

Tax Law Rewrite – Bill 5

Responses to Papers CC/SC (07) 15, 16, 17 and 18

Currency

Relief for employee share acquisitions: SIPs, SAYE option schemes, CSOP schemes and ESOTS

Unauthorised unit trusts

Loan relationships

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2 November 2007

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Introduction

INTRODUCTION

1. In May 2007 we published Committee Papers CC/SC (07) 15, 16, 17 and 18 on the HMRC internet website www.hmrc.gov.uk/rewrite. The closing date for responses was 3 August 2007. The draft clauses rewrite the legislation for:

- Currency
- Relief for employee share acquisitions: SIPs, SAYE option schemes, CSOP schemes and ESOTS
- Unauthorised unit trusts
- Loan relationships

2. The purpose of this response document is to provide details of the substantive technical points made and to explain our analysis and proposals in respect of them. Minor points, such as suggestions to improve punctuation, are not covered but all comments received have been carefully considered. Some respondents made useful suggestions about the explanatory notes. We have not commented on these in every case but we will revisit the explanatory notes with them in mind.

3. Several respondents made policy suggestions for reform. Such issues are outside the remit of the Tax Law Rewrite project but we have passed them to the relevant specialists for consideration. Some commented on strategic policy issues concerning the rewriting of the loan relationships provisions. These will be dealt with separately and discussed with our Committees.

4. A number of minor changes were proposed in the Committee Papers. Where no mention is made of these in this response document, they either received approval or were not mentioned in responses.

5. We received written responses from the following:

- The Chartered Institute of Taxation
- The Confederation of British Industry
- Ernst & Young LLP
- The Institute of Chartered Accountants in England and Wales
- The London Society of Chartered Accountants

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- PricewaterhouseCoopers LLP
6. The following abbreviations for tax legislation are used in this response document:
- FA Finance Act
 - ICTA Income and Corporation Taxes Act 1988
 - ITEPA Income Tax (Earnings and Pensions) Act 2003
 - ITTOIA Income Tax (Trading and Other Income) Act 2005
7. We are grateful for all the comments made, many of which were detailed, and we appreciate the time and effort that went into them. We have sent each respondent a copy of this response document.

Currency

Clause 1: Introduction to Chapter

In subsection (2)(c), should there not be an appropriate reference to Part 8 of the Companies (Northern Ireland) Order 1986, as in subsection (2)(a)?

8. In the source legislation, section 92E(1)(a) of FA 1993 refers to the Companies (Northern Ireland) Order 1986 while section 92E(1)(c) does not.
9. It was necessary to mention the Companies (Northern Ireland) Order 1986 in section 92E(1)(a) because section 92E(1)(a) gives the definition of “accounts” for a UK resident company and a UK resident company could have been subject to the Companies Act 1985 or the Companies (Northern Ireland) Order 1986.
10. It is in fact no longer necessary to mention the Companies (Northern Ireland) Order 1986 in subsection (2)(a). This is because the effect of section 1(1)(b)(i) of the Companies Act 2006 is that that Act (including the provisions of Part 15 relating to accounts) applies to companies which were subject to the Companies Act 1985 or the Companies (Northern Ireland) Order 1986.
11. The reason why the source legislation in section 92E(1)(c), rewritten as subsection (2)(c), did not refer to Part 8 of the Companies (Northern Ireland) Order 1986 was that the purpose of the provision was to provide a single legal standard for company accounts. The single legal standard chosen by Parliament for that purpose was Part 7 of the Companies Act 1985. It follows that subsection (2)(c) of clause 1 need not refer to Part 8 of the Companies (Northern Ireland) Order 1986 either.

12. ***We will amend subsection (2)(a) to remove the reference to the Companies (Northern Ireland) Order 1986. We do not propose to amend subsection (2)(c).***

Clause 2: Basic rule: sterling to be used for calculating and expressing income and chargeable gains

In subsection (1), is it appropriate to refer to ‘income and chargeable gains’?

13. Subsection (1) rewrites section 92(1) of FA 1993. Subsection (2) rewrites section 92(2) of that Act.

14. The respondent notes that the source legislation refers in section 92(1) of FA 1993 to “profits” and in section 92(2) (and sections 92A to 92C) to “profits and losses”. The respondent also appears to ask whether “profits” in section 92(1) (now clause 2(1)) has the same meaning as “profits or losses” in subsection (2) and in clauses 3(2), 4(2), 5(2) and 6(2).

15. In subsection (1), we have rewritten the word “profits” in section 92(1) of FA 1993 as “income and chargeable gains”. This is because we consider that “profits” in section 92(1) is to be read in accordance with section 6(4) of ICTA. Section 6(4) provides that “profits” means “income and chargeable gains”.

16. In subsection (2) and in clauses 3(2), 4(2), 5(2) and 6(2), we have not rewritten the word “profits” in the phrase “profits and losses” as “income and chargeable gains” because we believe that in these contexts, as in the source legislation, it has a different meaning. Hence the use of different terminology. In these cases we do not think that the word “profits” in that phrase is to be read in accordance with section 6(4) of ICTA.

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

Replace the heading of clause 2 with the title in the source legislation.

18. The respondent suggests that the heading of clause 2 is lengthy, while the heading in the source legislation, section 92 of FA 1993, is more succinct and appropriate.

19. ***We will amend the clause heading.***

Clause 4: UK resident company operating in currency other than sterling and preparing accounts in another currency

In subsection (1)(c), insert “other” after “that”.

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20. The respondent suggests that this amendment would clarify the rewritten provision.

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

In paragraph 14 of the explanatory notes, should the word “to” not be “from”?

22. *We agree and will amend paragraph 14 of the explanatory notes.*

Clause 6: Non-UK resident company preparing return of accounts in currency other than sterling

In subsections (1)(a) and (4), the use of “United Kingdom” and the abbreviation “UK” is apparently inconsistent.

23. The Project has adopted a convention on the use of the abbreviation “UK”.

24. The convention is that the abbreviation is used only in defined expressions. In all other contexts, the words “United Kingdom” appear in full.

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

Clause 7: Translating amounts into equivalent in different currency

In subsection (4), omit the phrase “as the case requires”.

26. We consider that the words “as the case requires” are a helpful pointer to the clause for the purposes of which the currency translation is required.

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

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

General comments

In the explanatory notes, the use of “United Kingdom” and the abbreviation “UK” is apparently inconsistent.

28. The convention adopted by the Project is that the abbreviation is used only in defined expressions. In all other contexts, the words appear in full. The explanatory notes are therefore consistent with the convention.

29. *We do not propose to amend the explanatory notes.*

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Clause 2: Chapter to form part of SIP code etc

Subsections (3) and (4) should form part of a separate paragraph.

30. The respondent comments that forfeited shares should not be dealt with in the same paragraph as an introductory provision signposting the definitions index. The respondent notes that in the source legislation, paragraphs 6(1) and (2) of Schedule 4AA to ICTA, the treatment of forfeited shares is dealt with separately.

31. We disagree that subsections (1) and (2) are mere signposts. They are substantive provisions relating to the interpretation of the Chapter. We consider that it is appropriate to locate subsections (3) and (4) in the same clause as subsections (1) and (2).

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

Clause 3: References to a deduction being allowed to a company

In subsection (3), the meaning of the parenthetical words in the second sentence of subsection (3) “(and subsection (2) applies instead)” is ambiguous.

33. The respondent comments that the parenthetical words in subsection (3) can be read either as an additional condition (the company’s business is a property business which is subject to subsection (2)), or as an additional consequence of the condition being met (if the company’s business is a property business then subsection (3) does not apply and subsection (2) does apply).

34. The respondent suggests that subsection (2) be redrafted to state explicitly its scope (that the subsection deals with a trade or a property business), in the same way that subsections (3) and (4) of clause 3 and subsection (2) of clause 4 state explicitly their scope.

35. The same point applies in respect of clauses 17 and 18.

36. We consider that the scope of subsection (2) of clause 3 is sufficiently clear as it stands. But we will amend the parenthetical words in subsection (3) in order to put the point beyond doubt.

37. *We will amend this clause.*

Clause 4: Income received under Chapter

Q2: We welcome comments on the proposal to tax recoveries of relief on a company that does not carry on a trade or property business as an amount charged to corporation tax.

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38. Although all respondents approved this proposal, one respondent criticised the Change note.

The final sentence of the fourth paragraph of Change note 1 is incorrect.

39. This sentence reads as follows: “But paragraph 13 does not cover withdrawal of relief under paragraphs 10 and 12 of Schedule 4AA.”

40. The respondent comments that this sentence correctly states that paragraph 13(3) (now clause 4(4) and (5)) does not cover withdrawal of relief under paragraph 12 (now clause 11).

41. The respondent comments that this sentence incorrectly states that paragraph 13(3) does not cover the withdrawal of relief under paragraph 10. The respondent argues that paragraph 13(3) does cover withdrawal of relief under paragraph 10, because paragraph 13(3) refers to paragraph 11(2) (now clause 16), paragraph 11(2) in turn refers to paragraph 11(1), and paragraph 11(1) contains a list which includes paragraph 10(3) (now clause 9).

42. The respondent suggests that this error requires a change to the wording of the Change note, but not to the wording of clause 4.

43. We consider that the wording of the last sentence of the fourth paragraph of Change note 1 may have given rise to a misunderstanding. That sentence is, in fact, correct. But it would be clearer if it were redrafted to say: “But paragraph 13 does not apply to the case where a deduction under paragraph 9 of Schedule 4AA is withdrawn under paragraph 10(1) or (8) or paragraph 12.”

44. Where a deduction under paragraph 9 of Schedule 4AA is withdrawn under paragraph 10(1) (or (8)), paragraph 10(2) (or (8)) provides that the amount of the deduction is treated as a trading receipt of the company. Paragraph 12(2) likewise provides for the amount of the withdrawn paragraph 9 deduction to be treated as a trading receipt of the company. But paragraph 13(3) does not operate on paragraph 10(2) (or (8)) or 12(2). That is the point made in the last sentence of the fourth paragraph of Change note 1.

45. The effect of the change in the law proposed in Change note 1 is to bring the treatment of relief withdrawn under paragraph 10(1) or (8) or paragraph 12 into line with treatment of relief withdrawn under paragraph 11(1).

46. ***We will amend the Change note to clarify the last sentence of the fourth paragraph.***

The concluding sentence of the Change note is incorrect.

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47. The concluding paragraph reads: “This change clarifies the law and removes uncertainty. But it is expected to have no practical effect as it is in line with current practice.”

48. While not opposing the change, the respondent suggests that there is no current practice which justifies this statement.

49. The practice in question is the disallowance of Schedule D Case VI loss relief against chargeable Schedule D Case VI profits or gains, see paragraph 13(3) Schedule 4AA to ICTA (now income, see clause 4(4)). This practice is described in the Business Income Manual at BIM80135. See paragraph 20 of the explanatory notes.

50. We are satisfied that the final sentence in Change note 1 is accurate.

51. ***We do not propose to amend the Change note in response to this comment.***

In relation to subsection (4), incorporate provision to the effect that no loss relief is available under section 396 of ICTA.

52. We think it is preferable to leave the clause as it stands in this regard, because the income received under subsection (4) does not fall within the terms of section 396(1) (not being income arising from a transaction).

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

Clause 5: Deduction for costs of setting up an approved share incentive plan

Subsection (3) does not faithfully reflect the source legislation.

54. The source legislation in paragraph 7(2) of Schedule 4AA to ICTA denies a deduction under paragraph 7(1) (rewritten in subsection (1) of this clause) in certain circumstances.

55. The respondent comments that because subsection (2) does not explicitly state that the deduction which may be denied is the deduction in subsection (1), subsection (2) can be interpreted as referring not just to expenses deductible under subsection (1) but to expenses deductible under general principles too (see clause 6(2)).

56. The respondent suggests that this apparent defect might be remedied by inserting “under this section” after “but no deduction is allowed” in subsection (3).

57. We are happy to adopt the respondent’s drafting suggestion.

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58. *We will amend this clause.*

Clause 6: Deductions for running expenses of an approved share incentive plan

Subsections (1) and (2) are less clear than the source legislation.

59. The respondent comments that subsection (1) raises the expectation that the clause will provide positive guidance relating to the expenses incurred by the company, only for these expectations to be dashed by subsection (2), which simply provides that normal principles are to apply.

60. The respondent comments that, if subsection (2) cannot be phrased in positive terms, then it would be preferable for the wording to follow the drafting approach adopted in paragraph 8(1).

61. We consider that subsections (1) and (2) are clearer than paragraph 8(1), and more in keeping with the rewrite drafting style.

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

The respondent queries whether subsection (4)(a) accurately reflects the source legislation.

63. Subsection (4)(a) rewrites paragraph 8(2)(b).

64. The source legislation in paragraph 8(2) of Schedule 4AA to ICTA reads “For this purpose the expenses of the trustees in operating the plan – (a) do not include expenses in acquiring shares for the purposes of the trust, other than incidental acquisition costs, but (b) do include the payment of interest on money borrowed by them for that purpose.”

65. Subsection (4)(a) reads: “The expenses within this subsection are – (a) interest incurred on money borrowed by the trustees, ...”.

66. The respondent comments that “that purpose” in paragraph 8(2)(b) could be read as referring to the purposes of “acquiring shares” in paragraph 8(2)(a); or to “operating the plan” in the introductory words of paragraph 8(2). In the respondent’s view, the first possibility is the narrower of the two interpretations. The respondent suggests that clause 6(4)(a) has been drafted on the basis of that narrower interpretation.

67. In our view, “that purpose” in paragraph 8(2)(b) can only be read as referring to the purposes of “acquiring shares” in paragraph 8(2)(a). Subsection (4)(a) has been drafted on that basis as that is what we think the source legislation means.

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68. We will insert a reference in subsection (4)(a) to clarify that it covers money borrowed for the purpose of “acquiring shares” (for the purposes of a share incentive plan).

69. *We will therefore make a minor amendment to this clause.*

Clause 9: Another deduction to be allowed if all acquired shares are awarded

Repeat clause 7(6) in clause 9.

70. Clause 7(6) rewrites paragraphs 9(5) and 10(5) of Schedule 4AA to ICTA.

71. Paragraphs 9(5) and 10(5) give priority to paragraphs 9 and 10 and deny a double deduction in respect of the amounts allowed as deductions in these two paragraphs.

72. Paragraph 9 (rewritten as clause 7) allows a company a deduction for the amount of any contribution by the company to its SIP trust. Paragraph 10(1) and (2) (now clause 8) allows Her Majesty’s Revenue and Customs to withdraw a deduction made under paragraph 9 where the SIP trust fails to meet certain conditions. Paragraph 10(3) and 10(4) (clause 9) allows a company “another deduction” (effectively reinstating the original paragraph 9 deduction) where its SIP trust subsequently fulfils the conditions which it had previously failed to fulfil.

73. The prohibition against a double deduction in clause 7(6) has not been repeated in clause 9. The respondent considers that the prohibition against a double deduction in clause 7(6) does not prohibit any other deduction under clause 9 itself. The implied concern is that, as clause 9 stands, a company claiming “another deduction” under clause 9 will be entitled to make a deduction in respect of the same expense under some other provision.

74. We consider that clause 7(6) is sufficient to prohibit a double deduction in respect of a contribution by a company to its SIP trust and that the prohibition does not need to be repeated in clause 9. A further deduction under clause 9 in respect of the original contribution to the SIP trust is an exception to the prohibition set out in clause 7(6). It is clear from clause 7(6) that no other deduction is allowed.

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

Clause 10: Award of shares to excluded employee

Subsection (1)(b) does not accurately reflect the source legislation.

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76. The source legislation in paragraph 10(6)(b) of Schedule 4AA to ICTA refers to “shares ... awarded ...”. This is rewritten in subsection (1)(b) as “a number of the acquired shares are awarded ...”.

77. The respondent notes that the words “a number of the” do not appear in the source legislation.

78. We consider that the words “a number of the ...” add clarity without changing the substance of the law. So we think the inserted words should be retained.

79. We therefore disagree with this comment.

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

Subsection (2) does not accurately reflect the source legislation.

81. The respondent notes that the words “not all” [the earnings], which appear in subsection (2), do not appear in paragraph 10(6)(b) of Schedule 4AA.

82. Paragraph 10(6)(b) reads “(b) shares are awarded under the plan to an individual at a time when the earnings from the required employment - (i) are not (or would not be if there were any) chargeable earnings.” This has been rewritten in subsection (2) as “An employee is excluded if, at the time the shares are awarded to the employee, not all the earnings from the relevant employment are (or would be if there were any) general earnings - .”

83. The “chargeable earnings” definition in paragraph 4(3) has been rewritten in clause 10(2)(a) and 10(2)(b) by reference to “general earnings” to which sections 15 or 20 of ITEPA 2003 apply. The “required employment” definition in paragraph 4(3) has been rewritten in clause 10(3) as “the relevant employment”.

84. The respondent suggests that subsection (2) sets up an “almost all” or “substantial compliance” test. That is, it does not require that all of the employee’s earnings from the “required employment” fall within the “chargeable earnings” definition. The respondent notes by contrast that paragraph 10(6)(b) sets up an “all or nothing”. That is, it requires that all of the employee’s earnings fall within “chargeable earnings”.

85. We agree that paragraph 10(6)(b) sets up an all or nothing test. In other words, if even a minimal percentage of the earnings from “the required employment” are not “chargeable earnings”, then the claw-back condition in paragraph 10(6) is met.

86. In our view it is not possible for some of the earnings from “the required employment” (rewritten in subsection (2) as “the relevant employment”) to be

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chargeable earnings and the rest not. The definition of “the relevant employment” contemplates a single “employment”. And the ITEPA-based test in the definition of “chargeable earnings” is an all or nothing test. Thus in paragraph 10(6)(b) the words “the earnings” can only refer to earnings of a uniform quality from a single employment. It follows that inclusion of the words “not all” in subsection (2) is misleading.

87. We therefore agree with the respondent’s comment and are grateful to them for identifying this issue with regard to the drafting of subsection (2).

88. The same point arises in respect of clause 14 (Exclusion 1).

89. ***We will amend clause 10(2) and Exclusion 1 in clause 14.***

In subsection (3), the meaning of “because of which” is not clear.

90. The respondent suggests that the phrase “because of which”, in the definition of “the relevant employment”, is too imprecise.

91. The source legislation uses the term “the required employment”, which is defined in paragraph 4(3) of Schedule 4AA to mean “the employment by reference to which the individual is eligible to participate in the award”.

92. We think that the definition of “the relevant employment” is sufficiently clear, and accurately reflects the source legislation.

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

Clause 12: Deduction for providing free or matching shares

Query whether subsection (9) accurately reflects the source legislation.

94. The source legislation in paragraph 2(7) of Schedule 4AA to ICTA reads: “If a deduction is made under this paragraph by a company, no deduction may be made by any other company under this paragraph in respect of the provision of the shares”.

95. Paragraph 2(7) has been rewritten in clause 12(9) to read: “If the shares are awarded to the employees because of their employment with two or more companies, only one of those companies can make a deduction under this section in relation to the award”.

96. The respondent suggests that, where shares in a company are awarded to an employee because of his or her employment with two or more companies, paragraph 2(7) does not explicitly prohibit those employer companies from

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apportioning among themselves the amount of the deduction in paragraph 2(1) (rewritten as subsection (2)).

97. The respondent comments that clause 12(9) prevents such apportionment. The respondent comments that, if clause 12(9) is considered to be correctly drafted, there should be guidance as to which of the employing companies should make the deduction.

98. We consider that subsection (9) correctly rewrites paragraph 2(7) and that paragraph 2(7) does not contemplate apportionment of a deduction between two employing companies.

99. We consider that the guidance sought by the respondent is beyond the scope of the Project. But we have alerted our specialist colleagues to this point.

100. The same comment applies to clause 13(6).

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

Clause 13: Deduction for additional expense in providing partnership shares.
Subsection (6) does not accurately reflect the source legislation.

102. See paragraphs 94 to 101.

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

Clause 14: Shares excluded from clauses 12 and 13
Exclusion 1 does not accurately reflect the source legislation.

104. See paragraphs 81 to 89.

105. *We do not propose to amend this clause in response to this comment.*

Exclusion 4 does not accurately reflect the source legislation.

106. The source legislation in paragraph 4(9) of Schedule 4AA to ICTA reads: “No deduction is allowed in respect of the award of shares acquired by the trustees by virtue of a payment in respect of which a deduction has been made under paragraph 9 (deduction for contribution to plan trust) or 10(3) (further deduction where deduction under paragraph 9 withdrawn)”.

107. Paragraph 4(9) has been rewritten in Exclusion 4, which reads: “Shares acquired by the trustees of the plan trust as a result of a payment in relation to which a

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deduction is made under [clause] 7 (even if the deduction is withdrawn under [clause] 8)”.

108. The respondent comments that the parenthetical words “even if the deduction is withdrawn under [clause] 8” do not correspond to anything in the source legislation. The respondent objects that these words represent a change adverse to the taxpayer. The respondent comments that, to the extent that the source legislation is unclear, it is not appropriate for the rewrite to insert wording which definitively settles the meaning in favour of Her Majesty’s Revenue and Customs.

109. The respondent appears to consider that the effect of the parenthetical words is to limit the availability of the deductions in clauses 12 and 13, in cases where the original paragraph 9 (now clause 7) deduction is withdrawn under paragraph 10(1) (now clause 8) but a deduction for that expenditure is not subsequently allowed under paragraph 10(3) (now clause 9). In other words, the respondent considers that the effect of the parenthetical words is to deny a deduction under clause 12 or 13 even where the original deduction has been clawed back.

110. The consultation draft proceeded on the basis that once shares in a trust are “tainted” by a paragraph 9 deduction, they remain tainted, and the paragraphs 2 and 3 deductions remain unavailable regardless of the timing of appropriation of shares in relation to the withdrawal of the paragraph 9 deduction under paragraph 10(1). The absence of a reference in paragraph 4(9) to a paragraph 9 deduction being withdrawn seemed to support the inclusion of the parenthetical words in Exclusion 4.

111. Equally, the reference in paragraph 4(9) to a deduction under paragraph 10(3) could be taken to mean that an implied reference to withdrawal of a paragraph 9 deduction should be read into paragraph 4(9).

112. On balance we therefore agree that Exclusion 4 should be brought more closely into line with paragraph 4(9) by the inclusion of a reference to clause 9.

113. ***We therefore propose to amend this clause in response to this comment.***

Paragraph 62 of the explanatory notes is not correct.

114. Paragraph 62 of the explanatory notes reads: “Exclusion 4 is complementary to clause 7(6)”.

115. See paragraphs 70 to 75.

116. The respondent comments that clause 7 provides for a deduction in respect of the contribution by the company to the plan trust (to enable the plan trust to acquire shares for the plan), while clauses 12 and 13 provide for a deduction to the company

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for the market value of plan shares (when transferred by the plan trustees to an employee). The respondent argues that the purpose of clause 7(6) is to prevent a double deduction for the amount of the contribution, and that this has no bearing on the availability of a deduction under clause 12 or 13.

117. The purpose of the provisions mentioned in the respondent's comment is to prevent a double deduction to a company on the award of the shares. But we agree with the respondent that the forms of double deduction in view in clause 7(6) and Exclusion 4 in clause 14 are different.

118. So we will clarify the commentary in paragraph 62 of the explanatory notes.

119. ***We will amend the explanatory notes.***

Clause 17: Deduction for costs of setting up SAYE option scheme or CSOP scheme

Where will section 84A(1)(b) of ICTA be rewritten on the proposed repeal of section 84A of ICTA?

120. Section 84A(1)(b) deals with expenditure on the establishment of an approved profit sharing scheme under Schedule 9 of ICTA. Approved profit sharing schemes were phased out by section 49 of FA 2000. Unless the application had already been received, no new schemes could be approved after 6 April 2001. The effect is that no relief could be given under section 84A(1)(b) after 5 April 2001.

121. Section 84A(1)(b) is therefore obsolete and will not be rewritten. The whole of section 84A will be repealed.

122. ***We do not propose to rewrite section 84A(1)(b) of ICTA.***

Is it considered unnecessary to rewrite section 84A(5)?

123. The respondent comments that, in view of the lapse of time since 1991, this would not be an unreasonable view.

124. We consider that there is no need to rewrite section 84A(5). As the respondent notes, clause 17 could not apply to expenditure incurred before 1 April 1991.

125. ***We do not propose to rewrite section 84A(5) of ICTA.***

Unauthorised unit trusts

Clause 2: Income charged

In subsection (7), insert “separate” before the final words “distribution periods”.

126. The respondent appears to accept that subsection (7) accurately rewrites the source legislation in section 469(6)(b) of ICTA, but suggests that the drafting can be clarified.

127. Although we see the merits of the drafting suggestion we do not propose to adopt it. The suggested change is not essential and would introduce an unnecessary difference between the wording of subsection (7) and the wording of the corresponding income tax provision in section 548(7) of ITTOIA 2005. Our aim here is to bring the corporation tax code back into line with the income tax code.

128. *We do not propose to amend the clause.*

Loan relationships

Clause 1: Overview of Part

The replacement of “profits and gains” in Chapter 2 of Part 4 of FA 1996 by “gains” confuses the distinction between taxable profits and accounting gains. “Profits and gains” is an established tax term and its use enables case law on what is a profit for tax purposes to be applied to the loan relationships legislation.

129. “Profits and gains” will now be rewritten as “profits”. We believe that this will remove the objection to the use of “gains” alone and that the case law will still apply. This will also align the loan relationships provisions with derivative contracts in Part 8 of the Bill which uses the term “profits” alone. But we will review this decision in the light of responses to the derivatives contracts Part.

130. *Suitable amendments to the clauses will be made.*

Clause 10: Meaning of money debt.

Subsection (2) should additionally refer to subsection (1)(a)(iii).

131. Section 81(2) of FA 1996 requires money debts to be settled by the methods listed in heads (a) to (c) disregarding options exercisable. Clause 10(2), which rewrites section 81(2), refers only to disregarding options exercisable under heads (a) and (b) (rewritten in subsection (1)(a)(i) and (ii)).

132. ***We agree and the clause will be amended.***

Clause 13: Introduction

“Gains” in subsection (2) are not the same as “gains” in subsection (1). In subsection (2) the term is used in a quantitative sense.

133. Clause 13 is based on drafting and acts as a general introduction to the Chapter.

134. Subsection (2) will be completely redrafted to avoid the criticism.

135. ***The clause will be amended to avoid any confusion.***

Clause 14: Method of bringing gains into account

Subsection (1) duplicates clause 13(1).

136. Clause 13 is purely introductory, following the normal pattern of rewrite Bills, and explains what the Chapter does. Clause 14 requires the profits to be brought into account in accordance with the Chapter. Clauses 13 and 14 will, however, be redrafted to remove any apparent overlap.

137. ***The clauses will be amended to avoid the appearance of duplication.***

Subsections (1), (2) and (3) are incorrect because debits and credits are brought directly into the calculation of the overall trading profit and there is no calculation of gains arising from the company’s trading loan relationships.

138. ***The clause will be amended to express more clearly the way that trading profits are computed.***

Subsections (1) to (5) appear to serve no purpose other than as signposts.

139. ***The clause will be amended to reduce the number of signposts.***

Clause 16: Profits and expenses of trades from loan relationships: trading credits and debits

The reference to “profits and expenses” in subsection (1) should be to “profits and losses” or just “profits”.

140. Clause 16(1) is based on section 82(1) and part of (2) of FA 1996. Subsection (1) requires profits and gains and deficits (of all loan relationships) to be computed using the debits and credits given by the loan relationship provisions and

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subsection (2) deals with trading loan relationships only. There the credits are treated as receipts and the debits as expenses.

141. We consider subsection (1) should refer to “profits” alone.

142. *We agree and the clause will be amended to refer to “profits”.*

Clause 18: Income charged under section 17

This clause is unnecessary. Because the loan relationships legislation is a stand-alone code section 70 of ICTA has no bearing on its interpretation.

143. Section 70(1) of ICTA provides that for the purposes of corporation tax income shall be computed under Schedule D on the full amount of profits, gains or income arising in the accounting period. The charge under the loan relationships provisions is under Schedule D Cases I and III.

144. *The necessity of rewriting section 70(1) where charges under Schedule D are rewritten is currently being considered as a Bill wide issue.*

Clause 21

Confusion is created by using the word “gains” with the result that circularity arises whereby debits and credits must fairly represent the company’s gains but at the same time are brought into account in calculating those gains.

145. The circularity here is in the source legislation. In section 84(1) of FA 1996 the credits and debits must fairly represent the profits, gains and losses. In section 82(1) the profits, gains and any deficit are computed in accordance with the debits and credits. A similar point arises in the derivative contracts provisions in Schedule 26 to FA 2002.

146. *The means of dealing with this circularity are being further considered.*

It is incorrect to split “credits and debits ...when taken together” in section 84(1), particularly in the case of trading relationships as the gain might be the balance between a debit and a credit.

147. Section 84(1) requires the credits and debits when taken together to fairly represent all profits, gains and losses of the company including those of a capital nature (disregarding interest and any charges and expenses) which arise to the company on loan relationships and related transactions and all interest under the loan relationships and all charges and expenses for the purposes of the loan relationships and related transactions.

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148. We agree on reflection that it is preferable not to split up the credits from the debits in rewriting this subsection. The treatment of credits and debits will be reunited in the clause.

149. ***We agree and the clause will be amended.***

The reference to “interest” in section 84(1) of FA 1996 should have been rewritten as it is not beyond doubt that interest is a profit on a loan relationship.

150. ***A reference to “interest” will be inserted for the avoidance of doubt.***

The words “including those of a capital nature” should not have been omitted from the rewrite of section 84(1) as the profits referred to are taxable profits rather than accounting profits and these would normally exclude gains of a capital nature.

151. We agree that these words are necessary as taxable profits would not otherwise be expected to include gains of a capital nature.

152. ***We agree and the words “including those of a capital nature” will be inserted.***

The words in subsection (3)(c) “(expenses incurred) ... in making payments under any of those relationships” relate to incidental costs in making the payments rather than, say, interest and this could be clarified in the rewrite.

153. We will be including interest as a debit (see above) which will make it clear that the expense must be something other than interest.

154. ***The clause will not be changed to refer explicitly to incidental costs because other amendments will make its context clear.***

In subsection (4) of the clause the words “before entering a loan relationship” imply that the relationship is subsequently entered into.

155. We agree that it is not necessary under clause 22 (based on section 84(4)) that the relationship should be subsequently entered into.

156. ***We agree and the clause will therefore be amended.***

Insufficient distinction has been made in subsection (3)(c) between “making payments under a loan relationship” and “making payments in pursuance of any of those transactions (ie related transactions)”.

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157. We have rewritten the section in this way because “loan relationship” already includes a related transaction.

158. *We do not propose to change the clause.*

Clause 24: Generally accepted accounting practice and recognised amounts

Subsection (4)(c) should refer to amounts recognised in a company’s statement of changes in equity where the company prepares such a statement and not a statement of recognised income and expenditure.

159. *Agreed in principle. The clause will be amended to reflect the alternatives.*

Subsection (3) should also refer to clause 21(2) since credits and debits were split between two subsections in that clause.

160. Section 85A(1), which this subsection rewrites, cross-refers to section 84(1) of FA 1996 which has been rewritten in clause 21(1) and (2). The clause needs to reflect that.

161. *We agree and the clause will be amended.*

Clause 30: Power to make regulations about changes from amortised cost basis to fair value accounting

“Apart from the regulations” in subsection (1)(a) can be removed because the regulations do not deal with how accounts should be drawn up.

162. *We agree and the clause will be amended.*

Clause 32: Adjustments on change of accounting policy involving change of value

If “corresponding” here (and in paragraph 19A(3) of Schedule 9 to FA 1996) just means “a debit representing that amount” can that be made clear?

163. *We will amend the clause to clarify this.*

Clause 36: Credits and debits treated as relating to capital expenditure

The specific reference to interest in paragraph 14(4)(b) of Schedule 9 to FA 1996 should be dispensed with or a definition of the interest component of the asset or project is required.

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164. The most obvious meaning of “the interest component of the asset or project” is the interest element capitalised with the relevant asset or project. We do not consider it necessary to add a definition here.

165. *We do not propose to amend the clause but the explanatory notes will explain the meaning.*

Clause 49: Transactions to which section 48 applies

Subsection (2)(b) could reflect the fact that the company’s being in the charge to corporation tax is hypothetical.

166. *We agree and the clause will be amended to clarify this point.*

Clause 55: Formation of SE by merger: disregard of incidental transfers of loan relationships

“For the purposes of this Part” should be added to subsection (2) for clarity.

167. *We agree and the clause will be amended to clarify this point.*

Subsection (3) should end “except for the purposes specified in subsection (a) to (c)” since one cannot both ignore the transfer and treat the transferor and transferee as being the same company.

168. *We agree that this would be helpful. We will amend the clause accordingly.*

Clause 56: Exception to section 55: transferor using fair value accounting

A definition of “discount” as for clause 51 (ie by reference to clause 155(4)) is needed.

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

Clause 63: Introduction

One respondent disliked the phrase “companies with connections”.

170. We agree that the phrase is awkward and it will be changed to “connected companies”.

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

Clause 71: Deemed release of liability: acquisition of creditor rights by connected company at undervalue

In subsection (2)(b) the correct tense should be “was” rather than “has been”.

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

The reference to “impairment losses” in subsection (6)(c) is unnecessary as under current UK GAAP or International Financial Reporting Standards it is not possible for a company to make an impairment provision against a debtor relationship.

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

Clause 75: Reduction of impairment loss debits exceeding group relief credits where group relief claimed

Subsection (2) restricts the credits to those brought into account by “the debtor consortium company”. There may be more than one debtor consortium company since one may be a holding company of the other under paragraph 5A(3) of Schedule 9 to FA 1996.

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

Subsection (4) states that “the debits” are not to be reduced below nil. This should in fact be in subsection (5), referring to the net consortium debit.

175. We agree that because group relief cannot exceed the net consortium debit, group relief cannot exceed any individual impairment loss and so “not below nil” is unnecessary in subsection (4). The sense of the words “as does not exceed the amount of the relevant net debit” in paragraph 5A(6) of Schedule 9 to FA 1996 will be incorporated into subsection (5).

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

Step 3 of subsection (5) does not make clear that it is the debits that make up the net consortium debit which are reduced by the group relief as required by paragraph 5A(7) of Schedule 9 to FA 1996.

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

Clause 78: Reduction of group relief claims where there are earlier net consortium debits

Subsection (2) should add “but not below nil” for consistency with similar usage elsewhere in the consortium provisions.

178. ***The point is accepted in principle and will be incorporated into a somewhat amended clause.***

Subsection (3) should require that where two or more claims do not exceed the amounts mentioned in subsection (1)(b), all the claims are reduced to nil.

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

Clause 90: Debts owed by or to partnerships involving companies

The words in subsection (1)(a) “a trade ... is carried on by a partnership” should be “carried on by persons in partnership”.

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

Clause 93: Inter-partnership lending between connected company partners etc

“Inter-partnership lending” is inappropriate as the loans are not between partnerships.

181. This will be changed to “Lending between partners and the partnership”.

182. ***We agree and will amend the title.***

In subsection (3) “it” could refer to the company partner or the partnership. Could this be clarified?

183. It will be made clear that “it” refers to the company partner (see paragraph 19(7)(b) and (9) of Schedule 9 to FA 1996).

184. ***We agree and will clarify the clause.***

Subsection (6) implies that the whole of the loan relationship is treated as a connected companies relationship for the purposes of calculating the debits and credits attributable to the partner mentioned in subsection (2), not just the proportion of it which is notionally treated as a loan to or from partners which are companies.

185. Subsection (6) will be amended to avoid the implication.

186. *We agree and the clause will be amended.*

Clause 97: Venture capital trusts: gains or losses of a capital nature

Subsection (3)(b) has not reproduced the words “if the venture capital trust had been an investment trust”.

187. *We agree and will amend the clause to include these words.*

Clause 102: Gilt strips

The word “other” in subsection (1)(b) suggests that strips of gilts are themselves gilts.

188. *We agree and will remove the word “other”.*

Clause 106: Non-UK resident bankers, insurers and security dealers with interest on 3½% War Loan 1952 Or After

Step 2 does not reproduce the effect of the words in section 475(4) of ICTA “apart from subsection (2) above”.

189. *We agree and the clause will be amended.*

Step 5 should specify that the period of 12 months is the accounting period.

190. Section 475(5) of ICTA reads “in the case of a period of less than 12 months interest shall be taken for that shorter period instead of for a year”. For corporation tax purposes we do not need to refer to a 12 month period but simply to the accounting period since that is the period by which the provision applies.

191. *We agree in principle but the clause will be redrafted with the result that the point no longer arises.*

The words “in the United Kingdom” should appear in subsection (1)(a).

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

Clause 108: Postponement until redemption of debits for connected companies’ deeply discounted securities

For consistency with clause 110(1)(c) it should be stated that the provision does not apply for the accounting period in which the security is redeemed.

193. *We agree and will amend the clause for consistency with clause 110.*

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Clause 111: Exceptions to section 110

The words “for any accounting period” appear in clause 108(1)(d) but not in clause 111(2)(b) which is broadly the same test but for participators, etc. The rewrite could add these.

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

What is broadly the same test is expressed in clause 108(1)(d) as a condition and in clause 111(2)(b) as an exception.

195. This reflects the more complicated nature of clause 111(2) than clause 108(1)(d) since it contains an extra condition. To use the same approach to both would create complications in the drafting.

196. *We do not propose to amend the clause.*

Clause 114: Issue of funding bonds

“Public” in clause 114(1) could go with “body corporate”. Could this be clarified?

197. *We will amend the clause to clarify the point.*

Clause 117: Election for application of section 116

The conditions in clause 118(1)(a) and (b) should be incorporated into clause 117 since they are an essential condition of an election.

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

Clause 119: Assumptions where options etc are applied

In subsection (2)(c) “how long” is inappropriate as the purpose of paragraph 3(1)(c) of Schedule 9 to FA 1996 is to identify the time when an amount becomes due after the end of a period rather than being concerned with the length of time after the end of the period to the due date.

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

Clause 123: Schemes and arrangements for obtaining relief for interest

Subsection (2) should more accurately refer to the time before or after the debit for interest is brought into account rather than the transaction.

200. We do not think this is necessary as it is the transaction which results in the debit for interest that is in point.

201. *We do not propose to amend the clause.*

Clause 124: Transactions not at arm's length: general

Paragraph 11 of Schedule 9 to FA 1996 is now redundant since it is difficult to envisage non arm's length transactions in relation to which Schedule 28AA to ICTA (the transfer pricing rules) does not apply.

202. While most arm's length transactions are between related parties the paragraph has been applied to abusive situations involving unrelated parties. It is also applied when unconnected parties enter into two transactions, neither of which is at arm's length when viewed individually, but which when taken together are commercial.

203. *We do not propose to remove the clause.*

Paragraph 11(2) of Schedule 9 (subsection (4) of the clause) is puzzling and it is not clear what the "debit" in question is.

204. We agree that it is unclear in the source legislation what "debit" refers to. HMRC believe that it refers to the debit entry to an asset account on the acquisition of the rights (ie usually the purchase of the security).

205. *We hope to clarify this in the rewritten clause. Work on the matter is continuing.*

Clause 128: Exchange gains and losses: equity notes where holder associated with issuer

To be consistent with clause 127(1)(b) subsection (1)(b) should have "debtor" before "relationship" and subsection (2), to be consistent with clause 127(2), should have "exchange" before "gain or loss".

206. *We agree and will amend both this clause and clause 127.*

Clause 130: Meaning of "relevant corresponding debtor relationship"

The word "and" should replace "or" in subsection (1)(b)(i). Although paragraph 11A(4)(c) of Schedule 9 to FA 1996 uses "or" the definition is more concerned with the way in which debits and credits generally would be treated under the relationship in question, rather than the way in which a particular debit or credit would be treated.

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

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Clause 131: Exception to section 129 where loan exceeds arm's length amount

Subsection (3) should also refer to there being no debtor relationship (paragraph 11A(5)(c) of Schedule 9 to FA 1996).

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

Clause 133: Application of fair value accounting: reset bonds etc

The clause should state that this clause takes precedence over Chapter 5 of Part 6 (connected companies relationship).

209. The precedence should follow from the fact that a provision of narrower application takes precedence over a provision of wider application. It would be cumbersome to explain in every case which clauses take precedence over other clauses in the two loan relationship Parts.

210. *We do not propose to amend the clause.*

Clause 148: Treatment of connected companies and partnerships for section 147

The cross-references in subsections (2) and (8) are cumbersome.

211. Subsection (8) will be abbreviated but subsection (2) does not lend itself to abbreviation.

212. *We agree in part and will amend the clause.*

Clause 149: Meaning of expressions relating to exchange gains and losses

In clause 149(3)(b) references to other profits, gains or losses are not needed (although this reflects the source legislation) as subsection (1) deals only with exchange gains and losses.

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

Clause 151: Other definitions

(Regarding the definition of building society and the comment in the explanatory note to this clause that section 477A(3)(a) and (aa) of ICTA was not being rewritten). While there is nothing which prevents shares in a building society from being treated as a loan relationship a share would still need to fall within the basic definition of a debt. It is not clear that shares in a building society are necessarily debts.

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214. We agree that permanent interest bearing shares may not fall within the definition of debt if there is no firm obligation to redeem on a particular day.

215. *We agree. The appropriate parts of section 477A of ICTA will now be rewritten.*

Clause 154: Relevant non-lending relationships not involving discounts

Clause 154(2)(c) and (3) do not produce the right result in rewriting section 100(1)(c)(iii) of FA 1996. The source legislation does not require the impairment loss to arise in respect of a business payment, nor even that there actually is a payment. The requirement is that if there were a payment in respect of the debt it would qualify as a business payment. The same applies to clause 156(3)(d) and (e).

216. The source legislation says in sub-paragraph (c)(iii) that the provision applies to a money debt where, “a payment *would fall* to be brought into account...as a receipt of trade” etc [emphasis added]. If a payment were made it would be brought into account for the purposes of corporation tax as a receipt of trade etc. We agree that the provision does not require a payment to be made. The fact that the payment has not been made causes it to be a money debt to which the provision applies.

217. The draft clause says that the kinds of debt to which the section applies includes a debt in relation to which an impairment loss arises to the company in respect of a business payment. Subsection (3) then goes on to define what is meant by “business payment”. In this situation a “business payment” is one that “*would fall* to be brought into account” in the same circumstances as in the source legislation. As with the source legislation, it is not requiring a payment to have been made.

218. Consequently, we agree that the source legislation does not require a payment to be made for the provision to apply. The requirement is that if there were a payment in respect of the debt, then that payment would qualify as a business payment. However, we believe that the current clauses achieve this outcome.

219. That aside, we think the drafting should be improved to make it clearer that in this clause a “business payment” is not one that has been made but one that if made, would be treated as a business payment.

220. *We will amend and clarify the clause.*

Subsection (5)(b) implies that clause 161 contains an exception to the general rules in this clause, which merely define a relevant non-lending relationship. This is not the case. Clause 161 only modifies the way in which this Chapter

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applies to certain types of relevant non-lending relationships. The same applies to clause 155(7).

221. ***We agree and will amend the clauses.***

Clause 155: Relevant non-lending relationships involving discounts

Subsection (2) does not precisely reproduce the effect of section 100(1A)(d) of FA 1996. The debt (or, more precisely, the sales income which it represents) would normally be brought into account at the time when it arises. Hence it is necessary to frame the test in terms of the assumed collectability of the debt at that time, rather than what happens if and when it is actually paid.

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

Clause 156: Application of Part 6 to relevant non-lending relationships

Paragraph (c) of subsection (3) does not seem to be capable of applying in respect of a debt on which interest is payable by the company.

223. Subsection (3)(c) rewrites section 100(2ZA)(a) of FA 1996 which only applies “in respect of the right to receive interest” of a debt falling within section 100(1)(c) of FA 1996, so we agree that the clause is not capable of applying to interest payable by the company.

224. Therefore, the “or by” should be removed from “...which interest is payable to or by the company” because the provision only applies in respect of the company’s right to receive interest.

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

Subsection (5) is drafted in such a way that the matters mentioned in subsection (3) are not “relevant matters” in the case of a relevant non-lending relationship involving a discount. That does not appear to be the effect of the source legislation.

226. Subsection (5) restricts the relevant matters to debts involving discounts in section 100(2ZA)(b) of FA 1996. We agree that this is not the effect of the source legislation. As section 100(2) starts off with “where a company has a relationship to which this section applies”, that must include relationships within section 100(1)(c)(iv). The matters in section 100(2ZA)(b) are additional to the other matters that also apply to discounts.

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

Clause 157: Miscellaneous rules about amounts to be brought into account because of this Chapter

Subsection (3) seems unnecessary, since subsection (2) (which contains the only reference to discounts) is in any case effectively confined to cases where discounts are treated as arising under the previous clauses.

228. *We agree and will remove subsection (3).*

Clause 158: Exchange gains and losses: amounts to be treated as money debts

Section 100(12) of FA 1996 requires the provision to satisfy both of the tests rewritten in clause 158(4) and (5), not just one of them.

229. In subsection (3) “A or B” should be “A and B”, thereby requiring both of the conditions in subsections (4) and (5) to be satisfied.

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

Clause 161: Exclusion of exchange gains and losses in respect of tax debts etc

In clause 161(1)(b) delete “not” before “deductible”. Also in the Commentary, paragraph 281, delete “not” in first sentence.

231. Exchange gains and losses are not taken into account where the money debt is an amount that is not deductible (section 100(9)(c) of FA 1996). There is no error in clause 161(1)(b).

232. Although technically correct, we will amend the clause to improve clarity.

233. *We will amend and clarify the clause to make it easier to follow.*

The effect of section 100(9)(c) of FA 1996 is that no exchange gains or losses are deemed to arise on amounts which are not actually deductible, because of a statutory provision or rule of law, but would otherwise be so. That is the opposite of the effect which appears to be achieved by the double negative in clause 161(2). In any case subsection (2) represents an integral part of the condition in subsection (1)(b) rather than, as the present misleading lay-out would imply, an addition to it.

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

The meaning of subsection (3) would be more readily apparent if it used the word “deduction” rather than “reduction”, that being the word in common usage and the one which is actually used in the heading of section 811 of

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ICTA. If however it is considered essential to use the same word as in the body of section 811, saying “reduction of income” would be an improvement.

235. ***We agree and will amend the clause to use the word “deduction”.***

Clause 162: Introduction

Q.8 We welcome comments on the proposal to apply the definition of an offshore fund in section 756A of ICTA for all purposes of the qualifying investments test

We do not object to the proposed change in relation to the definition of offshore fund, though we feel that it more clearly represents a change in law than the Change Note suggests. Paragraph 7(1)(b) of Schedule 10 to FA 1996, which effectively broadens the definition, was obviously inserted deliberately and the failure to make consequential amendments to paragraph 8 can only have been due to oversight. It may be that this error has rendered paragraph 7(1)(b) ineffective (though we would not regard this as certain) but even if that is so, removing it represents a departure from the original policy, whatever that may have been.

236. We are continuing to research and discuss this issue with specialists.
237. ***We are continuing to consider this response.***

Clause 165: The qualifying investments test

Expressing this test in terms of when a company meets it rather than when it fails to do so is probably an improvement but, at least at the first reading, leaves open the possibility that there might be other ways of satisfying the test in addition to the one specified in subsection (1). Inserting the word “only” before “if” would remove the ambiguity.

238. ***We agree and will make the suggested amendment.***

Clause 166: Meaning of “qualifying investments”

Why is the definition of “relevant accounting period” provided for the purposes of this clause?

239. The definition is provided in this clause because the definition of “derivative contract” refers to “relevant accounting period” and the definition of “relevant accounting period” provides the meaning of this phrase for this clause.
240. ***The definition of “relevant accounting period” will remain.***

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In paragraph 294 of the explanatory notes, the reference to this clause providing for Treasury powers to add to or subtract from the list of “qualifying investments” is incorrect.

241. We agree that it is clause 169 that provides the power for the Treasury to amend the list of qualifying investments, not this clause.

242. ***We agree and will amend the explanatory notes.***

Clause 167: Qualifying holdings

We agree that the effect of paragraph 8(6A) and 8(6B) of Schedule 10 to FA 1996 is effectively replicated by Reg 76 of SI 2006/964. However we consider it should be reflected in the rewritten primary legislation rather than left in the SI. This is the case where the statutory instrument modifies the effect of the primary legislation, and we believe that the original agreed policy of the rewrite was that in such cases the effect of the SI should be included in the rewrite. This is a different situation from rewriting the SI itself, or bringing back into the primary legislation the subject matter of an SI which contains a separate body of administrative provisions, both of which we accept are outside the reference of the rewrite.

243. We have not rewritten paragraph 8(6A) and 8(6B) because they are covered by Regulation 76 of SI 2006/964. We are only rewriting SI’s where they actually refer specifically to provisions in the primary statute and modify them. This is not the case with SI 2006/964.

244. ***Paragraphs 8(6A) and 8(6B) will be repealed and SI 2006/964 will be relied upon to cover this situation.***

Clause 168: Meaning of “hedging relationship”

It seems that in paragraph 8(7G) of Schedule 10 to FA 1996 the words “and could affect the total net return of the scheme, fund or company” are intended to refer back to “a recognised asset” as the implied subject of the sentence, rather than to “an identified portion of such an asset”. That implies that the wording which appears as sub-para (b)(ii) of clause 168(3) actually belongs in para (a).

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

Clause 170: Industrial and provident society payments treated as interest under loan relationship

Q.10 We welcome comments on whether dividends, etc on shareholdings held in an industrial and provident society should be treated as trading income as if the shareholding were a loan relationship held for the purposes of the trade.

It is unclear to us why it is necessary to deem a shareholder to be party to any dividend paid in respect of the share for the purposes of its trade. What happens if the shareholder would otherwise be treated as an investment company? This could be of relevance where a shareholder has brought forward non-trading loan relationship deficits which cannot be relieved against trading income (but which could be relieved against investment income).

246. If subsection (1) applies, then regardless of the purpose for which those shares are held (ie trading or non-trading), the shareholder is treated (for the purposes of clauses 378 and 387, bringing gains into account whether for trading or non-trading), as party to the loan relationship for that purpose. “That purpose” can be either for trading or non-trading. The clause does not deem a shareholder to be party to any dividend paid in respect of the share for the purposes of its trade.

247. The change in this clause provides that share interest and loan interest of a registered industrial and provident society are treated as trading income where the company is a party to the respective shares or loan for the purposes of a trade.

248. The provision does not deem all companies to be party to the loan relationship for the purpose of a trade but we agree the clause should be amended to improve its clarity.

249. *We will amend and clarify the clause.*

Clause 171: Disallowance of debits for interest where failure to make returns

Subsection (2), like the source legislation, simply says that no interest paid by the society in the period is to be brought into account for the period for the purposes of Part 6. This appears to apply to both the society and the recipient of the interest (if that is a company), so reference in the heading specifically to debits is misleading. Compare section 486(4), which demonstrates that references to interest paid are not confined to its treatment in the hands of the payer.

250. Section 486(7) of ICTA states that share and loan interest paid by the society shall not be brought into account for the purposes of Chapter 2 of Part 4. This must apply for both the payer and recipient, so we agree with the respondent.

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251. ***We agree and will amend the title of this clause.***

It would be helpful if subsection (2) could be expanded to make it clear that the reference to interest includes both payments deemed to be interest by clause 171 and also actual interest. Although this may not be necessary as a matter of strict construction, the switch from clause 170, which deals only with what the source legislation calls share interest, to clause 171 which applies more generally is potentially confusing unless some emphasis is added.

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

Clause 173: Meaning of “financial institution”

The grouping of the various categories of persons in subsection (2)(b) is not logical. Either “persons acting on behalf of the parent” should be moved into paragraph (a) with the parent itself, or persons acting on behalf of the parent or the parent’s wholly-owned subsidiaries should be moved to a new paragraph (c).

253. ***We agree and will amend the clause by moving “persons acting on behalf of the parent” into paragraph (a).***

Clause 179: Treatment of alternative finance arrangements as loan relationships etc

In subsection (6) why is “this Part” applied rather than “Part 6”?

254. We agree that the reference should be to “Part 6”, as in subsections (1) to (3).

255. ***We agree that the reference should be to “Part 6” and will amend the clause.***

Clause 180: Meaning of “alternative finance return”: purchase and resale arrangements

Section 48 of FA 2005, which supplements the provisions rewritten in subsections (4) and (5) of this clause, appears not to have been rewritten.

256. Section 48 of FA 2005 is required only for income tax, since only a person other than a company is affected by the section. It follows that only that person’s effective return is in point and that there can be two effective returns where a company sells the asset to an individual; one for the company and one for the individual.

257. ***A rewrite of section 48 of FA 2005 should not be included in this Bill.***

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Subsection (2) also originates from section 47(4) of FA 2005.

258. ***We agree and will amend the origins.***

The origin of subsection (3) is section 47(7) of FA 2005.

259. ***We agree and will amend the origins.***

Clause 182: Meaning of “profit share return”

Section 54 of FA 2005 has not been rewritten. We assume that this will be covered by clause 7(3)(b), which refers to section 209(6A) of ICTA as preventing profit share return under alternative finance arrangements from being a distribution.

260. This assumption is correct. The clause rewriting 209(6A) of ICTA will exclude share return under an alternative finance arrangement from being a distribution.

261. ***No amendment is required.***

Clause 185: Provision not at arm’s length: non-deductibility of relevant return

Is it unnecessary to rewrite section 52(6) of FA 2005? This clause however, doesn’t itself provide this prohibition, as it relates only to a deduction for the person paying relevant return under the alternative finance arrangement.

262. Section 52 of FA 2005 denies corporation tax relief for “relevant returns” if the arrangement is not at arm’s length. Subsection (6) prohibits the company paying relevant returns from surrendering an amount by way of group relief if a deduction in respect of it is prohibited by subsections (4) and (5).

263. We intend to rewrite section 402(1) of ICTA in Bill 6 with the group relief provisions. The rule will be that the surrendering company may surrender the losses and other amounts only so far as the losses and other amounts are eligible for corporation tax relief.

264. So it is not necessary to rewrite the rule in this clause.

265. ***We do not propose to rewrite section 52(6) of FA 2005.***

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Clause 194: The redemption return condition

In view of clause 194(6) is it necessary to rewrite arrangements in section 91D(2)(a) of FA 1996 as “agreements, arrangements or understandings”?

266. We agree that the words “agreements” and “understandings” in subsection (3) are not required because subsection (6) provides that the meaning of “arrangements” includes agreements and understandings.

267. *We agree and will remove “agreements” and “or understandings” from subsection (3).*

Clause 206: Exemption of profits from FOTRA securities

Does the exemption also need to refer to “any loan relationship represented by a FOTRA security” as does section 154(2) of FA 1996?

268. Although a loan relationship represented by a FOTRA security is still a FOTRA security, for avoidance of doubt the phrase “and any loan relationship represented by a FOTRA security” will be included.

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

Clause 207: Income from savings certificates

In the case of savings certificates issued under Northern Ireland law, of the statutes listed in section 46(6) of ICTA is section 12 of the National Loans Act 1968 the only relevant corresponding enactment?

270. There are no Northern Ireland certificates in issue other than Ulster Savings Certificates, therefore there is only the need to refer to the most recent enactment in case of any future issue of certificates.

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