the charge to corporation tax changes the law. The change should be justified in detail. The same point arises in connection with clauses 1195 and 1196.

61. Section 114(1) of ICTA sets out how to calculate the profits of a trade if it is carried on in partnership. It applies “so long as a trade ... is carried on by persons in partnership and any of those persons is a company”. And it applies “for the purposes of corporation tax”. “Company” is defined in section 832 of ICTA for the purposes of the Corporation Tax Acts without reference to where the company is resident or to whether it is chargeable to corporation tax.

62. If the companies carrying on the trade in partnership are not chargeable to corporation tax, the calculation in section 114(1) of ICTA is not made. And section 115(4) of ICTA makes clear that the liability of any non-resident company on trade profits is restricted to the profits attributable to a permanent establishment in the United Kingdom.

63. It follows that all the references in section 114(1) of ICTA to a “company” must be to a company within the charge to corporation tax. The clauses in this Bill make this explicit. As paragraph 3252 of the explanatory notes for the draft Bill explains, each trading income rule which depends on whether a trade is discontinued sets out explicitly what happens on a change of persons carrying on the trade.

64. Clause 155 is such a trading income rule. Subsection (3) imports the rule in section 114(1)(c) of ICTA which sets out how “discontinued” is to be interpreted in section 100(1) of ICTA.

65. *We still believe that the inclusion of “within the charge to corporation tax” clarifies, but does not change, the law.*

Clause 190: Election to carry back

Why is this provision needed (contrary to the assumption made when it was repealed by ITTOIA)?

66. There were strong indications in section 108 of ICTA that it was intended to apply only for income tax. But, after ITTOIA was enacted, we received representations that the section did apply for corporation tax. We decided that the matter was not free from doubt and, rather than withdraw a relief that could conceivably be of value to taxpayers, we gave an undertaking to reinstate the relief.

67. *We will retain the clause.*

The reference to ‘in this section’ in clause 190(4) is inappropriate as regards “the period of the cessation” which is not referred to in clause 190.

68. We agree.

69. *We will amend the clause to meet this point.*

Clause 191: Deductions already allowed are not displaced

This clause does not have the effect intended. And “allowed” is not appropriate to Self Assessment.

70. The respondent reads the clause as potentially applying to a deduction under clause 188 from the receipt to which the election applies. This results in no deduction

being available. The intention of the clause is that the election should not disturb a deduction already allowed from another, earlier receipt.

71. We think that “made” is preferable to “allowed”. And we will consider whether the clause could be made clearer in other ways.

72. *We will amend the clause to meet these points.*

Clause 192: Election given effect in accounting period in which receipt is received

In subsection (2)(b) “the period of the cessation” would be clearer than “that accounting period”

73. There is only one “period” mentioned in the subsection. So there can be no uncertainty about the accounting period to which the subsection is referring.

74. *We will not amend the clause to meet this point.*

Part 4: Property income

Clause 201: Non-UK resident companies

This clause is less clear than the previous version and creates circularity between it and the proposed new section 276A of ITTOIA.

75. This comment caused us to look again in some detail at the rewrite of section 15(1A) of ICTA following the separation of the income and corporation tax rules.

76. We conclude that section 15(1A) of ICTA is no longer necessary and so need not be rewritten. It is part of a framework in which income tax and corporation tax are, broadly, governed by the same provisions. In that context its purpose is to keep the property income of a non-UK resident company chargeable to income tax separate from that company’s property income chargeable to corporation tax. But the provisions governing income tax have been separated from those governing corporation tax. Specifically, Part 3 of ITTOIA deals with property income charged to income tax and Part 4 of the draft Bill deals with property income charged to corporation tax. Clause 3 prevents the provisions in ITTOIA from applying to income of a non-resident within the charge to corporation tax. Together, this is all that is required to achieve the result of dividing a non-UK resident company’s property income between separate income tax and corporation tax property businesses.

77. *We will not rewrite section 15(1A) of ICTA for corporation tax or income tax and will include an explanation on the above lines in the commentary on the Bill.*

Part 5: Investment income

Clause 283: Overview of Part

Although Part 5 is headed “investment income” it actually covers only a small part of the taxable investment income of most companies because the majority is dealt with under other headings, particularly loan interest and intellectual property royalties. Some signposting of this fact would be useful here.

78. We agree that the heading may promise more than the Part delivers. Moreover, as a result of Schedule 13 and paragraph 8 of Schedule 14 to FA 2008, the draft clauses in Chapter 3 (purchased life annuity payments) are obsolete (such contracts are now dealt with under the loan relationships rules). We will therefore transfer the remaining material in this Part to Part 10 (miscellaneous income). That will remove any need for the signposting of “investment income” dealt with under other Parts.

79. *We will merge Parts 5 and 10 at the latter location as “miscellaneous income”.*

We note that the clauses in Appendix A to Paper CC/SC(06)06, dealing with gains from contracts for life insurance, are not included in Part 5 of Bill 5. What is the explanation for this?

80. The source legislation for the clauses in that Appendix, in Chapter 2 of Part 13 of ICTA, was repealed by paragraphs 3 and 7 of Schedule 14 to FA 2008 (as announced in the 2007 autumn statement). Section 36 of, and Schedule 13 to, FA 2008 replace it with provisions that deal with the subject under the rules for loan relationships. These provisions will be rewritten in Part 7 of the Bill.

Clause 284: Charge to tax under this Chapter

In sub-clause (1), “dividends paid by” would read more naturally than “dividends of”.

81. The draft clause uses the same wording as the equivalent clause for income tax. As a general rule we think it preferable to have common wording in such circumstances unless particular differences between income tax and corporation tax make a different approach necessary.

82. *We will not be amending the clause.*

Chapter 4: Distributions from unauthorised unit trusts

Why has section 469(2) of ICTA not been rewritten?

83. When this Chapter was published in Paper CC/SC(07)17 (Distributions from unauthorised unit trusts etc), it included a clause 4 that rewrote section 469(2) of ICTA. The respondent notes that that clause does not appear in the present draft.

84. Section 469(2) will now be rewritten in the second corporation tax Bill.

85. *We will not be amending this Chapter to rewrite section 469(2) of ICTA.*

Clause 298: Charge to tax under this Chapter

This clause does not say explicitly who is the person chargeable. Although it is probably not strictly necessary to do so, it is unusual for the rewrite to leave one of the basic elements of the charge to be inferred in this way.

86. The charge to corporation tax in Part 2 of the draft Bill makes clear that the charge is on the person whose profits they are and clause 298(1) makes clear what the profits to be charged are.

87. *We do not consider that a change is necessary here.*

Clause 300: Provisions which must be given priority over this Part

We wonder why the clause has been added at the end of a Part rather than at the beginning (as in ITTOIA). A consistent approach should be adopted in the two codes. Of the two approaches, we prefer that followed in ITTOIA. We would prefer all “boundary provisions” (which used the term “priority” in ITTOIA) to be relabelled and located at the front of each Part.

88. General boundary provisions relevant to corporation tax have a much lower profile than is the case for income tax. This is particularly so given the self-contained priority provisions in Parts 6 (loan relationships), 8 (derivative contracts) and 9 (intangible fixed assets) of the draft Bill. We also found that, in contrast to ITTOIA 2005, it was unnecessary to have a boundary provisions clause in Part 10 (miscellaneous income). In accordance with Tax Law Rewrite practice that more frequently used provisions generally come first (and similarly within Parts), such boundary provisions have been placed at or near the end of each Part to which they apply. We agree that it is unnecessary to use the term “boundary provisions” and will therefore re-label all such Chapters as “priority rules”.

89. *We will not relocate this or the other boundary provisions Chapters, but will re-label them as “priority rules”.*

Part 6: Loan Relationships

Clause 370: Reduction of impairment loss debits exceeding group relief credits where group relief claimed

Because subsection (2) has been amended so that there may be more than one consortium company, a consequential amendment seems needed to change “the debtor consortium company” in subsection (1)(a) to “a debtor consortium company” with similar amendments in clauses 373(1)(a) and 374(1)(a).

The legislation needs also to allow for the fact that more than one of the debtor consortium companies may be surrendering group relief. As it stands the clause would seem to require one to calculate reductions in the relevant debit separately in respect of each group relief claim. In order to achieve the correct result the clause needs to be further revised so that there is just a single calculation and the figure at Step 1 is the aggregate of all amounts surrendered by debtor consortium companies to the member company or a group member.

90. ***This is agreed in principle and Chapter 7 will be suitably amended.***

Step 3 would also be clearer if the “amount” were replaced by “deduction”. As it stands it is ambiguous as to whether the “amount” referred to is the amount of the deduction made at Step 2, or the amount to which the net consortium debit is thereby reduced. This also points up the curious fact that Step 2 requires one to calculate an amount, the reduced net consortium debit, which is then not used for anything. The only purpose of Step 2 is to establish that the total reduction to be taken into account at Step 3 cannot exceed the amount of group relief, and that surely could have been stated more directly.

91. ***This is agreed in principle and the Steps will be clarified to identify the “amount”.***

Clause 394: Basic rule: deficit set off against income and gains of deficit period

Q10. We welcome comments on whether the basic rule should be that the deficit is offset first against income and gains of the deficit period.

If the insurance companies find this acceptable we have no objection to the change.

92. ***This proposed change has been agreed with the ABI.***

The third paragraph of Change 62 in Annex 1 is misleading. It states that a non-trading deficit will be set off against other income and gains of the deficit period “unless a claim is made to carry it back”. This implies incorrectly that the carry back of the loss takes priority, whereas under clause 395(1) on a claim such a deficit for a deficit period could only be carried back to the extent that it exceeds the other income and gains of the deficit period.

93. ***The wording is agreed to be wrong and will be amended.***

Clause 410: Gilt strips

The response document to paper CC/SC(07)18 said that the word “other” in subsection [1](b) would be removed. This has not been done.

94. This answer was incorrect. Clause 464(1) reads:
- “gilt-edged securities” means any securities which—
- (a) are gilt-edged securities for the purposes of TCGA 1992 (see Schedule 9 to that Act), or
- (b) will be such securities on the making of any order under paragraph 1 of Schedule 9 to that Act the making of which is anticipated in the prospectus under which they are issued
95. Paragraph 1A of Schedule 9 to TCGA defines a strip of a gilt-edged security as being a gilt-edged security for the purposes of that Act.
96. *The legislation is correct as it stands and no amendment will be made.*

Clause 414: Non-UK resident bankers, insurers and security dealers with interest on 3½% War Loan 1952 Or After

Can the explanatory notes give guidance as to how the average rate of interest for the purposes of Step 3 and the average holding in the period (“AH”) are to be calculated? A weighted average would appear appropriate.

97. *The explanatory notes will explain that any reasonable computational method of the average interest rate or holding will be accepted.*

Clause 451: Priority of this Part for corporation tax purposes

Is it considered that subsection (1) adequately reflects section 337A(2)(a) of ICTA that in calculating a company’s income for corporation tax purposes a deduction for interest is allowed only under loan relationship provisions? Is section 337A(2)(a) of ICTA to be repealed?

98. *The answer to both questions is affirmative.*

Clause 460: Meaning of “major interest”

Should “an insurance company’s long-term insurance fund” be defined?

99. *The definition of “long-term insurance fund” from section 431(2) of ICTA will be included in Schedule 4 (index of defined expressions) to the Bill.*

Part 7: Relationships treated as loan relationships etc

Clause 474: Exclusion of exchange gains and losses in respect of tax debts etc

This clause has been much improved by redrafting, but we think it is still not sufficiently clear in sub-clause (3) that the debts in question are only those which would have been deductible (as defined) were it not for the statutory provision or rule of law.

100. *We will amend the clause to improve clarity.*

Clause 481: Meaning of “qualifying investments”

A signpost to the definition of “alternative finance arrangements” would be useful here.

101. A signpost is not necessary at this point because the expression is listed in the Index of Expressions (Schedule 4) where it is made clear that the definition in clause 488(2) applies throughout Parts 6 and 7.

102. *We do not agree that a definition is required here.*

Clause 491: Diminishing shared ownership arrangements

In subsection (4) there appears to be a need for a definition of “control” (see section 47A(3A) of FA 2005), or is it covered by clause 459?

103. The meaning of “control” in clause 1239(2) applies for the entire Bill unless otherwise indicated and therefore a separate definition is not required for this clause.

104. *The definition of “control” is in clause 1239(2) and we do not agree that clause 491 should be amended.*

Clause 494: Investment bond arrangements

In sub-section (1)(h), whilst “recognised stock exchange” is defined in section 841(1) of ICTA, by reference to the section 1005 of ITA definition, should source section 48A(3) of FA 2005 as inserted by FA 2007 nevertheless be rewritten in clause 494?

105. Section 841(1) of ICTA applies for the Corporation Tax Acts, and the Index of Expressions (Schedule 4) directs the reader to the definition of “recognised stock exchange” in that section.

106. Paragraph 474 of Schedule 1 (minor and consequential amendments) amends section 48A(3) of FA 2005 to allow a recognised stock exchange to be designated (under section 1005 of ITA) for the purposes of section 48A of FA 2005 and also clause 494 of the draft Bill.

107. *We will not be amending this clause.*

Clause 497: Deemed loan relationships and interest under particular alternative finance arrangements

In clauses 497(3)(b) and (4)(b) the use of the words “under them” instead of “under the arrangements” looks a little odd.

108. The current drafting is clear in that “under them” is referring to “under the arrangements”.

109. ***We will not be amending this clause.***

Clause 503: Treatment of principal under profit sharing agency arrangements

Is the explanation in explanatory notes (paragraph 1520) sufficiently clear? The reference to the agent's entitlement to relief "for payments made" under the arrangements to the depositor is confusing, as clause 503 itself does not refer to any payment. Is this intended to be a reference to the profit sharing mechanism?

110. ***We will amend the commentary to improve clarity.***

Clause 506: Investment bond arrangements: general provisions for corporation tax purposes

As section 48B of FA 2005 is newly introduced, since the previous draft of Part 7 was published, it would have been helpful to have more explanation of where the various provisions are being rewritten or whether they are considered irrelevant to corporation tax.

111. The Table of Destinations only features provisions that are to be repealed. Therefore, where a provision is being rewritten for corporation tax purposes but will remain for income tax purposes it will not appear in the Table of Destinations.

112. The explanatory note for each clause provides the source legislation on which the clause is based and we will amend the drafting to comment on provisions that are not being rewritten for corporation tax.

113. ***We will amend the commentary to include a paragraph that outlines the provisions in Chapter 5 of Part 2 of FA 2005 that are not being rewritten for corporation tax.***

Part 8: Derivative contracts

Clause 544: Overview of Part

With reference to paragraphs 11-14 of the 28.12.07 response document to Paper CC/SC(07)21 (Derivative contracts) we note that "profits and losses" are now referred to in clause 544(1) Part 8, whereas for loan relationships purposes the reference is to "profits and deficits" in clause 301(1). We are surprised at this lack of consistency.

114. The drafting differences reflect in part differences in the source legislation. That is, the provisions that deal with a non-trading deficit arising from a loan relationship (see Chapter 14 of Part 6) have no equivalent in the derivative contracts provisions. Non-trading credits and debits arising from a derivative contract will of course fall into the calculation of such a deficit by virtue of clause 548. But we will

consider this point as part of a larger exercise now underway to achieve greater consistency of drafting where appropriate between Parts 6 and 7 and Part 8.

115. *We will align the drafting of these clauses to achieve consistency where appropriate.*

Clause 570: Meaning of “related transaction”

The response document to paper CC/SC(07)21 said that the words “rights and liabilities” would be changed to “rights and obligations” “in all cases where it is wholly appropriate to do so”. The commentary on the present draft says only that this issue is still under consideration.

We think that there is probably no practical difference between the two expressions, at least as applied to derivative contracts. Nevertheless, purely as a matter of language, “obligations” is the converse of “rights”, so saying “rights and obligations” should minimise the risk of anything unintentionally dropping out of account between the two.

116. We had cause to change our minds on this (and apologise for not saying so in the explanatory notes). Although in most cases there may be no practical difference between “obligations” and “liabilities”, we now think that the latter term has the potential to be broader. That is, it encompasses the possibility that there may be risk inherent in the terms of the contract that is not necessarily envisaged at the outset, whereas “obligations” refers to the known duties of the contract holder at a moment in time. The source legislation uses “obligations” in that way and does not use the phrase “rights and obligations”; rather, it uses “rights and liabilities” under the contract. The drafting of Parts 6 to 8 of the Bill follows that practice uniformly.

117. *We will not be substituting “obligations” for “liabilities”.*

Clause 584: Contracts relating to holdings in unit trusts, OEICs or offshore funds

...spell out OEIC in cl 584(1)

118. This respondent suggested that we should spell out the term “OEIC” (open-ended investment company) in the heading and the descriptive cross-reference in subsection (1) of this clause. (The same respondent also offered this suggestion in relation to clause 641.) The term is actually used for the first time in this Part in clause 561 (contracts relating to holdings in unit trusts, OEICs or offshore funds), to which this clause refers, where the full words appear in subsection (3). (It is also used in Parts 6 and 7 of the Bill. See, for example, clause 481, where the full words are also given in the clause although the abbreviation is used in the clause heading.)

119. We think that anyone coming across the term will either be using a clause that gives the full words or a clause that requires reference to such a clause. In context,

and given that the abbreviation is widely used, we doubt that further use of the full words is necessary.

120. *We will not be amending the clause.*

Clause 593: Index-linked gilt-edged securities with embedded contracts for differences

A comment on the previous draft of this clause suggested that it needed to be made clear that amounts excluded from this Part by sub-clause (6) are still excluded from any alternative charge by what was then clause 8(1). Although the response document undertook to give consideration to this, no amendment seems to have been made. We consider that the point is still important, the more so since (as the response document pointed out) clause 606 does deal explicitly with the corresponding issue, and this difference in approach could be argued to imply a difference in intention. Although the point is mentioned in the commentary we do not consider that to be a valid alternative to getting the legislation right.

121. As a result of research in relation to a similar question, regarding paragraphs 38 and 38A of Schedule 26 to FA 2002, we do not now consider that the proposed clarification is justified. Unless a rule equivalent to paragraph 23(8) of Schedule 26 to FA 2002 is specifically supplied, any other relevant corporation tax provision that would actually do so may apply to the amounts excluded under this or a similar provision. It may of course be the case that no such corporation tax provision exists (and we are not aware of one that would apply to the amounts excluded by this clause) so that the net effect is in practice the same as if “clarification” had been supplied.

122. *We will not be amending the clause.*

Clause 599: Transactions to which section 598 applies

In our comments on paper CC/SC(07)21 we suggested that the clarity of sub-clause (3) could be improved, and the response document accepted the point. No change has in fact been made in this clause, but the corresponding point has been dealt with in clause 345 by inserting “would be” in place of “is”. While the point is not a major one, the two clauses should at least be made consistent.

123. We will consider this point as part of the larger exercise to achieve greater consistency of drafting where appropriate between Parts 6 and 7 and Part 8.

124. *We will align the drafting of these clauses to achieve consistency.*

Clause 603: Transferee leaving group otherwise than because of exempt distribution

In clause 603(4)(b) for ‘transferor’, in the s 351 bracketed heading, substitute ‘transferee’.

125. *We will amend the description of the cross-reference.*

Clause 612: Derivative contracts with non-UK residents

We note that this clause is still under review in the light of earlier comments.

126. We are now satisfied that subsection (4) of this clause reflects the source legislation fully and accurately.

127. *We will not be amending the clause.*

Chapter 7: Chargeable gains arising in relation to derivative contracts

128. A respondent asked (in connection with the question inviting comments on the proposal to include in this Part the provisions in Chapters 7 and 8, rather than insert them in TCGA) whether there would be a signpost in TCGA to these provisions. Although it is the practice of the project to add signposts where helpful, we do not think the provisions in these Chapters are sufficiently “mainstream” to justify a signpost in (or near), say, section 1(2) of TCGA.

129. *We will retain in this Part the provisions creating chargeable gains or allowable losses for the purposes of TCGA, but will not insert a signpost in TCGA.*

Clause 655: Contracts which became derivative contracts on 16 March 2005

We are unclear, however, why the more straightforward approach adopted in the similar clause 656 (Contracts which became derivative contracts on 28 July 2005), based on fair value at the change date, could not also be adopted in clause 655.

130. The differences in the drafting of these clauses reflect differences in the source legislation. These are essentially anti-avoidance provisions and each is carefully drafted to address the issue in question. Any change to align the drafting as suggested risks altering what is “caught” by the provision and may therefore be detrimental to some taxpayers.

131. *We will not be amending the clause in this respect.*

Clause 677: Meaning of “relevant credits” and “relevant debits”

We have some sympathy with the comment in the response document to paper CC/SC(07)21 that it is difficult in this clause to depart radically from the

model of the source legislation. However, as we commented previously, it is difficult to give paragraph 45G(2) and (3) of Schedule 26 FA 2002 any sensible meaning. And we cannot see any way in which the source legislation can be construed to produce the result put forward in the HMRC manual at paragraph 13540a (in the case where sub-paragraph (2)(a) of paragraph 45G produces a gain and sub-paragraph (3) a loss, or vice versa), in respect of either income or chargeable gains.

That being so, any attempt at clarifying the legislation is almost certain to change the law. It is nevertheless extremely unsatisfactory if the rewrite is used simply to reproduce legislation which is obviously defective. We think the position should be corrected, and if that requires Finance Bill legislation, so be it.

132. *We will not be amending the clause but have forwarded this policy suggestion to our colleagues.*

Clause 678: Other definitions

“Capital redemption policy” is defined by reference to capital redemption business ‘within the meaning of Chapter 1 of Part 12 of ICTA’. As sections 458 and 458A of ICTA (capital redemption business) were repealed by FA 2007, subject to transitional provisions, is this definition now sufficient?

133. Section 458 of ICTA, which formerly contained the definition in Chapter 1 of Part 12 of that Act, was repealed by FA 2007. However, that definition is now supplied by section 431(2ZF) of ICTA. The definition of “capital redemption policy”, by reference to the definition of “capital redemption business” in Chapter 1 of part 12 of ICTA, remains in strictness sufficient. However, a similar reference in an unpublished clause of the Bill (drafted to reflect provisions introduced by FA 2008) refers directly to section 431(2ZF) of ICTA.

134. *We will amend clauses as necessary to align such references.*

Part 9: Intangible fixed assets

135. Responses on Part 9 address principally comments received on the draft Bill published in February 2008 (“the February draft”).

136. However, many of the clauses had already been exposed on the internet for informal consultation in October 2007 in Paper CC/SC(07)32 (Bill 5: Intangible fixed assets) (“the October draft”) and we received some comments in respect of that draft. Where a comment on the October draft remains relevant to the February draft it is addressed below in the normal way. But in some instances comments on the October draft enabled us to make improvements to the February draft. In those cases the fact

that a clause reflects earlier comments (and how it does so) is noted under the clause heading.

General comments

Schedule 29 to FA 2002 was drafted in the “new” style and did not warrant rewriting. It is doubtful whether the rewriting and reordering achieves material clarification or improvement.

137. It is true that some rewrite drafting techniques were applied in drafting the source legislation. However it was drafted as a free-standing, self-contained regime. It would not have been sensible to exclude it from the rewrite which encompasses all the mainstream corporation tax provisions. Integrating it into the Bill requires some changes to ensure consistency not only of language and style but also of structuring and ordering principles.

138. ***We believe that is beneficial to rewrite this material.***

The revised terminology which replaces terms such as “commencement”, “existing law” and “existing assets” is not helpful and is change for its own sake.

139. We gave long consideration to the question of terminology when we began the rewrite of this legislation. We recognise that it is not possible to say that one set of terms is unequivocally better than another, but we concluded that, on balance, the rewrite’s proposed terms were more suited to a regime which was to be integrated directly into a wider legislative framework and re-enacted at a later date. In particular, “existing” would look increasingly odd as time went by to denote law that is obsolescent and assets that do not qualify to come within the regime because they are “old” assets.

140. ***We will retain the revised terminology.***

The draft legislation is generally expressed in terms that debits and credits “must be” brought into account. Previous rewrite practice was to say that something “is” or “is to be” done.

141. ***We are considering how far complete consistency is feasible and desirable in this context.***

There is at present no index of defined expressions for Part 9.

142. Our general policy is not to have a Part index as well as a Bill index and, as the respondent recognised, there are fewer terms defined solely for the purposes of Part 9 than there are for certain other Parts.

143. ***We will not be including an index of defined expressions in Part 9.***

Clause 696: Expenditure written off as it is incurred

Why does subsection (5) not mention section 74(1)(m) and 817(1)(b) of ICTA mentioned in paragraph 8(3) of Schedule 29 to FA 2002?

144. The ICTA provisions mentioned are redundant and are not being rewritten.
145. *The provisions referred to are correctly omitted.*

Clause 697: Writing down on accounting basis

The primacy of the adjustment required by paragraph 9(4) of Schedule 29 to FA 2002 is obscured such that the effect of sub-section (4) on the formula in subsection (3) appears to be that the result is always equal just to L.

146. We agree.
147. *We will amend the clause to address this point.*

Clause 698: Writing down at fixed rate: election for fixed-rate basis

Subsection (3) would be clearer if “may only” were changed to “must”.

148. We think that “may only” is more appropriate when the making of the election is a voluntary matter.
149. *We believe that the current drafting is appropriate in the circumstances.*

Clause 699: Writing down at fixed rate: calculation

In sub-section (6), the meaning of “the cost recognised for tax purposes in respect of the value of the asset recognised for accounting purposes immediately after the part realisation” is not clear. Similar comments apply to clause 704.

150. We have followed the source legislation closely here and the text has to capture the trail from accounting value to tax value. In particular, the clause (like the source) proceeds from “the cost of the asset” whose meaning is defined in subsections (3) and (4). An alternative approach introducing perhaps a new term such as “the value of the asset” would cut across the subsections (3) and (4) definitions and make the clause more complicated.
151. *The drafting follows the source legislation and we believe it is suitable here and for clause 704.*

Clause 708: Abortive expenditure on realisation

The word “corresponding” in sub-section (2) adds nothing, and tends to obscure the fact that the amount of the debit is actually defined in the subsequent sub-sections.

152. This word is reproduced from the source legislation and we think it is helpful in indicating the causal link with subsection (1). But we think the words “recognised for tax purposes” in subsection (3) are then superfluous.

153. *We will preserve “corresponding” but will amend subsection (3).*

Clause 724: Conditions relating to expenditure on other assets

Q21. We welcome comments on the proposal to change the references to “Inland Revenue” in paragraphs 35(2) and 39(1)(a) of Schedule 29 to FA 2002 to “officer of Revenue and Customs”.

There is no objection to the proposed terminology but there should be full consultation on any significant change in the current levels of authorisation.

154. *No such change of procedure is implied by this rewrite change.*

Clause 726: How the relief is given: general

Subsection (1) does not operate only on an entitlement basis and reference to a claim is needed.

155. Clause 722(3)(c) makes it clear that there can be no entitlement to relief without a claim.

156. *We believe the drafting is appropriate and will not be amending this clause.*

157. In response to a respondent’s comment that in the October draft of subsection (6) “any other party” should govern both (a) and (b), the clause was amended for the February draft to take account of this.

Clause 727: Determination of appropriate proportion of cost and adjusted cost

Sub-section (1) is expressed as a definition of “the appropriate proportion of the cost of the old asset”, but is actually a definition only of “the appropriate proportion”.

158. We agree.

159. *We will amend the wording to address this point.*

Clause 732: Introduction: “company”, “group” and “subsidiary”

Why has the reference in paragraph 46(2)(a) of Schedule 29 to FA 2002 to companies within the meaning of Northern Ireland legislation not been replicated?

160. Section 1 of the Companies Act 2006 defines “company” to include Northern Ireland companies. So the reference quoted is unnecessary and is omitted.

161. *There is no need to amend this clause.*

Clause 745: Roll-over relief on realisation and reinvestment: application to group member

“Relevant time” is too colourless to be helpful.

162. We intend to replace this term with the more descriptive “expenditure time”.

163. *We will amend the clause to address this point.*

Clause 747: Acquisition of group company treated as equivalent to acquisition of underlying assets

Sub-section (6) would be clearer if the phrase “treated as incurred” in paragraph (b) was amplified by “as a result of subsection (1)”.

164. The rewrite replicates precisely the source legislation and the suggested clarification would involve a change in the law.

165. *We do not propose to amend this clause.*

Clause 748: Company ceasing to be member of group (“degrouing”): general

The revised order of the words in sub-section (3) obscures or changes the meaning of the provision it rewrites.

Similar comments apply to clause 752(4).

166. We agree and will introduce wording closer to the source both in clause 748(3) and 752(4).

167. *We will amend both clauses to address this point.*

Clause 749: Company ceasing to be member of group (“degrouing”): relevance of transferee’s trade or other purposes

The clause does not provide any adequate way of dealing with a case where:

the asset is initially held by the transferee for one purpose but is then transferred to another group company which holds it for a different purpose, and/or

the second company (which is not “the transferee” as defined) initially holds the asset for the purpose of a trade etc. within clause 715, 716 or 717 but ceases that trade etc. before it and the transferee leave the group as associated companies.

Similar comments apply to clause 753.

168. As the respondent anticipated, it would not be within our remit to introduce this change.

169. *We believe that the clause correctly states the current law.*

Clause 750: Associated companies leaving group at the same time

170. In response to a respondent’s comment that the October draft seemed to go wider than the source legislation, the February draft was amended to follow more closely paragraph 59(1) of Schedule 29 to FA 2002.

Clause 751: Groups with a relevant connection

Sub-section (4)(b) is meaningless without further wording reading “if” Splitting the source into two sub-sections breaks the logical connection between the elements. Nor is the “It does not matter ...” formulation in sub-section (5) appropriate when what follows is actually part of the preceding definition, rather than just selecting for emphasis two cases which already fall within it.

171. We agree this could be more clearly expressed.

172. *We will amend this clause to address this point.*

Clause 754: Company ceasing to be member of group because of exempt distribution

Why has the three year time limit in paragraph 61(2) of Schedule 22 to FA 2002 been removed?

173. The time limit is preserved in clause 754(3).

174. *The rewrite accurately reproduces the source legislation.*

Clause 756: Merger carried out for genuine commercial reasons

In subsection (3) “one or more companies...acquire” rewrites “...acquires or acquire” covering both.

175. There is no difference in meaning from the source and the draft reflects rewrite style.

176. *This clause accurately reflects the law.*

Clause 764: Recovery of degrouping charge from another group company or controlling director: procedure etc

There is an ambiguity in sub-section (5) as to whether “such a payment” refers to the reimbursement by A, mentioned in the previous sub-section, or to the payment made in accordance with a notice under sub-section (1).

177. The reference is to the payment required to be made by the notice so we will make a small change to subsection (5) to make this explicit.

178. *We will amend the clause to address this point.*

Clause 769: Effect of partial exclusion

“Not so” is needed before “excluded” in the last line of subsection (1).

179. We agree.

180. *We will amend the clause to address this point.*

Clause 771: Assets for which capital allowances previously made

The verb “falls to be” in subsections (2) and (3) of this clause (and elsewhere) means simply “is” and was in the past avoided by the rewrite as archaic.

181. This wording reflects the emphasis in the clause on the proper treatment for accounting purposes, not on what is actually done and follows the source legislation in this respect.

182. *We will be retaining the existing wording in this clause.*

Clause 785: Company reconstruction involving transfer of business

Sub-section (7) expands the definition of “scheme of reconstruction” to deal separately with cases before and after the introduction of the new version of section 136 TCGA, which took effect from 17 April 2002. This may bring inadvertent changes in the law because the old definition of “scheme of

reconstruction” did not include the references to issues of shares and debentures.

We think it would be better to leave the definition of “scheme of reconstruction” as it currently stands in paragraph 84.

183. We agree and will revert to a definition by reference only to section 136 of TCGA.

184. *We will amend the clause to address this point.*

Clause 787: Application of sections 748 and 752 when transfer within section 786 occurs

185. In response to a respondent’s comment that the October draft of this clause used “building society” and “society” variously to refer to the same thing we adopted “building society” throughout for the February draft.

Clause 788: Amalgamation of, or transfer of engagements by, certain societies

A signpost is needed from subsection (3)(b) to the meaning of “registered industrial and provident society” in section 486 of ICTA.

186. “Registered industrial and provident society” is a term listed in the index of expressions in Schedule 4 and our practice is not to signpost those terms.

187. *A signpost here is not necessary.*

Clause 789: Claims to postpone charge on transfer of assets to non-UK resident company

In sub-section (4)(b) it is not clear that the reference to “such shares” imports both requirements, that the shares are within sub-section (5) and that they are issued by the transferee to the transferor.

188. We agree and will amend subsection (4)(b) so that it applies to “shares within paragraph (a)”.

189. *We will amend the clause to address this point.*

Clause 791: Transfer of assets to non-UK resident company: charge on subsequent realisations

Sub-section (1) needs to make clear that the securities referred to are those mentioned in clause [789](4), rather than any securities (or any securities in the transferee) which the transferor happens to own.

190. Adopting this suggestion would import a limitation on the meaning of “securities” which is not present in the source legislation.

191. *We believe that the clause correctly states the law.*

Clause 792: Transfer of assets to non-UK resident company: exclusion from section 791 of group transfers

Subsection (3)(b) should refer to a previous transfer that was not ignored.

192. We agree.

193. *We will correct the error.*

Is the transferor referred to in subsection (4) the same transferor referred to in clause 791(1)?

194. Yes, the answer is provided in clause 789(8).

195. *No amendment of the clause is necessary.*

196. In response to a respondent’s comment that subsection (5)(a) of the October draft of this clause should refer to subsection (2) (and not subsection (4)) we corrected the error for the February draft.

Clause 794: Procedure on application for clearance

Subsection (4) would be clearer if “may only” were changed to “must”.

197. We think that “may only” is more appropriate when the making of the election is a voluntary matter.

198. *We believe the drafting is appropriate because it reflects the fact that the election is voluntary.*

Clause 806: Overview of Chapter

199. In response to a respondent’s comments on subsection (3) of the October draft we made the reference there to “other such rules” more informative.

Clause 807: Transfer between company and related party treated as being at market value

Should the definition of “market value” in subsection (5) be applied specifically throughout the Part?

200. As in the source legislation, that is not necessary because subsection (1) applies “for all purposes of the Taxes Acts”. Where there is an exception to the rule in subsection (1), what is disapplied is the basic market value rule and not the definition of “market value” itself.

201. *No amendment of the clause is required.*

Clause 811: Transfers involving gifts of business assets

202. In response to a respondent’s comment on subsection (1)(b) of the October draft we corrected an incorrect TCGA cross-reference for the February draft.

Clause 817: Further provision about regulations under section 816

203. In response to a respondent’s comment that the October draft wrongly referred to a “lessor” in subsection (5), the clause was corrected for the February draft.

Clause 819: Deemed market value acquisition: adjustment of amounts in case of nil accounting value

In sub-section (1)(b), “acquired” and “acquirer” would fit better than “transferred” and “transferee”.

204. The terminology here replicates that of the source and reflects that of the related party/market value clauses.

205. *No amendment is appropriate because the clause is consistent with the source legislation and other clauses.*

Clause 823: Treatment of postponed gain on subsequent realisation

In sub-section (2), the words “a credit equal to” should qualify both of paragraphs (a) and (b).

206. We agree.

207. *We will amend the clause to address this point.*

Sub-section (4) does not adequately explain what is to be done when the second event is also a part realisation: sub-section (2) should be applied taking as “the postponed gain” the actual amount of that gain reduced by any amounts previously brought into account.

208. We believe this subsection does deal with the case if the second event is also a part realisation. In such a case subsection (2)(b) will apply subject to subsection (4). That enables postponed gain already brought into account to be ignored in

determining the amount of the postponed gain referred to in subsection (2)(b), from which the appropriate proportion is determined.

209. *We do not believe an amendment is necessary to deal with a second part realisation.*

Clause 826: Tax avoidance arrangements to be ignored

210. In response to a respondent's comment that the October draft may go wider than the source legislation in the use of the phrase "as if tax avoidance arrangements had not taken place" the clause was amended for the February draft to say "tax avoidance arrangements are ignored".

Clause 828: Delayed payment of employees' remuneration

We do not agree with the change from "debit" in the source legislation to "loss" which involves a degree of ambiguity which is unnecessary in a section which is specifically dealing with an expense rather than a real loss. The same applies in clauses 829 (Delayed payment of employees' remuneration: supplemental provisions) and 830 (Delayed payment of pension contributions).

211. Doubts were also expressed by another respondent on the appropriateness of "accounting loss" in clause 829(3).

212. We recognise that our proposed substitution of "loss" for "debit" may not, in these particular cases, be helpful. So we intend to revert to the term used in the source legislation.

213. *We will amend this clause and clauses 829 and 830 to address this point.*

Clause 832: Assumptions for calculating chargeable profits of controlled foreign companies

The ICTA provision cited in subsection (4) must be ignored only to the extent of making the assumptions set out in paragraphs (a) and (b) and not altogether.

214. We agree.

215. *We will amend the clause to address this point.*

Clause 839: Change of accounting policy involving disaggregation: election for fixed-rate writing down in relation to resulting asset

Subsection (3) would be clearer if "may only" were changed to "must".

216. We think that “may only” is more appropriate when the making of the election is a voluntary matter.

217. *We believe the drafting is appropriate because it reflects the fact that the election is voluntary.*

Clause 846: Internally-generated goodwill: time of creation

Sub-section (2) does not appear to add anything: the implication of sub-section (1) is clear.

218. No other respondent commented adversely on this subsection. We remain of the view that this adds a clear and helpful statement of the effect of the rule in subsection (1) and its relevance to Chapter 16.

219. *We believe the current drafting is helpful.*

Clause 850: When expenditure treated as incurred: application of chargeable gains rule

It is not clear that the disposal referred to in sub-section (1)(c) is the disposal by the person from whom the company in question acquired and not a disposal by the company itself.

220. We agree.

221. *We propose to amend the clause to address this point.*

Clause 855: Assets whose value derives from pre-FA 2002 assets treated as pre-FA 2002 assets

There is still a requirement for the 5 December 2005 transitional date for this provision.

222. Section 77(10) and (11) of FA 2006 set out a transitional rule for the amendments to Part 14 of Schedule 29 to FA 2002 introduced in FA 2006. That rule is not rewritten with the main provisions. But to the extent that it will have any ongoing life after the commencement of the Bill its effect will be preserved by transitional provisions in Schedule 2 to the Bill (Transitionals and savings etc).

223. *The transitional rule in section 77(10) and (11) of FA 2006 is not rewritten with the main provisions but its effect is preserved.*

Clause 857: Assets acquired in connection with disposals of pre-FA 2002 assets treated as pre-FA 2002 assets

224. In response to a respondent's comment that the October draft of subsection (4)(c) did not include the reference, present in the source, to acquiring an asset "in any other way" we amended that subsection for the February draft.

There is still a requirement for the 5 December 2005 transitional date for this provision.

225. Section 77(10) and (11) of FA 2006 set out a transitional rule for the amendments to Part 14 of Schedule 29 to FA 2002 introduced in FA 2006. That rule is not rewritten with the main provisions. But to the extent that it will have any ongoing life after the commencement of the Bill its effect will be preserved by transitional provisions in Schedule 2 to the Bill (Transitionals and savings etc).

226. The transitional rule in section 77(10) and (11) of FA 2006 is not rewritten with the main provisions but its effect is preserved.

Clause 860: Roll-over relief where pre-FA 2002 assets disposed of on or after 1 April 2002

227. In response to two respondents' comments on the October draft of this clause we amended it and introduced an ancillary, definitional, clause (clause 862) in the February draft.

228. One of those respondents commented that subsection (2)(b) excluded from the category of chargeable asset within TCGA 1992 the assets of a UK permanent establishment of a non-UK company.

229. Similarly, another of those respondents commented that it was necessary to take account of section 10B of TCGA when rewriting paragraph 130(3) of Schedule 29 to FA 2002.

Clause 862: Meaning of "chargeable asset within TCGA" in sections 860 and 861

230. In response to a respondent's comment on the October draft of clause 860 we rectified in the February draft of clause 862(3) a typographical error in paragraph 130(3)(b) of Schedule 29 to FA 2002 which refers to section 10(3) of TCGA instead of section 10B of TCGA.

Part 10: Miscellaneous income

Chapter 3: Annual payments not otherwise charged

Why have certain clauses been omitted from Chapter 3?

231. The respondent notes that when Chapter 3 was published in Appendix C to Paper CC/SC (06) 06 in May 2006, it contained clauses 4 to 6, and that these clauses no longer appear in this Chapter.

232. The omitted clauses rewrote section 347A of ICTA and parts of section 125 of ICTA. Section 30 of FA 2007 and paragraph 1(2) and (4) of Schedule 5 to FA 2007 have repealed section 347A of ICTA.

233. *We will not be amending this Chapter but section 125 of ICTA will be rewritten in the Bill.*

Clause 910: Charge to tax on income from holding an office

In clause 910(3)(a) for ‘in’ substitute ‘into’.

234. ***We agree and will make the amendment.***

In explanatory notes paragraph 2548 for “(6)” substitute “(7)”.

235. ***We agree and will make the amendment.***

The explanatory note (paragraph 2548) has an incorrect reference. We think it would be helpful to refer Part 21: Other general provisions also to GWR v Bater as well as to section 5(3) of ITEPA.

236. ***We agree and in addition will refer to the case of Edwards v Clinch (1981) 56 TC 367. Both these cases are shown as the origin for section 5(3) of ITEPA. In addition section 5(3) of ITEPA is now shown as the origin for this subsection instead of “drafting” as this is more accurate.***

237. In paragraph 2547 of the commentary on the draft Bill there was a reference to further research on section 9(5) and (6) of ICTA. Section 9(5) applies “where, by virtue of this section or otherwise” any enactment applies both to corporation tax and income tax. We are not repealing this provision since it could have an application to an enactment that is not rewritten in the Bill or the second corporation tax Bill.

238. *Section 9(6) of ICTA is to be repealed and is not rewritten in clause 910 since it no longer serves a useful purpose.*

Part 11: Relief for employee share acquisitions: SIPs, SAYE option schemes, CSOP schemes and ESOTs

Clause 915: Overview of Chapter

Is clause 54(2) considered sufficient to establish the priority of Chapter 1 of Part 11 over clause 54 (1)?

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Response document: Part 11: Relief for employee share acquisitions: SIPs, SAYE option schemes, CSOP schemes and ESOTs

239. Clause 54 rewrites section 74(1) of ICTA. This clause states the general rule that there is no deduction for items of a capital nature.

240. The respondent notes that when this Part was published for comment in May 2007 as Paper CC/SC (07) 16, this clause contained a subsection (8). The respondent notes that subsection (8) has been omitted from this draft.

241. Former subsection (8) explicitly gave Chapter 1 of Part 11 priority over clause 54 (1).

242. Since May 2007, clause 54 has been redrafted. A new subsection (2) states that subsection (1) is subject to provision to the contrary in the Corporation Tax Acts.

243. While clause 54(2) is arguably sufficient to establish the priority of Chapter 1 of Part 11 over clause 54 (1), we have decided that it is helpful to clarify the relationship between clause 54 and this Chapter by way of provision in this Chapter. So it is proposed to restore to this Chapter a provision on the lines of the omitted subsection (8).

244. *We will amend Chapter 1 of Part 11 by including express provision about its relationship with clause 54(1).*

Part 12: Other relief for employee share acquisitions

Clause 943: Calculation of amount of relief if shares are restricted or convertible

This clause changes the law adversely to the taxpayer because it applies to restricted securities an anti-avoidance measure applicable only to convertible securities.

245. This clause provides the amount of relief available if shares are restricted or convertible (or both). It rewrites paragraphs 21(3) and 22C(3) and (4A) of Schedule 23 to FA 2003.

246. This clause is similar to clause 951. That clause provides for the amount of relief available if an option is awarded to acquire shares which are restricted or convertible or both. It rewrites paragraphs 21(4) and 22C(4) and (4A) of Schedule 23 to FA 2003.

247. So the criticism of clause 943 applies equally to clause 951.

248. The anti-avoidance measure in question is the company-oriented measure in paragraph 22C(4A). The effect of paragraph 22C(4A) is that, in cases where the acquisition or award of a share which is both restricted and convertible is also affected by an avoidance motive, the employee-oriented anti-avoidance measure in section 437(2) of ITEPA does not apply to the calculations in paragraph 22C(3) and (4) in Part 4A of Schedule 23.

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Response document: Part 12: Other relief for employee share acquisitions

249. The respondent notes that the last sentence of paragraph 2672 of the explanatory notes suggests that we have drafted this clause on the basis that paragraph 22C(4A) in Part 4A of Schedule 23 (convertible shares) can apply to Part 4 of Schedule 23 (restricted shares).

250. Section 437 of ITEPA applies to convertible securities (Chapter 3 of Part 7 of ITEPA), and not to restricted securities (Chapter 2 of Part 7 of ITEPA). So paragraph 22C(4A) appears only in Part 4A of Schedule 23 and not in Part 4 of Schedule 23. Paragraph 22C(4A) applies only to paragraph 22C(3) and (4).

251. We agree that the last sentence of paragraph 2672 of the explanatory notes is wrong. We will redraft paragraph 2672.

252. But we do not agree that clause 943 can be read as applying to restricted shares an anti-avoidance related rule applicable only to convertible shares. Although paragraph 22C(4A) is rewritten in subsection (3) of this clause, it refers only to convertible shares. There is no suggestion in this clause that subsection (3) applies to restricted shares.

253. We note in passing that paragraph 22C(4A) of Schedule 23 to FA 2003 is not required. This is because of paragraph 7(3) in Part 2 of Schedule 23 to FA 2003, the effect of which is that a transaction affected by section 446UA of ITEPA does not qualify for relief under Part 2 or Part 4A of Schedule 23 to FA 2003. This means that the need to disapply section 437(2) in a calculation under Part 4A of Schedule 23 to FA 2003 can never arise.

254. ***We agree in part and will amend the explanatory notes.***

Paragraphs 21(5) and 22C(5) of Schedule 23 to FA 2003 have been incorrectly omitted.

255. The respondent notes that we have not rewritten paragraphs 21(5) and 22C(5) of Schedule 23 to FA 2003.

256. This clause is similar to clause 951. So the criticism of clause 943 applies equally to clause 951.

257. These two provisions are similarly worded. They provide for comparative calculations where the shares involved are both restricted and convertible. The one calculation uses the rules in Part 4 of Schedule 23 (restricted shares), the other uses the rules in Part 4A of Schedule 23 (convertible shares).

258. We concluded that paragraphs 21(5) and 22C(5) did not need to be rewritten because the two calculations involved would always yield the same result.

259. The respondent argues that the fact that paragraph 22C(4A) does not apply to Part 4 of Schedule 23 means that, in cases where the acquisition or award of a share which is both restricted and convertible is also affected by an avoidance motive, section 437(2) of ITEPA applies to Part 4 of Schedule 23. The respondent contends that this constitutes a material difference between the calculation rules in Parts 4 and 4A of Schedule 23. The respondent concludes that it is necessary to rewrite paragraphs 21(5) and 22C(5) because the difference in the two sets of calculation rules allows for a comparative calculation.

260. But since section 437 of ITEPA does not apply to restricted securities, section 437(2) of ITEPA cannot be applied to the calculations in Part 4 of Schedule 23. So the fact that paragraph 22C(4A) does not apply to Part 4 of Schedule 23 is not a factor which makes the calculation rules in Parts 4 and 4A of Schedule 23 different.

261. However, we now consider that paragraphs 21(5) and 22C(5) should be rewritten. These paragraphs allow a company to calculate the market value of the shares using two different sets of rules, and to choose the more favourable result. In the case of restricted shares, value is calculated using the rules in Chapter 1 of Part 3 of ITEPA read with Chapter 2 of Part 7 of that Act. In the case of convertible shares, value is calculated using the rules in Chapter 1 of Part 3 of ITEPA read with Chapter 3 of Part 7 of that Act. We agree that there is a difference in calculation rules which can lead to a difference in results.

262. A possible effect of the comparative calculation in paragraphs 21(5) and 22C(5) is to allow a company to claim relief on the higher amount in circumstances where the recipient has been charged to tax on the lower amount. So these paragraphs reflect an instance in which the treatment of the company and the recipient may diverge.

263. *We accept that the omission of paragraphs 21(5) and 22C(5) of Schedule 23 to FA 2003 results in an adverse change in the law and so we will rewrite these two paragraphs.*

Subsection (3) introduces confusion because it states an assumption which is already stated in section 437(1) of ITEPA.

264. Subsection (3) rewrites paragraph 22C(4A) of Schedule 23 to FA 2003. It does so by setting out in full the effect of section 437(1) of ITEPA, instead of referring the reader to section 437(1) of ITEPA.

265. This clause is similar to clause 951. So the criticism of clause 943 applies equally to clause 951.

266. Subsection (3) is intended to assist the user of the Bill. We think that it is unhelpful to oblige a user of the Bill to refer to the text of another Act.

267. *We disagree and will not amend subsection (3) of this clause.*

Clause 945: How the relief is given

Can the words in parenthesis at the end of the subsection (3) and clause 953(3) be drafted so as to be consistent with the words in parenthesis at the end of clauses 917(3), 931(4) and 932(3)?

268. *We agree and will amend these clauses accordingly.*

Clause 951: Calculation of amount of relief if shares are restricted or convertible

269. Please see paragraphs 245 to 267 of this document.

Clause 961: Transfer of qualifying business by group transfers

In paragraph 2725 of the explanatory notes, the reference to an interim period seems to be incorrect.

270. The explanatory notes for this clause, which mention its similarity to clause 956, wrongly indicate that clause 956 refers to an “interim period”. In fact, the reference in that clause is to “the option period”.

271. *We will amend the explanatory notes.*

Clause 969: Priority of Chapter 1 of Part 11

In subsection (2), what is the source for the words in parentheses?

272. The respondent suggests that paragraph 24(2) of Schedule 23 to FA 2003, the only source cited as the origin of this clause, is not the only or a sufficient source of the words in parentheses.

273. It is correct that the words in parentheses are not derived exactly from the explicit words of paragraph 24(2) of Schedule 23 to FA 2003. The words in parentheses merely make explicit what is implicit in the source legislation. The reference in paragraph 24(2) to a deduction which “has been made” includes a reference to a deduction made but subsequently withdrawn. That is perhaps less obvious from the reference in subsection (2) to a deduction being “allowed”. Hence the inclusion of the words in parentheses.

274. *We believe that the stated origin of the clause is justified.*

Part 13: Additional relief for expenditure on research and development

Clause 974: Meaning of “relevant research and development”

The definition of “relevant research and development” does not satisfactorily cover the case of sub-contracted research and development for the purposes of Chapter 3.

275. This definition rewrites the definition in paragraph 4(1) of Schedule 20 to FA 2000. The respondent acknowledged that the rewritten definition closely follows the source legislation, but considered that the source legislation might be seen as an ill-considered short cut in the drafting of Schedule 12 to FA 2002, which the project should be able to correct.

276. The respondent also made this point in response to the exposure of this Part in February 2007 and suggests that the project misunderstood it. In paragraphs 206 to 210 of our response document for papers CC/SC (07) 02, 03, 04, 05, 06 and 07, published in August 2007, we treated this point as a policy suggestion.

277. Clauses 996(4) and 997(4) in Chapter 3 require that the expenditure on sub-contracted R&D fall within the scope of this definition, by requiring that the expenditure be attributable to “relevant research and development” in relation to the sub-contractor company (“C”). The sub-contracted R&D will not be within the definition of “relevant research and development” if it is not “related to” a trade carried on by C (see clause 974(1)(a)). Sub-contracted R&D which is “related to” a trade is sub-contracted R&D which may “lead to or facilitate an extension” of the trade.

278. The respondent notes that if C’s trade is the carrying out of R&D work on a contract basis without C having any interest in the actual results of the work, there is a question over whether the definition of “relevant research and development” is met in relation to C. The respondent gives as an example the case where C’s work comprises purely routine operations such as testing. The respondent comments that while it may be possible for such work to fall within the definition of “research and development” in clause 973, it does not fall within the definition of “relevant research and development” in relation to C.

279. The respondent argues that it is the policy intention that such activities should benefit from the relief, since they form the whole of the subject matter of Chapter 3. In other words, C should be able to benefit from the relief even where it has no direct interest in the results of the research and development. The respondent contends that it should be possible to clarify the position by means of a rewrite change.

280. We have reconsidered this issue carefully. We do not consider this kind of change to be within the remit of the Project, as the source legislation is unambiguous. We continue to regard this point as a policy suggestion and we have passed it to our colleagues.

281. ***We will not be amending this clause.***

Clause 984: Qualifying expenditure on contracted out research and development

In subsection (3), the requirement that the “contracted out research and development” must be carried out by the sub-contractor itself is not in the source legislation.

282. Subsection (3) rewrites paragraphs 3(3) and 9(2) of Schedule 20 to FA 2000.

283. The respondent suggests that paragraph 3 of Schedule 20 to FA 2000 may not deny relief to an SME sub-contractor where that sub-contractor again sub-contracts the research and development. That is, paragraph 3 does not deny relief for the expenses of a “second level” of sub-contracting.

284. The respondent made this point in response to the exposure of this Part in February 2007. In paragraphs 274 to 282 of our response document for papers CC/SC (07) 02, 03, 04, 05, 06 and 07, published in August 2007, we intended to deal with this criticism, but undertook to reconsider the matter.

285. Having reconsidered the point carefully, we remain of the view that paragraph 3(3) of Schedule 20 to FA 2000 only covers expenditure which is attributable to “relevant research and development” where the relevant research and development is *directly undertaken* by the SME company, or where it is *directly undertaken* on its behalf. In other words, “directly undertaken” applies to both “in-house direct” research and development and “contracted out” (sub-contracted) research and development. We think that the effect of the “directly undertaken” requirement is to deny the sub-contractor relief in respect of its expenses for any second level of sub-contracting.

286. The respondent commented that the point can be argued either way, and that for that reason it is not appropriate for the rewrite to resolve it conclusively in favour of HMRC. But we have concluded after careful analysis that the wording of paragraph 3(3) of Schedule 20 to FA 2000 is unambiguous.

287. ***We will not be amending this clause.***

Clause 1010: Research and development expenditure of group companies

This clause should apply to Chapters 3 to 5 and not just Chapter 5.

288. This clause rewrites paragraph 14 of Schedule 12 to FA 2002. The location of this clause in Chapter 5 means that it applies to large companies only.

289. When this Part was published in February 2007 in Paper CC/SC (07) 06, this clause applied to Chapters 3 and 5. In paragraphs 335 to 347 of our response

document for papers CC/SC (07) 02, 03, 04, 05, 06 and 07, published in August 2007, we took the view that this clause could only apply to Chapter 5.

290. We now agree that nothing in the source legislation rewritten in Chapter 3 explicitly prevents a sub-contractor SME from claiming in respect of a contract between itself and a member of its group. And nothing in this clause explicitly prevents its application to Chapter 3. Therefore, we will make this clause applicable to Chapters 3 and 5.

291. *We will amend this clause to make it applicable to Chapters 3 and 5.*

Clause 1020: SMEs: deemed trading loss for pre-trading expenditure

The wording of subsection (10) is not consistent with the wording of clauses 1016(8) and (9), 1017(7) and (8), 1019(6) and (7) and 1024(3) and (4). Would a consistent approach not be preferable?

292. *We agree and will make amendments to improve the consistency of the provisions mentioned.*

Clause 1033: Amount of trading loss which is “unrelieved”

Paragraph 16(4)(d) has been incorrectly omitted from subsection (2). This can lead to the claiming of double tax relief.

293. The respondent made this criticism in response to the exposure of this Part in February 2007. In paragraphs 310 to 313 of our response document for papers CC/SC (07) 02, 03, 04, 05, 06 and 07, published in August 2007, we explained that paragraph 16(4)(d) was omitted from subsection (2) because we considered it to be superfluous.

294. We have considered the matter further. Paragraph 16(2)(a) of Schedule 13 to FA 2002 refers without qualification to a trading loss. Paragraph 16(2)(a) restricts the surrenderable loss to one arising in respect of the trade contemplated in paragraph 14(1)(b). The trade in paragraph 14(1)(b) is not necessarily a trade of doing only vaccine research.

295. We now agree that there is nothing in paragraph 14 which excludes from the trading loss in paragraph 16(2)(a) of Schedule 13 to FA 2002 the effect of the set-off of relief arising under Schedule 20 to FA 2000 against the income of the trade in paragraph 14(1)(b). So a surrenderable loss for the purposes of paragraph 16 of Schedule 13 to FA 2002 can include a loss surrenderable under paragraph 15 of Schedule 20 to FA 2000.

296. We agree that paragraph 16(4)(d) of Schedule 13 to FA 2002 should be rewritten in clause 1033(2).

297. ***We agree and will amend this clause.***

Clause 1043: Qualifications to section 1042

It is not clear why the effect of clause 1043 is to cause the company to fail to qualify as an SME in the second accounting period and not in the first as well.

298. This clause makes a qualification to the European Union definition of small or medium-sized enterprise. It is based on paragraph 2 of Schedule 20 to FA 2000, paragraph 2 of Schedule 12 to FA 2002 and paragraph 5 of Schedule 13 to FA 2002.

299. The European Union definition requires a company to include figures from a partner or linked enterprise in determining whether it breaches the qualifying thresholds (aggregation). Article 4(2) of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003, as incorporated by reference in clause 1042(1), gives the company a period of grace if the inclusion of those figures means it ceases to be a small or medium-sized enterprise. The company will cease to be a small or medium-sized enterprise within the European Union definition only if the limits are exceeded in two consecutive accounting periods.

300. The effect of the qualification in this clause is to remove that period of grace. The company ceases to be a small or medium-sized enterprise for the purposes of this Part in the second accounting period.

301. Article 4(2) applies to a change in status (generated by aggregation). A change in status means that there is to begin with a classification applying in a year. In other words, there is a base year classification (as a small or medium-sized enterprise or a large company). The base year is a rolling concept; it is always the year preceding the first year of threshold breach.

302. Under Article 4(2), the base year does not change in the first year of threshold breach, counted relative to the base year. The base year classification only changes in the second consecutive year of threshold breach, counted relative to the base year. So the year of change of classification is not the first year of threshold breach (the second year relative to the base year), but the second year of threshold breach (the third year relative to the base year). Thus the first year of threshold breach (the second year relative to the base year) is a year of grace. There is only one year of grace.

303. If Article 4(2) is disapplied, then the default rule applies. The default rule is in Article 2. Article 2 provides: “In respect of any year, you must use the year end accounts for that year to classify the company, according to these criteria”. As a result of the application of Article 2 without Article 4(2), the year of change is the first year of threshold breach (the second year relative to the base year).

304. ***We will amend the explanatory notes to make the application of the clause clearer.***

Part 14: Remediation of contaminated land

Clause 1067: Overview of Part

Should it be made clear at the outset that the contaminated land must be in the UK?

305. The source legislation sets out this requirement right at the start of the Schedule, and we can see the benefit of stating this clearly at the beginning of the Part.

306. *We will amend the clause to make this point clear.*

Clause 1068: Meaning of “qualifying land remediation expenditure”

Should there be a signpost in clause 1068(3) to the definition of “in a contaminated state” in clause 1069?

307. Subsection (2) of this clause has a signpost to clause 1069, and therefore we do not believe it is necessary to repeat the signpost in subsection (3).

308. *We will not be amending the clause to add a signpost in subsection (3).*

Clause 1070: Meaning of “relevant land remediation”

Sub-clause (3)(a) appears to reverse the natural order of events. One would expect the fact that the land is in a contaminated state to be the cause of the harm or pollution, rather than vice versa. Presumably what the drafter meant was “any harm or any pollution of controlled waters by virtue of which the land satisfies the above definition of being ‘in a contaminated state’”, but this is not immediately obvious to the reader and would be clumsy drafting even if written out in full. Saying “...which will result or might result from the land being in a contaminated state” would seem to achieve the same result. The same applies to clause 1097(3).

309. We agree that “because of” could suggest that the land was contaminated by the controlled waterways. We will amend the clause to reflect more closely the source legislation and will use words that are more neutral about the order in which the events may have occurred.

310. *We will amend the clause to clarify this point.*

Sub-section (4)(c) appears to be a new test which is not in the source legislation, at least in this form. It may be intended merely to replicate the effect of the requirement in paragraph 4(1)(b) of Schedule 22 to FA 2001 that the remediation activity should actually take place, but if so it is unclear what it adds to sub-section (4)(b); and to the extent that it does add anything we are concerned that it may change the law to the taxpayer’s disadvantage.

Arguably “results in” implies a stronger casual link than “is connected to”. For example if drilling tests establish that remediation is necessary on part of the land but not on the rest it might be argued that under the new wording only the cost of the drilling on the former part meets the test.

311. As a result of this response we will amend the clause by removing subsection (4)(c) and bringing subsection (4) more clearly into line with the source legislation.

312. *We will amend the clause to clarify this point.*

Clause 1071: Deduction for capital expenditure in calculating profits of UK property business or trade

In sub-section (8) it would be more accurate to say that the whole of this clause, rather than just sub-section (6), does not apply to the expenditure in question.

313. *We agree and will amend the clause.*

Clause 1073: Additional deduction in calculating profits of UK property business or trade

Although there is no difference in meaning, we wonder whether it would be better to align the wording of sub-section (2) with that in clause 1071(2).

314. *We agree and will amend this clause to align with clause 1071(2).*

We wonder why it is not possible to combine this clause with clause 1071. There could be a single set of conditions and then the various consequences being met. Consideration would then need to be given to whether both an election and a claim are necessary for the 50% uplift in the deduction.

315. Whilst there is some overlap between the two reliefs so far as relating to the conditions for their availability, the mechanisms for obtaining the reliefs are separate and we think that combining these provisions would result in a long and complex clause. The interests of simplicity are better served by keeping the clauses separate.

316. *We will not be combining this clause with clause 1071.*

Clause 1095: Staffing costs attributable to relevant land remediation

Q26. We welcome comments on the proposal to remove two methods of determining staffing costs attributable to relevant land remediation, leaving only straightforward apportionment.

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This mirrors a change which was made to the legislation on research and development expenditure in 2003, and which respondents believe was generally received favourably.

317. In principle respondents were in favour of bringing the two pieces of legislation back into alignment in this way. Nevertheless it was suggested that the change involved a substantive change in the law which was beyond the scope of the project. The change would produce winners and losers and would generally affect a different body of taxpayers from the R&D change. It was therefore suggested that it would be inappropriate to effect the change through the Bill and that it should be done through a Finance Bill.

318. Given the current review of the remediation of contaminated land provisions, and in view of the response we will not make the change in the Bill. Instead we will suggest to policy colleagues that it be made when other changes are made to the regime in a Finance Bill.

319. ***Paragraph 5(3) of Schedule 22 to FA 2001 will be rewritten.***

Given the decision to make all apportionments “just and reasonable” elsewhere, we wonder whether the term “appropriate proportion” ought to be replaced by “a just and reasonable proportion”?

320. “Appropriate proportion” is used extensively in the Parts on Intangible Fixed Assets and Relief for Expenditure on Research and Development. We believe that the terms “appropriate proportion” and “just and reasonable proportion” should not be standardised because they mean different things.

321. “Appropriate proportion” is used where it is intended that there should only be one correct answer (and in a number of cases the method of calculation is provided).

322. “Just and reasonable proportion” is used where it is not possible to set out precisely how the proportion is to be calculated. In which case the relevant proportion must be calculated on the basis of being just and reasonable – which allows the possibility of more than one correct answer.

323. Our understanding of the source legislation is that a determination of the proportion of staffing costs attributable to relevant land remediation should be more precise than the “just and reasonable” measurement.

324. ***We will not be replacing the term “appropriate proportion” with “just and reasonable proportion”.***

Clause 1096: Expenditure on materials

There seems to be no good reason to split this very simple provision into two sub-sections.

325. *We agree and will combine these two subsections.*

Clause 1099: “Qualifying expenditure on sub-contracted land remediation”: connected persons

We are unsure of the origin of sub-section (5)(b).

326. We now propose to drop the reference to “company” in clause 1096. This means that we can drop the reference to that clause in subsection (5) of this clause, as no modification is needed for it.

327. *We will amend this clause by omitting subsection (5)(b).*

Clause 1103: Definitions

In (c) of the definition of “controlled waters” should “water” be inserted, either before “waterways” or before “underground strata”?

328. We are grateful to the respondent for spotting the missing word in paragraph (c) of the definition.

329. *We will amend this clause to include “water in” before “waterways”.*

Part 15: Film production

Clause 1120: Intended theatrical release

We would prefer subsection (5) to be split into two subsections.

330. Subsection (5) is the same as the source legislation in section 39(5) of FA 2006. We think that, on balance, the approach in the source legislation is preferable.

331. *We will not be amending the clause to split subsection (5) into two subsections.*

Part 16: Companies with investment business

Clause 1147: Carrying expenses forward

We disagree with the response document issued in August 2007. Section 75(8)(b) of ICTA should be rewritten.

332. Section 75(1) and (4) of ICTA allows a deduction for expenses of management of the company’s investment business:

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to the extent that the expenses are in respect of so much of the company's business as consists in the making of investments.

333. Section 75(8)(b) of ICTA allows a company to carry forward excess charges on income:

paid for the purposes of so much of the company's business as consists in the making of investments.

334. HMRC's view, expressed in the August 2007 document, remains that any payment that meets the test in section 75(8)(b) of ICTA also meets the test in section 75(4). It follows from section 338A(3) of ICTA that any such payment is not a "charge".

335. But we are persuaded that for the avoidance of doubt we should cater for the theoretical possibility that something paid for the purposes of an investment business is not within the ordinary meaning of the words "expenses of management" as they apply to an investment business. There is no doubt that the company gets the deduction.

336. *We will rewrite section 75(8)(b) of ICTA.*

Clause 1149: Accounts conforming with GAAP

It should be made clear that this and other clauses refer to an accounting period that falls wholly or partly within a period of account.

337. In the August 2007 response document we said that "there is little doubt that a period of account of, say, 12 months ending on 30 June 2009 "falls within" an accounting period of 12 months ending on 31 December 2008".

338. We regret that that example was misleading. In the example the start of the period of account ending on 30 June 2009 must have followed a period of account that ended on 30 June 2008 (or a period for which the company did not draw up accounts). So clause 11(1)(b) or (c) (based on section 12(3)(b) of ICTA) means that there is an end of an accounting period on 30 June 2008. So there cannot be an accounting period of 12 months ending on 31 December 2008.

339. But it is still the case that, in general, the rules in clause 11 mean that an accounting period can never straddle the end (or beginning) of a period of account. So it would be misleading for the clause to suggest that an accounting period may fall *partly* within a period of account.

340. *We will not amend the clause to meet this point.*

Clause 1175: Business entertainment and gifts

In subsection (3) the reference to section 1212 should be to section 1222.

341. *We will correct the clause.*

Part 17: Partnerships

Clause 1185: Section 1184: supplementary

Charges now have to be allocated between the partners.

342. *We will rewrite section 114(2) of ICTA so far as it relates to charges “excluded ... by subsection (1)(b) above”.*

Clause 1189: Apportionment of profit share between partner’s accounting periods

Why has subsection (3) (apportionment to be on a time basis) of the clause published in July 2006 been dropped?

343. *There is now a Bill-wide rule in clause 1234.*

Clause 1195: Sale of patent rights: effect of partnership changes

Despite paragraphs 294 to 296 of the response document published in April 2007 (when this clause was numbered 257), the clause has not been amended.

344. The point has not been overlooked. We are still considering our approach to partnership changes and cessations.

345. *We will amend the clause (and propose amendments to sections 861 and 862 of ITTOIA).*

The reference to a company within the charge to corporation tax changes the law. The change should be justified in detail. The same point arises in connection with clause 155 (and 1196).

346. Please see paragraphs 61 and 64 of this document.

347. *We still believe that the inclusion of “within the charge to corporation tax” clarifies, but does not change, the law.*

Part 20: General calculation rules

Clause 1215: Making of “employee benefit contributions”

This clause does not reflect the changes introduced by FA 2007 section 34.

348. That is correct.

349. *We will amend this clause.*

Clause 1225: Social security contributions

In subsection (4) the word “those” is unhelpful.

350. As clause 910 does not expressly mention section 360A of ITEPA it would not be quite accurate to omit the word “those”.

351. *We will not amend the clause to meet this point.*

Clause 1226: Penalties, interest and VAT surcharges

The explanatory notes refer wrongly to interest under section 86 of TMA for accounting periods ending after 30 September 1993. They should refer to accounting periods ending before 1 October 1993.

352. *We will correct the explanatory notes.*

Clause 1227: Crime-related payments

In both subsections (1) and (2), the references to subsections (2) and (3) should be to subsections (3) and (4).

353. *We will correct the clause.*

Part 21: Other general provisions

Clause 1233: Orders and regulations

Subsection (4)(d) should be omitted.

354. *We are considering whether the power to make transitional provisions should be subject to annulment by resolution of the House of Commons.*

Clause 1236: Activities in UK sector of the continental shelf

Why does the rewrite omit the word “to” which comes before “interests” in the definition of “exploration or exploitation activities” in the source legislation?

355. This is a mistake which we will correct. We will consider making a corresponding amendment to section 874(2) of ITTOIA.

356. *We will correct the clause.*

Clause 1243: Interpretation: Scotland

What is the origin of the definition of “surrender”?

357. This definition is covered by the “drafting” part of the origins of the clause shown in the Table of Origins. But it is modelled on section 121 of FA 1973 (a stamp duty land tax provision).

Schedule 1: Minor and consequential amendments

Section 531 of ICTA

Subsections (7) and (8) need amendment, or should be repealed.

358. We agree. We are working on the rewrite of section 531 of ICTA so far as it applies to assets not covered by the regime for intangible fixed assets in Part 9 of the draft Bill.

359. *We are considering the amendment or repeal of section 531(7) and (8) of ICTA.*

Section 48 of ITTOIA

Q35. We welcome comments on the proposal to extend the restriction in section 48(4) of ITTOIA.

360. The respondents who commented supported this proposal but one suggested that the amendment should be made by an order under section 882 of ITTOIA. We think that this amendment is not “a consequence of” ITTOIA. So such an order is not appropriate.

Section 860 of ITTOIA

Q36. We welcome comments on the proposal to clarify the application of section 860 of ITTOIA.

361. The respondents who commented supported this proposal but one suggested that the amendment should be made by an order under section 882 of ITTOIA. We think that this amendment is not “a consequence of” ITTOIA. So such an order is not appropriate.

Schedule 4: Index of expressions

Registered industrial and provident society

The reference to section 834(1) of ICTA is wrong because that section contains no definition of “registered industrial and provident society”.

362. Paragraph 202(2)(g) of Schedule 1 to the draft Bill inserts the definition into section 834(1) of ICTA. This is a temporary solution to the problem of what to do with section 486(12) of ICTA, which is used in several places in the Corporation Tax Acts to define “registered industrial and provident society”. We plan to rewrite the definition in the second corporation tax Bill.

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363. *We will amend the explanatory notes to draw attention to the insertion.*