

## **EXPLANATORY NOTE**

### **CLAUSE 41 AND SCHEDULE 6: RELATED AMENDMENTS TO OTHER ENACTMENTS**

#### **SUMMARY**

1. This clause introduces Schedule 6, which contains consequential amendments to other enactments.

#### **DETAILS OF THE CLAUSE**

2. Clause 41(1) introduces the Schedule.
3. Clause 41(2) provides that the Schedule is subject to the commencement and transitional provisions in Clauses 42, 43 and 44.

#### **DETAILS OF THE SCHEDULE**

##### *Paragraph 1*

4. Paragraph 1 of the Schedule amends section 76B of the Income and Corporation Taxes Act 1988 (“ICTA”) – levies and repayments under the Financial Services and Markets Act 2000.
5. Paragraph 1(2) and (3)(b) substitute “company with investment business” for the existing phrase “investment company” to bring this provision into line with the changes made to section 75 by Clause 38, as is done by other paragraphs of this Schedule.
6. Paragraph 1(3)(a) makes it clear that the Case VI charge on refunds of levies etc. applies only for the purposes of corporation tax.

##### *Paragraph 2*

7. This paragraph amends section 77 ICTA (incidental costs of loan finance). In 1996 this section was amended to apply for income tax purposes only (as the loan relationships rules in Chapter 2 Part 4 of the Finance Act 1996 apply to such costs for the purposes of corporation tax). But a reference to expenses of management which apply only for that tax remained by error. Paragraph 2(2) removes it.

*Paragraphs 3 to 6*

8. These paragraphs amend sections 768B to 768E ICTA subject where relevant to the transitional rule in Clause 43(7). Those provisions deal with the treatment of certain types of loss other than trading losses on the change of ownership of a company. The main change is to substitute “company with investment business” for the existing phrase “investment company” – thus widening the existing anti-avoidance rules which currently apply only to investment companies and not to the non-trading losses of a trading company. This particular change is made in
- section 768B(1) by paragraph 3(2);
  - section 768B(14) by paragraph 3(6);
  - section 768C(2) by paragraph 4(2);
  - section 768C(12) by paragraph 4(4);
  - section 768D(1) by paragraph 5(2);
  - section 768D(4) by paragraph 5(3);
  - section 768D(6) by paragraph 5(4);
  - section 768D(8) by paragraph 5(5);
  - section 768E(1) by paragraph 6(2); and
  - section 768E(7) by paragraph 6(3).
9. In other places, references to “disbursed” are replaced by “deductible” or other phrases appropriate to the new section 75:
- paragraph 3(3) and (5) – in section 768B(6) and (9); and
  - paragraph 4(3) – in section 768C(7).
10. Paragraph 3(4) makes a consequential change to a cross-reference to section 75 in section 768B(4), and paragraph 3(7) amends the sidenote to section 768B to reflect the new wording.
11. The consequential amendments necessary to Schedule 28A itself will be made in the Treasury regulations under the powers set out in Clause 46, as explained in the Background Note below.

*Paragraph 7*

12. Paragraph 7(1) provides for the amendment of section 85 of the Finance Act 1989 (charge of certain receipts of basic life assurance and general annuity business of life assurance companies).
13. Paragraph 7(2) omits paragraphs (c) to (d) of subsection (2). Those paragraphs related to amounts which under the old section 76 fell to be deducted from expenses of management by virtue of
- section 76(1)(a) (fines, fees and reversions),
  - section 76(1)(c) (repayment or refunds of expenses) and
  - section 76(1)(ca) (reinsurance commissions referable to basic life assurance and general annuity business).

14. Under the new section 76 the amount of expenses payable shown in the Form 40 is not reduced or balanced by “credit” items. Instead those items will now fall within section 85 of the Finance Act 1989.
15. Paragraph 7(3) inserts three new subsections into section 85.
16. New subsection (2A) provides the timing rule which is that the receipts falling within section 85 are taken into account for tax purposes when they are brought into account in the periodical return.
17. New subsection (2B) allows for a deduction for expenses from the receipts in accordance with the rules of Case VI of Schedule D and new subsection (2C) provides, for the first time, a proper apportionment rule for section 85 amounts. The rule used depends on the type of receipt:
  - reinsurance commissions are referable to BLAGAB if the business being reinsured is BLAGAB
  - refunds of acquisition expenses are referable to BLAGAB if the acquisition expenses were so referable
  - and in any other case the apportionment is made using section 432A ICTA. This basis is normally used in any event - see the Inland Revenue’s Life Assurance Manual, paragraph 5.131.

*Paragraph 8*

18. Paragraph 8(1) provides for the amendment of section 86 of the Finance Act 1989 (spreading of relief for acquisition expenses of life assurance companies). For the most part the amendments made by paragraph 8 are mechanical to fit section 86 for operation by reference to the new section 76.
19. Paragraph 8(2) substitutes a new section 86(1) which provides the main rule, defining acquisition expenses, in the same way as the existing section 86(1). But the new subsection (1) also includes the rules previously in section 86(1A)(a) (relating to the proportionate deduction for losses) and in subsection (1B) which determines how the appropriate portion of losses is calculated. It also makes it clear that reinsurance commissions and refunds of acquisition expenses falling within section 85 FA 1989 are deducted.. The rule in the existing subsection (1B) is also simplified and clarified in the second sentence of new subsection (1).
20. Paragraph 8(3) makes a necessary amendment to section 86(2) as a result of the abolition of the concept of “expenses of management” in section 76.
21. Paragraph 8(4) omits, as now unnecessary, section 86(5) and 86(5A).

22. Paragraph 8(5) rewrites section 86(6) concerning how the deduction in a base period, that is the accounting period to which the acquisition expenses are referable, is to be relieved. It provides that the adjusted amount of the acquisition expenses goes through the one-sevenths apportionment and defines adjusted expenses as those left after making the reduction in Step 2 (Schedule A and mineral rights expenses and expenses of a capital nature). The new subsection 6 also provides that the one-seventh of the adjusted amount is slotted into the main calculation at Step 6 thus linking the section with Step 6.
23. Paragraph 8(6) repeals section 86(7) which related to the transitional rules for periods up to 1993 and is now spent.
24. Paragraph 8(7) rewrites section 86(8) and (9) to deal with the deduction of further one-sevenths of the full amount in succeeding accounting periods. The only effect is to change the language to make it march in step with the new section 76.
25. Paragraph 8(8) inserts two new subsections. New section 86(9A) defines expenses payable as having the same meaning as in Step 1 of section 76 and then new section 86(9B) defines any reference to a Step as a reference to that Step as found in section 76(7).

### **BACKGROUND NOTE**

26. Many of the consequential amendments to statute needed as a result of changes to the rules on management expenses contained in this bill, are mechanical in nature and will be contained in secondary legislation – see Clause 46. The ones made in this Schedule are those that are more far-reaching or substantial.

**EXPLANATORY NOTE**

**CLAUSE 42: COMMENCEMENT OF SECTIONS 38 TO 41**

**SUMMARY**

1. This clause provides the date of commencement for the revised relief for expenses of management in Clauses 38 to 41 and Schedule 6, subject to the transitional provisions in clauses 43 and 44 and in Schedule 6.

**DETAILS OF THE CLAUSE**

2. Clause 42(1) provides that the amendments to expenses of management take effect for accounting periods beginning on or after 1 April 2004.
3. Clause 42(2) provides that the commencement provisions will be subject to the transitional provisions.

**BACKGROUND NOTE**

4. These changes were announced in December 2003 and the draft legislation was exposed for comment at that time, as part of the continuing programme of consultation on Corporation Tax Reform.

**EXPLANATORY NOTE**

**CLAUSE 43: COMPANIES WITH INVESTMENT BUSINESS:  
TRANSITIONAL PROVISIONS**

**SUMMARY**

1. This clause contains provisions which supplement the general commencement rule in Clause 42 for the new management expenses regime set out in Clauses 38 and 39. It sets out the transitional provisions which apply where an investment company already entitled to deduct management expenses under the existing section 75 of the Income and Corporation Taxes Act 1988 comes within the new rules. The clause also sets out the detailed commencement rules for companies which become entitled to deduct management expenses for the first time.
2. As well as achieving a smooth transition from the existing rules to the new these rules ensure in particular that companies' entitlement to management expenses under the new rules will not vary with the date to which they happen to draw up accounts.

**DETAILS OF THE CLAUSE**

3. Clause 43(1) ensures that excess management expenses carried forward and treated as disbursed in the following accounting period under the existing rule in section 75(3) are to be treated as deductible for that following period, the first "new accounting period", under the proposed new rules. Those expenses are therefore treated in the same way in this respect as excess management expenses arising in an accounting period to which the new rules apply.
4. Clause 43(2) to (4) provide rules to ensure that sums can be deducted as expenses of management once and once only on the change from the "disbursed" basis of deducting management expenses to the accounts basis set out in the proposed new section 75A of the Income and Corporation Taxes Act 1988 in Clause 39. These rules are only of application to companies entitled to deductions under the current rules, that is to say "investment companies" as defined in section 130.
5. Clause 43(2) provides that an amount deductible under old section 75(1) for an accounting period ended before 1 April 2004 (including a deemed accounting period under subsection (5)), is not to be deducted again for a "new accounting period", that is one subject to the new rules. This

could happen if an expense, or part of an expense, is regarded as disbursed for a period before that in which it is debited in the profit and loss account of a company.

6. Clause 43(3) provides that the “no double-counting rule” in subsection (2) does not prevent an unrelieved excess of management expenses being carried forward under the old section 75(3) or under the new section 75(9).
7. Clause 43(4) deals with the situation which is the reverse of that addressed by subsection (2). It is concerned with the possibility that an expense may not be deductible for an accounting period ending before commencement because it is not regarded as ‘disbursed’ for a pre-commencement period. At the same time, it may not be deductible for a post-commencement accounting period on the accounts basis in the new section 75A because it was (correctly) charged in the accounts for a pre-commencement period.
8. To avoid an expense falling between two stools in this way subsection (4) provides that if an “investment company” would have been entitled to a deduction for such an expense under the new timing rules for pre-commencement periods (had they so applied) then the amount is to be deductible for the first “new accounting period” under the new rules (which may include the deemed accounting period beginning on the 1 April 2004 by virtue of subsection (5) of the clause).
9. Clause 43(5) is concerned with the case where a company has an accounting period which straddles 1 April 2004. In this case the period is notionally divided into two accounting periods, one ending on 31 March 2004 and the other beginning on 1 April, the first “new accounting period”, for the purpose of computing relief for expenses of management for that period, except to the extent set out in Clause 43(6).
10. This provision has no wider effect. The total of the management expenses deductible for each period can therefore be aggregated to arrive at a single figure for the whole straddling accounting period. It is some or all of that total figure which is set off against the profits of the period chargeable to corporation tax, carried forward under the new section 75(9) or surrendered as group relief.
11. Clause 43(6) ensures that this division of the straddling period into two deemed accounting periods for the purpose of computing management expenses does not have to be made for purposes where it would make no practical difference. That is, in the case of an investment company, in relation to:
  - its management expenses of a previous accounting period, treated as those of the straddling period by virtue of section 75(3) (as it currently stands);

- particular sums specifically treated as management expenses for the straddling accounting period under provisions other than those of section 75 or this clause.
12. Sums in these categories may therefore be added to the total deductible expenses for the two deemed accounting periods (though as at present management expenses brought forward from an earlier accounting period cannot be surrendered as group relief).
  13. Clause 43(7) deals with the interaction of the deemed accounting period rule in Clause 43(5) with existing provisions in sections 768B and 768C of the Income and Corporation Taxes Act 1988 which also split an accounting period into component deemed periods for their own purposes. These are anti-avoidance provisions restricting the extent to which unused management expenses of a company may be carried forward when its ownership changes.
  14. Subsection (7) provides that the rule in Clause 43(5) is applied first and that the rules in sections 768B and 768C then split one of the deemed accounting periods thereby created. In carrying out this exercise the rule in subsection (6) is disapplied to ensure that all a company's management expenses are allocated to one or other of the deemed periods created by Clause 43(5). This ensures that the correct amount of management expenses is prevented from being carried forward under the anti-avoidance rules.
  15. Clause 43(8) sets out certain definitions for the purpose of the clause. In particular, it defines a "new accounting period" as one beginning on or after 1 April 2004. Except in applying the rules set out in Clause 43(6), it includes the accounting period beginning on 1 April 2004 deemed into existence under Clause 43(5) for the purposes of management expenses deductions where a company's accounting period under the general corporation tax rules would straddle that date.

### **BACKGROUND NOTE**

16. These changes were announced in December 2003 and the draft legislation was exposed for comment at that time, as part of the continuing programme of consultation on Corporation Tax Reform.

## **EXPLANATORY NOTE**

### **CLAUSE 44: INSURANCE COMPANIES: TRANSITIONAL PROVISIONS**

#### **SUMMARY**

1. This clause provides the transitional provisions for the revised expenses of management relief for insurance companies. It covers periods of accounts which straddle the commencement date of 1 April 2004.

#### **DETAILS OF THE CLAUSE**

2. Subsection (1) requires the reference to section 76(12) and (13) (brought forward amounts) to be read in the first “new” accounting period as including amounts carried forward under (old) section 75(3) and (old) 76(5) at the end of the last “old” accounting period. “Old” and “new” accounting periods mean an accounting period (including the deemed accounting period in the straddling period) ending before, or on or after 1 April 2004 respectively – subsection (8).
3. Subsection (2) deals with the case where in an old accounting period an amount was not deductible under old section 76 (for example because it had not been disbursed for that period) but because it was brought into account in the revenue account in Form 40 in an old period and not in a new period, it does not fall to be deducted in a new period either. In such a case, the amount that would have been deducted had the new section 76 applied in the old period, but was not deducted under the old section 76, is treated as added to the “basic deduction” in Step 8 for the first new accounting period.
4. Subsection (3) deals with a straddling period, one in which 1st April falls otherwise than at the start. Here the period is divided into two notional accounting periods, one ending on 31 March 2004 and another beginning on 1 April.
5. Subsection (4) limits the extent to which the straddling period rules are used. For the second period only Steps 1 and 2 of new section 76(7) are used. For the first period, amounts falling within section 76(1) are found except for the deduction for losses given by section 76(1)(aa). These two amounts are then aggregated, together with any amounts brought forward and deductions under the old section 76(1)(aa) made. Then the

balance is set off in accordance with old section 76(1)(e) for the straddling period as a whole, subject to old 76(2) to (2D).

6. Subsection (5) provides that no other provision of the Tax Acts that relates to expenses under the new section 76 applies for the straddling period, so that in particular the old version of section 86 FA 1989 (acquisition expenses) applies for that period. Subsection (6) then makes subsections (4) and (5) the exclusive source of rules for the straddling period.
7. Subsection (7) says that any reference to a numbered Step means a Step of new section 76(7).
8. Subsection 8 provides definitions for the section.

### **BACKGROUND NOTE**

9. This clause provides the details about the transitional measures between the existing legislation for management expenses of insurance companies and the revised deduction rules for their expenses.

## **EXPLANATORY NOTE**

### **CLAUSE 45: AMOUNTS REVERSING EXPENSES OF MANAGEMENT DEDUCTED: CHARGE TO TAX**

#### **SUMMARY**

1. This clause inserts a new section to deal with a charge to tax where sums credited in the company's accounts reverse sums charged in the accounts which have already been allowed as expenses of management. This reflects the fact that under the new timing rules it is not necessary to "disburse" sums in order to obtain a deduction.

#### **DETAILS OF THE CLAUSE**

2. New section 75B(1) identifies the circumstances where the section applies. That is where:
  - in one period of account there has been a debit in the accounts for a sum which represents (wholly or partly) an amount deductible as an a management expense (other than as a sum brought forward from an earlier period);
  - in a later period of account (the "reversal period") an amount is credited which reverses some or all of that deduction;
  - that later period of account ends on or after 1 April 2004 and is not a straddling accounting period.
3. New section 75B(2) introduces the provisions imposing the charge and the computation of the amount chargeable.
4. New section 75B(3) identifies the amount chargeable (the "reversal amount"). That is so much of the sum debited in the accounts (matched with the later credit) as represents sums deductible as expenses of management. The amount chargeable is reduced by any part of it which is taxable under other provisions for the accounting period for which it would be chargeable or an earlier accounting period.
5. New section 75B(4) provides that if the period of account coincides with an accounting period then the reversal amount shall be dealt with in accordance with section 75B(7).
6. New section 75B(5) deals with the case where that period of account does not coincide with a single accounting period, in which case the

reversal amount is apportioned between the accounting periods that do fall in the reversal period. Any amount apportioned to an accounting period beginning on or after 1 April 2004 is then dealt with in accordance with s75B(7).

7. New section 75B(6) provides for a time apportionment for the purposes of subsection (5) unless that would appear to be unreasonable or unjust. In such a case a just and reasonable method is to be used.
8. New section 75B(7) provides that where an amount needs to be dealt with in accordance with s75B(7) it should first be set against the company's expenses of management deductible for that accounting period (other than any brought forward from a previous period) and anything left after reducing those to nil is charged to tax under Case VI of Schedule D for that period.
9. New sections 75B(8) and (10) provide the link to the profit and loss account drawn up in accordance with GAAP for the reversal amount.
10. New section 75B(9) is the equivalent of new section 75A(8). It provides for a deemed period of account if there is an accounting period but no actual period of account to contain it, and for that deemed period of account to coincide with the accounting period.
11. New section 75B(11) provides that a credit reverses a debit (see subsection 1) not only where the sum debited turns out never to have been paid but also where it is paid but subsequently repaid.
12. New section 75B(12) defines the commencement date (as 1 April 2004) and the terms "credit" and "debit".
13. Subsection (2) of Clause 45 ensures that when an old accounting period is involved, references to the carry-forward provisions operate correctly.
14. Subsection (3) of Clause 45 provides that "old accounting period" and "the old section 75" shall have the same meanings as in Clause 43.
15. Subsection (4) makes an amendment to section 842 of the Income and Corporation Taxes Act 1988. That section sets out the conditions an investment company must satisfy in order to be regarded as an "investment trust", conferring an exemption from corporation tax on capital gains. One of the conditions to be satisfied is that an investment company's income must be wholly or mainly investment income (as defined). A Case VI charge under Clause 45 on the reversal of a deduction for management expenses could cause that test to be failed (by creating income which is not investment income). To prevent that result, this subsection provides that the Case VI charge is left out of account in determining whether the condition is satisfied.

**BACKGROUND NOTE**

16. These changes were announced in December 2003 and the draft legislation was exposed for comment at that time, as part of the continuing programme of consultation on Corporation Tax Reform.

## **EXPLANATORY NOTE**

### **CLAUSE 46: POWER TO MAKE CONSEQUENTIAL AMENDMENTS**

#### **SUMMARY**

1. This clause inserts a power for the Treasury to make consequential amendments to other legislation as a result of the changes to the relief for management expenses.

#### **DETAILS OF THE CLAUSE**

2. Subsection (1) provides the main power to make consequential amendments to other legislation as a result of the changes to the relief for management expenses by clauses 38 to 40, 45 and Schedule 6.
3. Subsection (2) allows different amendments to be made for different cases, and to make all other incidental, transitional etc changes.
4. Subsection (3) permits an order made under the power to have effect for an accounting period ending on or after 1 April 2004 if it is made by 31 December 2004. The order itself can only be made after Royal Assent to Finance Act 2004.
5. Subsection (4) defines enactment and includes secondary legislation. There are several regulations, mostly in the field of companies carrying on life assurance business, that refer to section 75 or 76 of the Income and Corporation Taxes Act 1988 (“ICTA”) in ways that need modification.

#### **BACKGROUND NOTE**

6. The changes made to the structure of sections 75 and 76 ICTA, and the extension of management expenses to companies with investment business, require minor amendments to a number of provisions within the Taxes Acts. The purely mechanical changes will be made by Treasury order.
7. On 2 March a draft Schedule of consequential amendments relating to relief for management expenses, and explanatory notes covering the consequential amendments, were published on the Inland Revenue’s website.

**EXPLANATORY NOTE**

**CLAUSE 47 AND SCHEDULE 7: INSURANCE  
COMPANIES ETC**

**SUMMARY**

1. The clause and Schedule prevent avoidance of corporation tax by companies carrying on life assurance business through the use of financial reinsurance arrangements. They also make some technical corrections to legislation about such companies in Schedule 33 Finance Act 2003.

**DETAILS OF THE CLAUSE**

2. The Clause simply introduces Schedule 7.

**DETAILS OF THE SCHEDULE**

3. Paragraph 1 is the first of four paragraphs dealing with aspects of transfers of business by companies carrying on life assurance business (see Background Note). In the Finance Act (“FA”) 2003, a limitation was introduced on the ability of a company to inherit Case VI losses arising from e.g. pension business on a transfer of business. The limitation was set out in section 444A(3ZA) Income and Corporation Taxes Act 1988 (ICTA) which imported certain conditions and operative parts of section 343 ICTA (which deals with transfers of losses between connected persons and already applied to the Case I losses of an insurance company transferring business). One of the parts of section 343 which was imported was section 343(2) which deals with the capital allowances implications of a transfer of business. But section 560 Capital Allowances Act 2001 already performs that function in a wider range of circumstances.
4. So paragraph 1 makes a minor correction to section 444A by omitting a reference to section 343(2) ICTA in section 444A(3ZA).
5. Paragraphs 2 and 3 make some changes to section 444AB ICTA. This too was inserted by FA 2003 and imposes a charge to tax where a company ceases entirely to carry on life assurance business as a result of

a transfer of business. Where this happens and assets are retained by the transferor which represent untaxed profits in the hands of the transferor, section 444AB imposes a charge under Case VI on the amount of the retained assets (subject to certain limits).

6. But there may be circumstances in which for proper commercial and regulatory reasons the transferor retains some liabilities which it owes to its policy holders, but without the company still being regarded as carrying on insurance business. It will of necessity need to retain assets to enable it to meet these liabilities as they fall due. Paragraphs 2 and 3 take this situation into account.
7. Paragraph 2(1) is introductory
8. Paragraph 2(2) substitutes a new section 444AB(5)(a) ICTA. Instead of referring to the fair value of the retained assets as one of the measures of charge (and defining which assets), it limits the amount of the charge to the excess of the value of the assets over the fair value of the retained liabilities (if any).
9. Paragraph 2(3) inserts a new section 444AB(6A). This now defines what is meant by retained assets – section 444AB(6A)(a) – in the same terms as was previously in section 444AB(5)(a), namely such assets as were assets of the transferor’s long-term insurance fund immediately before the transfer. It also defines the new concept of retained liabilities – section 444AB(6A)(b) – as such retained liabilities to policyholders as were included in the company’s periodical return for the period ending immediately before the transfer.
10. Paragraph 2(4) gives the commencement rule: the amendments to section 444AB apply where there is a transfer of business taking place on or after Budget Day (17<sup>th</sup> March 2004).
11. Paragraph 3 inserts a new section 444ABA into ICTA.
12. New section 444ABA(1) sets out the case. It is where section 444AB has applied and the amount of retained liabilities (as defined in new section 444AB(6A)(b)) has reduced otherwise than by payment. This might happen because the amounts due to policy holders is actuarially estimated to have reduced.
13. New section 444ABA(2) is the operative rule. There is a charge under Case VI on the “taxable amount”. The charge is made for the accounting period in which the reduction occurs.
14. New section 444ABA(3) defines the taxable amount where the company was, in its last accounting period before the transfer, charged to tax under Case I of Schedule D (actual Case I) and not under the usual I

minus E basis. The taxable amount is the entire amount of the reduction of liabilities not caused by payment.

15. New section 444ABA(4) and (5) defined the taxable amount in an I minus E case as the non-BLAGAB fraction. That fraction is one based on the value of the liabilities to policy holders which were transferred, and takes the non-BLAGAB value (i.e. any relating to pension business, overseas life assurance business, life reinsurance business, ISA business and long-term non life business) as a fraction of the total. This is the same fraction as is given by section 444AB(9) for the main charge under section 444AB.
16. New section 444ABA(6) deals with the case where the retained liabilities increase because for example the amounts due to former policy holders is actuarially estimated to have increased. The increase does not result in any reduction of the Case VI charge, but any subsequent decrease does not result in a charge unless the amount reduces below the level of the liabilities before the increase.
17. Example: Suppose there was a transfer where retained assets and liabilities were both £700 million. In a subsequent period, retained liabilities reduced, not by payment, to £500 million. There is a charge on £200 million (subject to reduction to the non-BLAGAB fraction). Next year the liabilities increase to £550 million. There is no tax effect. The year after the liabilities decrease to £450 million. There is a charge on £50 million, not on the decrease of £100 million.
18. Paragraph 4(1) amends section 444AD ICTA. It corrects an omission in the section when it was enacted in FA 2003. In making the calculation of the amount which may be excluded from charge under section 83(2B) ICTA it should have only referred to assets of the transferee which were acquired from the transferor in the relevant transfer of business. This error is corrected by the insertion of a new version of section 444AD(4)(a). The operation of other parts of section 444AD would usually have the effect of making this omission irrelevant, but there may be cases where that is not so.
19. Paragraph 4(2) gives the commencement rule: the amendments to section 444AD apply where there is a transfer of business taking place on or after Budget Day (17<sup>th</sup> March 2004).

*Reinsurance*

20. Paragraph 5(1) amends section 82(1) Finance Act 1989 to reflect the introduction of a new section 82C and ensures that it applies for the purposes only of Case I basis computations. It will apply to Case VI computation of the profits of pension business etc., with any necessary modifications – section 436(3)(a), 439B(3)(a) and 441(4)(a) ICTA. The

attribution to the Case VI categories of business will be on a factual basis by reference to the characterisation of the liabilities concerned.

21. Paragraph 5(2) introduces a new section 82C into the Finance Act 1989.
22. New section 82C(1) explains that the section applies where an insurance company has entered into a certain type of financial reinsurance contract and one of two further conditions is met.
23. New section 82C(2) described the type of contract covered by the section. These are contracts that reduce the company's liabilities for the purposes of its regulatory return in circumstances where either the reinsured liabilities may revert to the company or it may have to pay the reinsurer additional premiums to enable it to meet its obligations under the agreement.
24. The section will not apply to all such agreements. The aim is to target agreements where the initial reduction in liabilities is excluded from the computation of trading profits but the later increase, or the further premium, would otherwise be included.
25. New section 82C(3) sets out the first of the two further conditions for the section to apply. This is simply that the reduction in liabilities brought about by the agreement is not reflected in trading profits.
26. New section 82C(4) sets out the second of the two further conditions for the selection to apply. This deals with the reinsurance of liabilities received on a transfer of business, where it may be difficult, using the test in the previous paragraph, to decide whether the reduction in liabilities has been reflected in trading profits. In most cases it will not have been, but if the transferred business is the company's only business – so that a period of account starts with the transfer – and the transferred liabilities are reflected at their gross value in the company's opening position, any subsequent reduction in value will be reflected and the new section will not apply.
27. The second test also requires that the assets included in the transfer be less than the transferred liabilities. New section 82C(5) explains how the deficiency is measured. It is the excess of the liabilities (including any non-insurance liabilities) transferred under the transfer and the assets transferred.
28. New section 82C(6) says that where the section applies an amount will be added to the trading profits of the company. This will be the amount by which the reinsurance of liabilities has been reduced (and hence the gross liabilities have increased) – section 82C(7).

29. New section 82C(8) limits the total amounts that can be added to trading profits, in a case where a transfer of business triggers the liability, to the deficiency of assets on the transfer.
30. New section 82C(9) modifies the definition of insurance business transfer scheme (which is given by section 431(2) ICTA and covers a scheme under section 105 Financial Services & Markets Act 2000 and the excluded Cases under that section) to also include a scheme that would be a section 105 scheme but for the fact that the transferred business is carried on outside the European Economic Area (EEA).
31. Paragraph 5(3) is the commencement rule: the new measure applies for accounting periods ending on or after 17 March 2004, irrespective of when the reinsurance agreement was entered into.

*Chargeable gains*

32. Paragraph 6 makes a small amendment to section 210A Taxation of Chargeable Gains Act (TCGA) 1992. That section was inserted into TCGA to codify the ring-fence for allowable losses. The gains and losses which are ring-fenced are the policy holders share of gains and losses. Section 210A(10) defined the concept of the policy holders' share of such gains and losses. But in section 210A(10)(b) the term "relevant profits" was used instead of the correct term "BLAGAB profits". As a result the proportion of gains and losses that are treated as policy holders' can be excessive having regard to the clear intention of the legislation.
33. Paragraph 6(1) corrects the error in section 210A(10)(b). Paragraph 6(2) is the commencement rule: the definition applies for accounting periods beginning on or after 17 March 2004.

*Double taxation*

34. Paragraph 7 amends section 804B(7) ICTA. This is a provision which gives an apportionment rule for allocating foreign tax for credit purposes where the income that has suffered foreign tax is subject to apportionment under section 432E ICTA. Section 804B(7) was originally enacted in FA 2000, and because of difficulties in operating it in extreme cases, was amended in FA 2003. But its operation remains difficult, as explained in the Inland Revenue's Life Assurance Manual at paragraph 14A.69B.
35. Paragraph 7 therefore inserts a new section 804B(7A) which allows regulations to be made to explain the operation of section 804B(7). The regulations may be made to have effect for accounting periods during which they are made. It is expected that the regulations will be made at

some time in the latter half of 2004 (they cannot be made until Royal Assent to FA 2004).

*Meaning of referable*

36. Paragraph 8 amends section 432A ICTA. That section is the main apportionment rule for income and gains of companies carrying on life assurance business – and contains a series of conditions which attribute income to the different categories of business. The section 432A apportionment is referred to and used in a number of other places in the life assurance tax provisions. But it has become apparent that there may be cases where a requirement to follow a section 432A apportionment does not operate entirely smoothly. This is because section 432A only applies where it is necessary to do so, and if a company only carries on one category of business it is not necessary to use section 432A.
37. Paragraph 8(1) provides for the amendment of section 432A
38. Paragraph 8(2) removes the requirement that the apportionment be necessary from section 432(1).
39. Paragraph 8(3) inserts a new section 432(1A) to cover the case where there is only one category of business, and makes the obvious link that that all the income is attributable to that business.
40. Paragraph 8(4) makes a consequential amendment to section 432(2).
41. Paragraph 9(1) inserts the words “(in accordance with section 432A) into section 438(1) and 439B(6) ICTA to make it absolutely clear that any apportionment of income or gains to pension business or life reinsurance business is made by section 432A.
42. Paragraph 8(2) makes a similar amendments to section 210A(13), 211ZA(10) and 213(1A)(a) TCGA

## **BACKGROUND NOTE**

*Transfers of business*

43. In the absence of special provisions, if a company carrying on life assurance business wished to transfer its business or part of its business to another such company, there would be substantial difficulties and inconvenience involved. This is because, under English law at least, it is not possible to transfer liabilities without the consent of the creditor. Since a company carrying on life assurance business has in many cases thousands if not millions of creditors in the shape of policy holders, obtaining the consent of all them would be very difficult. Accordingly

there has long been a process under which transfers of business could be made without the policy holders' consent if the transfer is sanctioned by the High Court, or in Scotland, the Court of Session.

44. The current provisions for this sanction are in Part 7 Financial Services and Markets Act 2000 and such transfers are described in this note as "Part 7 transfers". They are still often referred to as Schedule 2C transfers, as the previous rule was in that Schedule to the Insurance Companies Act 1982
45. In 1990 a number of special tax provisions were enacted to deal with transfers of business. Their object was primarily to provide a "stand in shoes" or tax neutrality rule where assets were transferred, and to allow carry over of reliefs which would otherwise be lost on the cessation of business of the transferor. The reliefs were intended to recognise that although the shareholder ownership of the business may have changed, the same policy holders had their interest in the business before and after, and that matters which related to the taxation of the policy holders' interest in company's income gains or profits should be unaffected by the change of company. In addition, section 12(7A) ICTA was enacted to bring an accounting period of the transferor to an end where there was a transfer of business if it would not otherwise do so
46. Some gaps and weaknesses in the tax rules concerning Part 7 transfers were filled and corrected in FA 2003. It also introduced countermeasures to schemes by some companies which used Part 7 transfers as an opportunity to ensure that income and profits escaped taxation altogether.

*Financial reinsurance*

47. The trading profits of the life assurance business of insurance companies are based on figures taken from the company's regulatory return to the Financial Services Authority. In particular, any increase in the liabilities to policyholders will reduce profits and any reduction in liabilities will increase them.
48. Life companies often reinsure some or all of their business. Conventional reinsurance allows them to reduce exposure to certain types of risk that are not core to their business. For example, companies that specialise in the management of investments may decide to reinsure the mortality risk in the policies they write to a company that specialise in such risks. Or all life companies in a group may reinsure their pensions in payment into a group member dedicated to the management of annuities and the special range of assets needed to back them. The premiums paid for such reinsurance are usually broadly equivalent to the proportion of the premiums received that relate to the reinsured risk and the reinsured liabilities are also of the same order of magnitude.

Conventional reinsurance therefore has only a small effect on trading profits. This measure does not affect such arrangements.

49. The primary purpose of financial reinsurance is not to transfer risk but to raise finance. The premiums paid are very much smaller than the reinsured risk because the transfer of risk is only temporary. For example, a company may have written business that it expects will generate profits in future years. It may therefore reinsure liabilities that are likely to fall due well into the future that have a net present value equal to the future profits. The liabilities will cease to be reinsured before they fall due, so the premium required is relatively small. But the liabilities will only cease to be reinsured if the profits expected from the business have by then emerged and are available to meet the liabilities. So the only risk taken on by the reinsurer is the risk that these profits will not emerge in time.
50. The benefit to the company is that it can reduce its liabilities immediately by a large amount for a very much smaller premium. This boosts its solvency ratios and enables it to distribute profits immediately (and so remove assets from its long-term insurance fund) that would otherwise only become available when the future profits emerged.
51. The normal consequence of entering into such financial reinsurance arrangements for trading profits is an immediate, large increase followed by a series of reductions in future years. This is unattractive to companies and some have sought to combine reinsurance with transfers of business in such a way that they escape, or argue that they can escape, the initial uplift in profits. But they still seek the subsequent reductions in profits for tax purposes, thereby hoping to secure a permanent tax advantage. The purpose of this measure is to deny such companies the benefit of those subsequent reductions in taxable profits.

## **EXPLANATORY NOTE**

### **CLAUSE 48 AND SCHEDULE 8: LOAN RELATIONSHIPS: MISCELLANEOUS AMENDMENTS**

#### **SUMMARY**

1. This clause and Schedule make a number of miscellaneous changes to the legislation that deals with loan relationships (debt and securities). The changes affect:
  - the treatment of certain venture capital limited partnerships,
  - companies in insolvency proceedings,
  - companies that emigrate or move assets from a permanent establishment, and
  - the “major interest” test.

#### **DETAILS OF THE CLAUSE**

2. The clause is introductory only and provides for the Schedule to have effect.

#### **DETAILS OF THE SCHEDULE**

3. Paragraph 1 of the Schedule is also introductory, and provides for amendments to be made to Schedule 9 to the Finance Act (FA) 1996 (special computational provisions).
4. Paragraph 2 of the Schedule amends the “late interest” rule in paragraph 2 Schedule 9 FA 1996 to exclude from its ambit loans made to close companies where limited partnerships which are collective investment schemes (CIS) are involved. Under the “late interest” rule, any interest on a relevant loan not paid within 12 months of the end of the period in which it accrued due is allowed as a debit only when paid.
5. Paragraph 2(1B) Schedule 9 sets out one condition when the “late interest” rule can apply. This is where a loan is made to a close company by a participator, an associate of a participator or a company controlled by, or in which a major interest is held by, a participator, other than where the creditor is a limited partnership that is a collective

investment scheme (CIS) within the meaning of section 235 Financial Services & Markets Act 2000 (FSMA).

6. Paragraph 2(1) is again introductory.
7. Paragraph 2(2) amends paragraph 2(1B) of Schedule 9 FA 1996 to exclude from the “late interest” rule certain close companies where a limited partnership which is a CIS is involved.
8. Paragraph 2(2)(a) ensures that a close company that is a “CIS-based close company” is not subject to the “late interest” rule in relation to any interest payable on its loans from participators etc.
9. Paragraph 2(2)(b) ensures the same exclusion where the debt is owed to certain limited partnerships by designating them as a “CIS limited partnership”.
10. Paragraph 2(3) provides definitions of “CIS-based close company” and “CIS limited partnership” and inserts them into paragraph 2(6) Schedule 9, which contains other definitions used for the “late interest” rule.
11. Paragraph 2(3) defines a “CIS-based close company” as a company which is close only as a result of the attribution of rights of partners in a CIS limited partnership to one or more persons that is either a close company or not a company at all, e.g. an individual or the trustees of a pension fund or a foreign government.
12. Section 417(3)(a) of the Income and Corporation Taxes Act 1988 (ICTA) provides that rights and powers of a partner are attributed to every other partner. If for example a limited partnership held 100% of the shares in a company and the partners consisted of:
  - Mr Black with a 4% interest; and
  - 24 publicly quoted companies each with a 4% interest.By virtue of the attribution of the rights of the other partners to him, Mr Black would control the company, and the company then being controlled by five or fewer participators (Mr Black alone), it would be close.
13. Attribution under section 417(3)(a) ICTA of a partner’s rights is the only attribution that is not taken into account in determining whether the partner has control of a company. If Mr Black happened to have other rights attributed to him the company might still be close.
14. “CIS limited partnership” is defined to mean a collective investment scheme within the meaning of section 235 FSMA (as now) but also a partnership that would be such a scheme were it not for the fact that it is a body corporate.

15. This change is made to put beyond doubt a point of concern to the venture capital industry. Under paragraph 21 of the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062) no body corporate apart from an OEIC can be a collective investment scheme. Some commentators have suggested that limited partnerships established in certain jurisdictions may have such characteristics as require them to be regarded as bodies corporate. This amendment ensures that even if that is the case, those limited partnerships may still qualify as a “CIS limited partnership”.
16. Paragraph 2(4) gives the commencement rule. It applies to accounting periods ending on or after 10 December 2003 (the date of announcement of the changes).
17. Paragraph 3 of the Schedule amends paragraph 5 Schedule 9 (bad debts etc.) to relax the rules relating to the taxability of releases where parties are connected but where one (or both) is in some form of insolvency proceedings.
18. Paragraph 3(1) is again introductory.
19. Paragraph 3(2) amends paragraph 5(3) Schedule 9. That sub-paragraph currently provides that a release of a debt is not brought into account on the debtor if either the loan relationship concerned is one where an accruals basis is mandatory (because the parties are connected within the meaning of sections 87 and 87A FA 1996) or there is a voluntary arrangement or compromise.
20. Paragraph 3(3) amends paragraph 5(3) Schedule 9 to provide that the release is not brought into account if any one of four conditions is satisfied. It adds the four conditions as new sub-paragraphs (4) to (7) of paragraph 5 Schedule 9.
21. New paragraph 5(4) of Schedule 9 repeats the first condition in the existing paragraph 5(3) – that the release is part of an arrangement or compromise.
22. New paragraph 5(5) of Schedule 9 repeats the second condition in the existing paragraph 5(3) – that the release is of a debt owed to a connected person.
23. New paragraph 5(6) of Schedule 9 inserts the first of the new conditions. It applies if new paragraph 5(5) Schedule 9 does not apply, and if the creditor company releasing the debt is in one of the circumstances given by paragraph 6A(1)(a) to (d) (including new paragraph 6A(1)(bb) covering the insolvent administrative receivership case). There are five such circumstances - that the creditor is in:
  - Insolvent liquidation

- Insolvent administration
  - Insolvent administrative receivership
  - Insolvent provisional liquidation
  - Overseas proceedings equivalent to any of the above.
24. This paragraph applies where the parties to the loan relationship were connected immediately prior to the liquidation etc. but not connected immediately after the liquidation etc.
25. New paragraph 5(7) of Schedule 9 inserts the second of the new conditions. It applies if paragraph 5(5) does not apply, and if the debtor company released from the debt is in one of the same circumstances given by paragraph 6A(1)(a) to (d).
26. Paragraph 3(4) gives the commencement rule. It applies to releases made on or after 10 December 2003.
27. Paragraph 4 of the Schedule amends paragraph 6A Schedule 9 (cases where creditor in insolvency proceedings).
28. Paragraph 4(1) is again introductory.
29. Paragraph 4(2) revokes as if it had never been made Article 29 of the Enterprise Act (Insolvency) Order 2003. This is because that Order purported to amend paragraph 6A to reflect changes made by the Enterprise Act, but the necessary changes had already been made by paragraph 4 Schedule 41 FA 2003.
30. Paragraph 4(3) inserts a new sub-paragraph (bb) into sub-paragraph 6A(1). It adds a fifth circumstance where the paragraph applies: where the creditor is in insolvent administrative receivership.
31. Paragraph 4(4) makes a similar insertion in sub-paragraph 6A(2), which determines when the relevant paragraph of paragraph 6A(1) applies.
32. Paragraph 4(5) inserts a reference to the new paragraph 6A(1)(bb) in the list in paragraph 6A(2)(d).
33. Paragraph 4(6) adds a new sub-paragraph (5) into paragraph 6A Schedule 9, which defines what is meant by a company being in insolvent administrative receivership: that term to mean a case where:-
- an administrative receiver has been appointed (as provided by Chapter 1 or 2 of Part 3 of the Insolvency Act 1986 or Part 4 of the Insolvency (Northern Ireland) Order 1989) – paragraph (a); and
  - the company entered into administrative receivership at a time when it was insolvent, i.e. it could not pay its debts – paragraph (b).

34. Paragraph 4(7) gives the commencement rule. It applies to accounting periods ending on or after 10 December 2003.
35. Paragraph 5(1) of the Schedule inserts a new paragraph 10A into Schedule 9 FA 1996. The new paragraph is the equivalent for loan relationships of paragraph 108 Schedule 29 FA 2002 (intangible fixed assets). It operates where a company either emigrates from the UK or moves an asset or liability held in a UK permanent establishment (“PE”) to another part of the company.
36. New paragraph 10A(1) sets out the circumstances when the new paragraph applies. It applies if either:
- a company ceases to be UK resident (paragraph (a)) (the emigration case), or
  - an asset or liability representing a loan relationship of a non-resident company ceases to be held for the purposes of the company’s PE in the UK without being disposed of. (paragraph (b)) (the PE case).
37. New paragraph 10A(2) provides that in the emigration case, the company is treated as if it had assigned the assets or liabilities for their fair value and then immediately reacquired them. “Fair value” takes its meaning from section 85 FA 1996 – essentially open market value – by virtue of new paragraph 10A(5). This deemed assignment is therefore a related transaction, and any profit or loss on the asset or liability is brought into account as a credit or debit under the provisions of Chapter 2 Part 4 FA 1996.
38. New paragraph 10A(3) provides a let out from the deemed disposal rule for an emigrating company if the asset or liability remains, after emigration, held for the purposes of a PE of the company in the UK. Where that happens, the asset or liability remains within the UK tax charge, and there is no need for a deemed assignment. If the asset subsequently ceases to be held by the PE, paragraph 10A(2) may apply.
39. New paragraph 10A(4) provides that in a PE case, the company is treated as if it had assigned the assets or liabilities (so far as they are treated as ceasing to be held for the PE) for their fair value. The same consequences apply as apply where paragraph 10A(2) applies.
40. Paragraph 5(2) gives the commencement rule. New paragraph 10A applies where the relevant cessation (of residence or being held for the PE) occurs on or after 17 March 2004.
41. Paragraph 6 of the Schedule amends paragraph 18 Schedule 9 (relevant discounted securities issued by close companies). It makes amendments to that paragraph equivalent to those made by paragraph 2 of this Schedule to paragraph 2 Schedule 9 (and cross-refers to that paragraph

for definitions). It also applies to accounting periods ending on or after 10 December 2003.

42. Paragraph 7 of the Schedule amends the “major interest” test in paragraph 20 Schedule 9 FA 1996. The major interest test treats a company as connected with any persons having a major interest in it (essentially 40% or more of the share capital). It was a requirement of paragraph 20 when introduced that both the persons with a major interest had also to make loans to the company before the rules applied. This requirement was being circumvented to prevent a major interest being present, and so the condition is being removed.
43. Paragraph 7(1) is introductory.
44. Paragraph 7(2) omits the condition in paragraph 20(1)(c) that both parties must be creditors of the company. The condition itself is set out in paragraph 20(2), and so that sub-paragraph is removed by Paragraph 7(3).
45. Paragraph 7(4) supplies the commencement rule. The amendments have effect for accounting periods beginning on or after 17 March 2004.

### **BACKGROUND NOTE**

46. The loan relationships legislation was introduced in FA 1996. It was subject of a major review and consultation in 2001 that also looked at the legislation relating to foreign exchange gains and losses and financial instruments. Major changes were made in FA 2002, covering both loan relationships and derivative contracts.
47. A Post Implementation working group consisting of practitioners and Revenue staff has been looking at how those changes are working in practice. A number of technical defects have come to light, and some were addressed in FA 2003. This clause and schedule deal with some which have come to light since then.
48. One of the changes is necessary following the introduction of the Enterprise Act in 2003, to ensure that the rules for charging releases of debt between connected parties do not produce unwarranted tax charges.

## **EXPLANATORY NOTE**

### **CLAUSE 49 AND SCHEDULE 9: DERIVATIVE CONTRACTS: MISCELLANEOUS AMENDMENTS**

#### **SUMMARY**

1. This clause and Schedule make a number of miscellaneous changes to the legislation that deals with derivative contracts. The changes affect:
  - existing powers to amend parts of the derivative contracts legislation;
  - companies that emigrate, or move assets from a permanent establishment;
  - the “unallowable purposes” test; and
  - the measure of the capital element of profits and losses on derivative contracts held by open-ended investment companies.

#### **DETAILS OF THE CLAUSE**

2. The clause is introductory only and provides for the Schedule to have effect.

#### **DETAILS OF THE SCHEDULE**

3. Paragraph 1 of the Schedule is also introductory, and provides for amendments to be made to Schedule 26 to the Finance Act (FA) 2002 (derivative contracts).
4. Paragraph 2 of the Schedule amends paragraph 13 Schedule 26 FA 2002. That paragraph contains a power to make regulations amending Part 2 of Schedule 26 (the main definitional rules) apart from paragraph 13 itself.
5. Paragraph 2(1) amends paragraph 13(2) by inserting a reference to Part 9 Schedule 26 as being a part of the Schedule that may be amended by paragraph 13. Part 9 contains “miscellaneous provisions” and includes some definitional material. The main reason for extending the power is to cater for changes proposed to be made to Schedule 26 by Statutory Instrument to modify the tax treatment of derivative contracts whose underlying subject matter is land.

6. Paragraph 2(3) substitutes a new paragraph 13(4) which allows any order made by the paragraph to have effect for accounting periods current when the Order comes into force.
7. Paragraph 2(4) amends the heading of paragraph 13 to reflect its increased scope.
8. Paragraph 3(1) inserts a new paragraph 22A into Schedule 26. The new paragraph is the equivalent for derivative contracts of paragraph 108 Schedule 29 FA 2002 (intangible fixed assets). It operates where a company either emigrates from the UK or a non UK resident company moves a derivative contract held at a permanent establishment (“PE”) of it in the UK to another part of the company.
9. New paragraph 22A(1) Schedule 26 sets out the circumstances when the new paragraph applies: if either
  - a company ceases to be UK resident (the emigration case) (paragraph (a)); or
  - a derivative contract of a non-resident company ceases to be held for the purposes of the company’s PE in the UK without being disposed of (the PE case) (paragraph (b)).
10. New paragraph 22A(2) Schedule 26 then provides that in the emigration case, the company is treated as if it had assigned its rights and liabilities under the derivative contract for their fair value and then immediately reacquired them. “Fair value” takes its meaning from paragraph 17 Schedule 26 – essentially open market value – by virtue of new paragraph 22A(5). This deemed assignment is therefore a related transaction, and any profit or loss on the derivative contract is brought into account as a credit or debit under the provisions of Schedule 26 FA 2002.
11. New paragraph 22A(3) provides a let out from the deemed disposal rule on an emigrating company if the asset or liability remains, after emigration, held for the purposes of a PE of the company in the UK. Where that happens, the asset or liability remains within the UK tax charge, so there is no need for a deemed assignment. If the asset subsequently ceases to be held by the PE, paragraph 22A(2) may apply.
12. New paragraph 22A(4) then provides that in a PE case, the company is treated as if it had assigned the rights and liabilities under the derivative contract (so far as they are treated as ceasing to be held for the PE) for their fair value. The consequences are the same as where paragraph 22A(2) applies.
13. Paragraph 3(2) gives the commencement rule. New paragraph 22A applies where the relevant cessation (of residence or being held for the PE) occurs on or after 17 March 2004.

**BOARD OF INLAND REVENUE  
RESOLUTION 34**

**FINANCE BILL 2004  
CLAUSE 49  
SCHEDULE 9**

14. Paragraph 4 of the Schedule amends paragraph 23 Schedule 26 (the “unallowable purposes” rule).
15. Paragraph 4(1) amends paragraph 23(7)(b). That sub-paragraph sets out what is meant by “accumulated credits”. The accumulated credits are compared with the accumulated net losses (that is the total debits for previous periods which have an unallowable purpose less the exchange credits which have such a purpose, so far as unused in those periods). Accumulated net losses are deductible only if there is a matching amount of accumulated credits.
16. “Accumulated credits” means the credits apart from exchange credits arising on the derivative contract in question for the period and all previous accounting periods. But it is reduced by any net losses actually allowed in previous periods – see paragraph 23(7)(b).
17. The amendments made by sub-paragraph (1) divide paragraph 23(7)(b) into two parts and insert another amount that reduces the accumulated credits. It is the amount of any debits under the contract which are not tainted by the unallowable purpose and which arise in the period in question or any earlier period. The effect is to reduce the extent to which accumulated net losses may be allowed, and prevents unwarranted relief being given.
18. Paragraph 4(2) supplies the commencement rule. It applies in relation to accounting periods ending on or after 17 March 2004.
19. Paragraph 5 of the Schedule amends paragraph 33 Schedule 26 which gives special rules for dealing with the gains and losses from derivative contracts accruing to open-ended investment companies (OEICs).
20. Paragraph 5(1) omits the words “issued by the Financial Services Authority (FSA)” from paragraph 33(4). The tax treatment of gains and losses of an OEIC depends on their treatment in the relevant Statement of Recommended [Accounting] Practice (SORP). The SORP for OEICs in 2002 was the 2000 SORP issued by FSA. That SORP has been replaced by a new SORP issued by the Investment Managers' Association (IMA). But paragraph 33(4)(b) erroneously refers only to a replacement SORP issued by the FSA. So the offending words are omitted.
21. Paragraph 5(2) provides the commencement rule - accounting periods beginning on or after 1 February 2004 (the date from which the new IMA SORP is effective).

**BACKGROUND NOTE**

22. The derivative contracts legislation was introduced in FA 2002, and is contained in Schedule 26 of that Act. It was introduced following a review of, and consultation on, the reform of the legislation relating to foreign exchange gains and losses, loan relationships and financial instruments.
23. The financial instruments legislation was originally introduced in FA 1994, to bring clarity to the tax treatment of certain types of derivatives, such as interest rate swaps, currency contracts and the like. Following consultation, the range of instruments covered was greatly expanded, and the legislation applying to derivative contracts was re-written to bring it, where possible, into line with the loan relationships legislation.
24. A Post Implementation working group consisting of practitioners and Revenue staff has been looking at how the changes to loan relationships and derivative contracts legislation are working in practice. A number of technical defects have come to light, and some were addressed in FA 2003. This clause and schedule deal with some which have come to light since then.

## **EXPLANATORY NOTE**

### **CLAUSE 50: GENERALLY ACCEPTED ACCOUNTING PRACTICE**

#### **SUMMARY**

1. The clause allows companies and other entities which choose to adopt International Accounting Standards (IAS) to draw up their accounts to use those accounts for tax purposes. Currently tax legislation only allows accounts drawn up using UK Generally Accepted Accountancy Practice (UK GAAP) to form the basis of a tax computation. The clause applies for periods beginning on or after 1 January 2005.

#### **DETAILS OF THE CLAUSE**

2. Subsection (1) defines the phrase “generally accepted accounting practice” (GAAP) for the Tax Acts, replacing the definition in section 836A Income & Corporation Taxes Act 1988 (ICTA). It provides that, in relation to a company or entity using IAS to draw up its accounts, it means GAAP with respect to IAS accounts, and in any other case it means UK GAAP. Therefore it can mean either IAS or UK GAAP depending on which standards are used by a company.
3. Subsection (2) defines “international accounting standards” as having the same meaning as in the EC Regulation 1606/2002 which says:-

“...‘international accounting standards’ shall mean International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related Interpretations (SIC-IFRIC interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB).”

But this is limited to those IAS which the European Commission has adopted in accordance with Article 3 of the Regulation. Not all current standards are yet approved but this subsection allows them to form part of the IAS approved for UK tax as they are adopted.

4. Subsection (3) covers the possibility of Standards not being adopted by the Commission, and, in particular, the possibility that IAS 32 and IAS 39 (Financial Instruments) will not have been adopted in time for the

commencement of the clause. It allows a company that is using IAS to draw up its accounts to take one of two courses of action in relation to the matters covered by an unadopted standard. They are either to use the unadopted standard, or to follow UK GAAP. It is relevant to note here that on 25 March 2004 the Accounting Standards Board issued a consultative paper in which they proposed that IAS 39 (with some modifications) should form the basis for a UK standard, applicable in mandatory terms to listed companies and optional for others for 2005.

5. Subsection (4) defines UK GAAP, using the existing wording of section 836A ICTA.
6. Subsection (5) provides for the amendment of the entry in section 832(1) ICTA (general interpretation section for the Tax Acts) relating to GAAP and the insertion of new entries relating to UK GAAP and IAS.
7. Subsection (6) gives the starting date from which this clause applies – accounting periods beginning on or after 1 January 2005. But if a company has changed its accounting date by virtue of section 223 Companies Act 1985, the new rules apply from the start of a period advanced from after 31 December 2004.

### **BACKGROUND NOTE**

8. In 2002 the European Union approved a Regulation (having direct effect in member states) that requires the consolidated (group) accounts of listed (on a stock exchange) companies to be drawn up using IAS from 2005. These consolidated accounts are not used for tax purposes.
9. In August 2003 the DTI announced that the UK would take up an option in the Regulation to permit, but not require, all UK companies to use IAS to draw up their accounts, also from 2005.
10. IAS differ from UK GAAP in a number of specific areas. Legislation appears elsewhere in the Bill to allow companies and other entities which choose to use IAS to receive broadly the same tax treatment as those using UK GAAP.

## **EXPLANATORY NOTE**

### **CLAUSE 51: USE OF DIFFERENT ACCOUNTING PRACTICES WITHIN A GROUP OF COMPANIES**

#### **SUMMARY**

1. This clause prevents companies within the same group from gaining a tax advantage through the use of International Accounting Standards (IAS) by one company and UK Generally Accepted Accounting Practice (UK GAAP) by the other in relation to the same transaction.

#### **DETAILS OF THE CLAUSE**

2. Subsection (1) sets out the case. It is where one company in a group (defined in subsection (3) by reference to section 170 Taxation of Chargeable Gains Act 1992 (TCGA) - broadly a parent and its 75% subsidiaries) uses IAS and enters into a transaction (or series of transactions) with another company in the same group which uses UK GAAP. But the clause only applies where a tax advantage is obtained by the use of different accounting standards.
3. Subsection (2) is the operative rule. In the subsection (1) case, the tax effects of the transactions are determined by reference to UK GAAP in both companies.
4. Subsection (4) glosses the term “series of transactions”. It has here the same meaning as in Schedule 28AA Income & Corporation Taxes Act 1988 (ICTA) - transfer pricing. The two companies mentioned in paragraph 2 above do not have to be parties to all the transactions in the series, nor to the same transactions.
5. Subsection (5) defines “tax advantage” by reference to the well known definition in section 709 ICTA (transactions in securities).
6. Subsection (6) gives the starting date for this clause - accounting periods beginning on or after 1 January 2005. But if a company has changed its accounting date in accordance with section 223 Companies Act 1985, the new rules apply from the start of a period advanced from after 31 December 2004.

**BACKGROUND NOTE**

7. In 2002 the European Union approved a Regulation (having direct effect in member states) that requires the consolidated (group) accounts of listed (on a stock exchange) companies to be drawn up using IAS from 2005. These consolidated accounts are not used for tax purposes.
8. In August 2003 the Department of Trade and Industry (DTI) announced that the UK would take up an option in the Regulation to permit, but not require, all UK companies to use IAS to draw up their accounts, also from 2005.
9. The DTI is currently consulting on implementing changes to the Companies Act 1985 to permit companies to choose whether to switch to IAS (Modernisation of Accounting Directives/IAS Infrastructure – A Consultation Document – March 2004)
10. The proposed amendments to the 1985 Act set out a mechanism for companies to choose IAS, provide that companies that make this choice are able to reverse it only in limited circumstances, and require parent companies to ensure consistency of choice within the group unless there are good reasons against it.
11. Because individual companies within the group will still be able to prepare accounts using either standard if there are good reasons for doing so, this clause is therefore required to ensure that the element of choice of accounting standard does not allow a company to obtain a tax advantage.

## **EXPLANATORY NOTE**

### **CLAUSE 52 AND SCHEDULE 10: AMENDMENT OF ENACTMENTS REFERRING TO ACCOUNTING PRACTICE**

#### **SUMMARY**

1. This clause and Schedule make a number of detailed changes to the legislation relating to loan relationships, derivative contracts and intangible fixed assets. They adapt the legislation in the light of new accounting concepts and definitions used in International Accounting Standards.

#### **DETAILS OF THE CLAUSE**

2. Subsection (1) simply introduces Schedule 10.
3. Subsection (2) lists the 4 parts of the Schedule and their subject matter:
  - Part 1 covers amendments to the loan relationships legislation in Chapter 2 Part 4 Finance Act (“FA”) 1996
  - Part 2 covers amendments to the derivative contracts legislation in Schedule 26 FA 2002
  - Part 3 covers amendments to the intangible fixed assets legislation in Schedule 29 to that Act
  - Part 4 covers amendments to the currency accounting rules in FA 1993
4. Subsection (3) gives the starting date for the clause and Schedule – accounting periods beginning on or after 1 January 2005. But if a company has changed its accounting date in accordance with section 223 Companies Act 1985 the new rules apply from the start of a period advanced from after 31 December 2004.

#### **DETAILS OF THE SCHEDULE**

##### *Part 1*

5. Part 1 Schedule 10 covers amendments to the loan relationships rules in Chapter 2 Part 4 FA 1996. The main purpose of the amendments is to modernise the language of the Chapter to reflect the use of International

Accounting Standards (“IAS”) and of revisions likely to be made to UK Generally Accepted Accounting Practice (“GAAP”).

6. In particular, because IAS and expected revised UK GAAP provide for the first time a comprehensive set of standards for financial instruments (in current UK GAAP there is only a standard – Financial Reporting Standard (“FRS”) 4 - for issuers) the need for the concept of “authorised accounting methods”, as set out in section 85 FA 1996, substantially recedes. That concept is not used for example in the intangible fixed assets legislation in Schedule 29 FA 2002 where there exists a comprehensive accounting standard - FRS 10 which is applied directly.
7. Accordingly the Chapter will now take the credits and debits that form the building blocks of the profits and losses to be taxed and allowed directly from the use of GAAP, whether IAS or UK GAAP (see Notes on clause 50).
8. Paragraph 1 amends section 84 FA 1996, the main rule providing for debits and credits to be brought into account – paragraph 1(1). It omits references to an authorised accounting method from section 84(1) – paragraph 1(2) - and repeals section 84(4A) – paragraph 1(3) - which dealt with amounts which could not be directly attributed to either of the two authorised accounting methods and is no longer needed in the absence of the concept of authorised accounting methods.
9. Paragraph 1(3) also omits section 84(2) as its function is now performed by new section 85B.
10. Paragraph 1(4) amends section 84(7) to introduce Schedule 9 FA 1996 as giving further provisions rather than just computational provisions as before. This reflects some recent additions to that Schedule which are not computational.
11. Paragraph 2 amends section 84A FA 1996 (exchange gains and losses) – paragraph 2(1).
12. Paragraph 2(2) replaces section 84A(3) with two new subsections.
13. New section 84A(3) recasts the previous section 84(3)(a) to (c) and (4) to (7) in a simpler way. It now only requires that the exchange gains arise from an asset, liability or the translation of a “branch” operation and is reflected in the statement of recognised gains & losses (“STRGL”) – the UK GAAP term used in FRS 3 – or the statement of changes in equity – the IAS equivalent term used in IAS 8.
14. New section 84A(3A) replaces section 84A(3)(d), allowing the Treasury to prescribe other cases where exchange gains and losses are disregarded. This power will be used to prescribe exchange gains and losses on liabilities to finance share etc acquisitions where the cover method in paragraph 51 Statement of Standard Accounting Practice

(“SSAP”) 20 cannot be used because the company uses IAS. It will also be used to prescribe gains and losses arising where a company has a functional currency which is not sterling and a presentation currency which is.

15. Paragraph 2(3) omits section 84A(4) to (7) which are replaced by new section 84A(3) and (3A). Paragraph 2(4) and (5) makes some other consequential amendments, and allows the regulatory power to be subject to an election.
16. Paragraph 3 inserts new sections 85A and 85B FA 1996 which replace both section 85 and 86 FA 1996, as well as section 84(2).
17. New section 85A(1) provides the general rule that amounts to be brought into account are those that are recognised in determining profit or loss in accordance with GAAP. This is subject still to the requirement that the credits and debits must fairly represent the profits and losses made.
18. New section 85A(2) provides that if accounts are not drawn up in accordance with GAAP then the Chapter applies as if they were. This rule duplicates the requirement currently in section 42 FA 1998 and section 836A ICTA so far as trading transactions re concerned, but imposes the requirement for non-trading transactions as well. This rule mirrors that in paragraph 5(1) Schedule 29 FA 2002 (intangibles).
19. New section 85A(3) ensures that the rule in section 85A(2) applies continuously over a period of years. This rule mirrors that in paragraph 5(2) Schedule 29 FA 2002 (intangibles).
20. New section 85A(4) says that section 85A(2) and (3) also apply where there are no accounts. This rule mirrors that in paragraph 5(3) Schedule 29 FA 2002 (intangibles).
21. New section 85B(1) expands on the meaning of “recognised in determining profit or loss” in section 85A(1). As well as the profit and loss account, it includes the STRGL in UK GAAP and a statement of changes in equity in IAS, as well as any other similar statement such as a “revenue account”. This rule mirrors that in paragraph 134 Schedule 29 FA 2002 (intangibles) which is also amended – see Part 3.
22. New section 85B(2) limits the meaning of recognised where a statement of changes in equity includes “fundamental errors”. Such errors are not included in a prior period adjustment under UK GAAP. Where such errors arise, the usual approach for tax purposes is to require a recalculation of the profits for the period in which the error occurred, with interest and penalties (if appropriate) being sought.
23. New section 85B(3)(a) allows the Treasury to make regulations allowing amounts to be disregarded despite the fact that they have been recognised in computing profit or loss. This will be used for example to

disregard certain profits or losses on “held to maturity” assets which are recharacterised as “available for sale”. New section 85B(3)(b) also allows regulations to be made to deal with the bringing into account of amounts which are disregarded by any regulations made under subsection (3)(a).

24. New section 85B(4) allows regulations to be made to prevent gains and losses being brought in a second time when they are “recycled” from a statement of changes in equity to profit and loss account in accordance with IAS 39
25. New section 85B(5) allows the regulations to make different provisions for different cases and to be subject to election or other prescribed conditions.
26. New section 85B(6) makes it clear that the regulations under this section do not apply to exchange gains and losses (as section 84A contains the power to make regulations there)
27. Paragraph 4 amends section 87 FA 1996 (rule for use of accounting method where the parties have a connection)
28. Section 87(2) is replaced by a new version, but to the same effect. It requires companies which hold an asset or owe a liability representing a loan relationship and which are connected with each other, or where one has a major interest in the other, to depart from the accounting basis used in their accounts in accordance with GAAP where that basis is a fair value basis of accounting. They must instead compute the credits and debits for tax purposes as if an amortised cost basis of accounting had been used. “Fair value basis of accounting” and “amortised cost basis of accounting” are defined in section 103 FA 1996 – see paragraph 52 below. They effectively replace the authorised accruals method and the authorised mark to market method.
29. Section 87A(2A) and (2B) are new, and replace section 90 FA 1996. They apply where there is a requirement in Chapter 2 to follow section 87(2) and depart from the accounting basis actually used, or to resume following such a basis after a departure. For example, if a company makes a loan to another (unconnected) company and used fair value accounting in period 1, but becomes connected so that section 87(2) applies to require tax to be computed as if an amortised cost basis applied, there will often be a difference between the fair value at the end of period 1 and the amortised cost at the beginning of period 2. Section 87(2A) and (2B) ensure that these differences are brought into account in the later period.
30. Paragraph 5 omits references to an authorised mark to market method in section 88 FA 1996.

31. Paragraph 6 modifies section 88A FA 1996 (reset bonds) along the same lines as the amendment to section 87(2) but in this case requiring a fair value basis of accounting to be used for tax purposes – paragraph 6(2). Paragraph 6(3) omits section 88A(5) as no longer necessary in the light of.....
32. ....Paragraph 7, which repeals section 90 FA 1996, as its function is now taken over by section 87(2A) and (2B).
33. Paragraph 8 inserts a new section 90A FA 1996. This deals with the case where by virtue of regulations made under section 85B(3) fair value gains and losses are disregarded on assets previously dealt with on an amortised cost basis of accounting. Section 90A allows regulations to be made requiring the debits or credits to be brought into account on an amortised cost basis of accounting
34. Paragraph 9(1) repeals section 92 FA 1996 (convertible securities). Paragraph 9(2) and (3) are the transitional rules. At the end of the last accounting period to begin before 1 January 2005, there is a deemed disposal by virtue of section 92(7). The gain or loss on that deemed disposal is then brought into account as a chargeable gain or allowable loss on the disposal of the asset.
35. Paragraph 10 introduces a new section 92A FA 1996 (convertible securities of issuer) to replace the existing section.
36. New section 92A(1) replicates the existing section 92A(1) but extends it to cover mandatorily convertible securities.
37. New section 92A(2) provides that amounts to be brought into account by the issuer are interest, exchange gains and losses and releases only. This reverses the existing section 92A(2) and (3) which states what amounts are not brought into account.
38. New section 92A(3) disapplies the restriction in subsection (2) where the issuer is a bank or securities house and where the security is issued in the ordinary course of a banking or securities business. This may be the case particularly where the security is used in derivatives trading.
39. New section 92A(4) defines “securities house” to have the same meaning as that term has in section 349(5) and (6) ICTA.
40. Paragraph 11 repeals sections 93, 93A and 93B FA 1996 (asset linked securities). Paragraph 11(2) and (3) are the transitional rules. At the end of the last accounting period to begin before 1 January 2005, there is a deemed disposal by virtue of section 93B. The gain or loss on that deemed disposal is then brought into account as a chargeable gain or allowable loss on the disposal of the asset.
41. Paragraph 12 omits section 94 FA 1996 (indexed-linked gilts)

42. Paragraph 13 inserts a new section 94A FA 1996. This replaces sections 92 to 94.
43. New section 94A(1) provides the case. It is where a company is permitted or required in accordance with GAAP to split or bifurcate an asset into two or more parts, one of which, the host contract, has the rights and liabilities of a debt security or loan relationship, and the other(s), embedded derivatives, of a derivative financial instrument. This form of accounting for hybrid instruments is required by IAS 32 and 39 and will be required for disclosure purposes and for certain companies for measurement purposes under UK GAAP if the ASB's convergence proposals are implemented. So all companies holding hybrid instruments will be required to bifurcate them for tax purposes.
44. New section 94A(2) sets out the tax treatment. The host contract will be fully within Chapter 2 Part 4 FA 1996 as if it was a loan relationship – section 94A(2)(a). The embedded derivatives will be taxed under Schedule 26 FA 2002 as if they were derivative contracts.
45. New section 94A(3) provides that the embedded derivatives are treated as having the character of the particular relevant contract (future, option or contract for differences) which the rights and liabilities of the embedded derivative have.
46. It is intended to make regulations under paragraph 13 Schedule 26 FA 2002 (as amended by paragraph 2 Schedule 9 to the Bill) to give to embedded derivatives the tax treatment that is currently given by section 92, 93 and 94 FA 1996; that is, to treat value increases and decreases as chargeable gains and allowable losses (section 92 and 93 assets) or as exempt (section 94).
47. Paragraph 14 amends section 95 FA 1996 (gilt strips) to remove references to an authorised accruals basis of accounting
48. Paragraph 15 deletes section 96(3) FA 1996 – certain gilt-edged securities. This also refers to an authorised accruals method being used to determine the amounts of interest. This is no longer necessary.
49. Paragraph 16 amends section 101 FA 1996 (priority between loan relationships and derivative contracts rules). It ensures, inserting a new section 101(1A) that the section 94A bifurcation rules are not affected by section 101 which generally gives priority to Chapter 2 Part 4 FA 1996.
50. Paragraph 17(1) provides for the amendment of section 103 FA 1996 – the interpretative section for the Chapter.
51. Paragraph 17(2)(a) and (c) omits definitions that are no longer used.

52. Paragraph 17(2)(b) inserts definitions covering the new terms for accounting bases. “Amortised cost basis of accounting” is defined along the lines of the definition in IAS 39. It makes it clear that the amortised cost of an asset or liability is the figure that starts with the actual cost (whether on issue or acquisition) and progresses towards the maturity amount by way of amortisation of the premium or discount (whether original issue or market). It also reflects the fact that the cost is reduced by any repayments or releases of principal and by the amount of any impairment of the asset or liability, e.g. by way of allowance for bad or doubtful debts.
53. “Fair value” has the same meaning as it has already as given by section 85(6) FA 1996 which is repealed. “Fair value accounting” is given a corresponding meaning.
54. “Impairment” when used in the Chapter includes uncollectability, and “impairment loss” is the new term for a debit for a bad or doubtful debt.
55. Paragraph 17(3) omits the definition of “ecu” in section 103(5) as no longer needed as a result of the introduction of the Euro.
56. Paragraph 18 introduces the amendments to Schedule 9 to FA 1996.
57. Paragraph 19 substitutes “amortised cost basis of accounting” for “authorised accruals method” in paragraph 3 Schedule 9 FA 1996 (options)
58. Paragraph 20(1) provides for the amendment of paragraph 5 Schedule 9. That Schedule deals firstly with bad and doubtful debts generally, including releases, from the point of view of the creditor – paragraph 5(1) to (2A). It also deals with releases from the point of view of the debtor, but only where there is a connection between the parties – paragraph 5(3) in the current version, but also in paragraph 5(4) to 5(7) inserted by Schedule 8 to the Finance Bill.
59. With impairment being a feature of the definition of “amortised cost basis of accounting” in section 103, there is no need to refer to it again in a computational paragraph. Accordingly paragraph 5(1) to (2A) is repealed by paragraph 20(3).
60. That leaves paragraph 5 dealing only with releases, and paragraph 20(4) and (5) accordingly amends those parts of paragraph 5(3) to (7) which refer to section 87(2) FA 1996 in terms of requiring the use of an authorised accruals method, and instead provides that the condition is that section 87(2) (the new version) applies. Paragraph 20(2) then amends the heading to reflect the fact that paragraph 5 Schedule 9 now only deals with releases.
61. Paragraph 21 makes a number of straightforward amendments to paragraph 5A Schedule 9 FA 1996 which deals with the relationship

between consortium group relief and bad debts. With paragraph 5(1) Schedule 9 disappearing, the references in paragraph 5A to “paragraph 5(1) debits” or similar (or in colloquial but not entirely accurate parlance “bad debt relief”) are no longer appropriate, and are replaced by references to “bad debt losses”

- in paragraph 5A(2) – made by paragraph 21(3)
- in paragraph 5A(5)(a) and (8)(b) - made by paragraph 21(4)
- in paragraph 5A(15) – made by paragraph 21(8)

62. Similarly, the references in paragraph 5A to “paragraph 5(2)” are no longer appropriate, and are repealed – paragraph 21(5) and (9).
63. Paragraph 21(6) corrects a typographical error in paragraph 5A(14) Schedule 5A, and paragraph 21(7) corrects an incorrect reference to the provision governing releases.
64. Paragraph 21(2) then amends the heading to reflect the fact that paragraph 5A Schedule 9 deals with “impairment losses”, and no longer with “bad debts”.
65. Paragraph 22 covers amendments to paragraph 6 Schedule 9 , which restricts “bad debt relief” where the parties have a connection. Paragraph 22(1) is introductory.
66. Paragraph 22(3) amends paragraph 6(1) which refers to the meaning of section 87(2) FA 1996 parenthetically in terms of requiring the use of an authorised accruals method. It provides instead that the description refers only to the use of an accounting method where person are connected. Paragraph 22(4) also amends paragraph 6(2) which refers back to the authorised accruals method by omitting any reference to an accounting method.
67. Paragraph 22(5) rewrites paragraph 6(3) which sets out the cases where the general rule that no bad debt loss is possible in a connected person case does not apply, and paragraph 22(6) inserts a new paragraph 6(3A) which establishes that no reversal of any impairment or bad debt loss is brought into account.
68. Paragraph 22(7) rewrites paragraph 6(4) to reflect the new concepts.
69. Paragraph 22(2) then amends the heading to reflect the fact that paragraph 6 Schedule 9 deals with “impairment losses”, and no longer with “bad debts”.
70. Paragraph 23(1) provides for the amendment of paragraph 6A Schedule 9 (insolvencies etc). Paragraph 23(3) amends paragraph 6A(2) to reflect the rewriting of paragraph 6(3) made by paragraph 21(4).

**BOARD OF INLAND REVENUE  
RESOLUTION 35**

**FINANCE BILL 2004  
CLAUSE 52  
SCHEDULE 10**

71. Paragraph 23(2) then amends the heading to reflect the fact that paragraph 6A Schedule 9 deals with “impairment losses”, and no longer with “bad debts”.
72. Paragraph 24 amends paragraph 6B Schedule 9 (companies becoming connected). Paragraph 24(1) is introductory.
73. Paragraph 24(3), (4)(a) and (6) restructure paragraph 6B by dividing it up into two clear cases. Paragraph 24(4)(b), (5) and (7) modify paragraph 6B(2)(a), (3) and (7) to reflect the new concepts.
74. Paragraph 24(2) then amends the heading to reflect the fact that paragraph 6B Schedule 9 deals with “impairment losses”, and no longer with “bad debts”.
75. Paragraph 25 amends paragraph 6C (companies ceasing to be connected). Paragraph 25(1) is introductory. Paragraph 25(2) to (4) modify paragraph 6C(1) and (2) and the heading to the paragraph to reflect the new concepts.
76. Paragraph 26 amends paragraph 8 Schedule 9 (sovereign debt). Budget Note 25 issued on 17 March 2004 says that paragraph 8 would not be amended pending a review of the applicability of the sovereign debt rules. But to guard against the possibility that that review might conclude that no change is needed, or that the change should be made later, paragraph 8 is being amended.
77. Paragraph 26 therefore rewrites paragraph 8(1) and (2) to reflect the new language of “impairment” and “fair value accounting”. Paragraph 27(1) provides for paragraph 9 to be amended.
78. Paragraph 27(2) rewrites paragraph 9(1)(a) and (b) to reflect the new language of “impairment”. Paragraph 27(3) amends paragraph 9(2) to reflect the new provisions.
79. Paragraph 28 amends paragraph 10 Schedule 9 (loss importation). It rewrites paragraph 10(1) to reflect the new concepts, and in particular provides that the paragraph does not apply where fair value accounting is used
80. Paragraph 29 repeals paragraph 10A(5) Schedule 9. That paragraph defines fair value, and is not needed for accounting periods beginning on or after 1 January 2005 as the definition is placed in section 103 FA 1996 and is therefore of general application in the Chapter.
81. Paragraph 30 amends paragraph 11 Schedule 9 (non arm’s length transactions not involving groups of companies). Paragraph 30(1) is introductory.

**BOARD OF INLAND REVENUE  
RESOLUTION 35**

**FINANCE BILL 2004  
CLAUSE 52  
SCHEDULE 10**

82. Paragraph 30(2) rewrites paragraph 11(1), dividing it into two – sub-paragraphs (1) and (1A) - to reflect the new concepts.
83. Paragraph 30(3) amends other sub-paragraphs of paragraph 11 to reflect the new sub-paragraph (1A).
84. Paragraph 31 amends paragraph 12(2A) Schedule 9 (tax neutral transfers between group members). It changes a reference to an authorised mark to market method so it becomes a reference to a fair value basis of accounting, and omits reference to section 90 which is repealed.
85. Paragraph 32 amends paragraph 13 Schedule 9 (unallowable purposes) and paragraph 34 amends paragraph 16(2) Schedule 9 (imputed interest) to remove the unnecessary references to authorised accounting methods.
86. Paragraph 33 amends paragraph 14 Schedule 9 (capital expenditure). Paragraph 33(1) is introductory.
87. Paragraph 33(2) omits the reference to authorised accounting methods in paragraph 14(1).
88. Paragraph 33(3) introduces a new paragraph 14(4) which gives a “no second bite of the cherry” rule, similar to that in paragraph 8(4) Schedule 29 FA 2002.
89. Paragraph 35 amends paragraph 19 Schedule 9 (partnerships). Paragraph 35(1) is introductory.
90. Paragraph 35(2) repeals paragraph 19(10), while paragraph 35(3) amends paragraph 19(11). This now requires companies with interests in partnerships which are fair valued to follow fair value accounting for their share of the partnership profits, and replaces the references to “mark to market”.
91. Paragraph 35(4) updates the reference to a reserve in paragraph 19(12), replacing it by a reference to the STRGL or statement of changes in equity.
92. Paragraph 36 inserts a new paragraph 19A into Schedule 9. It deals with changes of accounting approach, where the change is from UK GAAP to IAS or vice versa. These changes cannot safely be left to section 85B as there is no guarantee that under International Financial Reporting Standard (IFRS) 1 (First time application of IAS) that a full prior period adjustment will be recorded in the right period in a statement of changes in equity.
93. New paragraph 19A(1) provides the case. It is where there is a relevant change of accounting approach between one period of account and the next. This wording follows that in section 64 FA 2002.

94. New paragraph 19A(2) says what a “relevant” change is-
  - either where IAS is used in the later period, but UK GAAP in the earlier, or
  - where UK GAAP is used in the later period but IAS in the earlier.
95. New paragraph 19A(3) is the operative rule. Where the change is a relevant change the difference between the closing accounting value in the first period and the opening value in the second is treated as a credit or debit (as the case may be) brought into account in the second period.
96. New paragraph 19A(4) defines “accounting value” as the carrying value for accounting purposes.
97. New paragraph 19A(5) provides that the paragraph does not apply if the credits or debits given by paragraph 19A(3) would fall to be brought into account under the provisions of the rest of Chapter 2 Part 4 FA 1996. New paragraph 19A(6) prevents Schedule 22 FA 2002 from also operating where the paragraph applies.
98. Paragraph 36 also inserts a new paragraph 19B into Schedule 9 providing for regulations to be made dealing with a change of accounting basis. New paragraph 19B(1) sets out the case where the paragraph may apply. It is where there is a change of accounting policy from one period to the next affecting a company’s loan relationships.
99. New paragraph 19B(2) allows regulations to be made disregarding the credits and debits that would otherwise be brought into account entirely, or to a limited extent, or to spread or defer their recognition. This may apply in particular to the amounts found by new paragraph 19A – new paragraph 19B(3).
100. New paragraph 19B(4) allows the regulations to make different provisions for different cases and to be subject to election or other prescribed conditions.
101. Paragraphs 37 to 41 amend Schedule 10 FA 1996 (collective investment schemes). Paragraph 37 is introductory.
102. Paragraph 38 substitutes a new paragraph 1A Schedule 10 (investment trusts - ITCs).
103. New paragraph 1A(1) now follows the same approach as for authorised unit trusts and simply provide for capital profits, gains and losses to be left out of account for tax purposes.
104. New paragraph 1A(2) signposts definitions of capital profits, gains and losses. If the ITC uses UK GAAP then sub-paragraphs (3) and (4) apply. If it uses IAS, then the meaning is that given by Treasury Order. This reflects that the accounting for ITCs under IAS is still undecided.

105. New paragraph 1A(3) and (4) reproduce the previous rules about following the ITC Statement of Recognised Practice (SORP) in old paragraph 1A(3).
106. Paragraph 38 also substitutes a new paragraph 1B Schedule 10 (venture capital trusts - VCTs).
107. New paragraph 1B(1) follows the same approach as for ITCs.
108. New paragraph 1B(2) signposts definitions of capital profits, gains and losses. If the VCT uses UK GAAP, then sub-paragraphs (3) and (4) apply. If it uses IAS, then the meaning is that given by Treasury Order. This reflects that the accounting for VCTs under IAS is still undecided.
109. New paragraph 1B(3) and (4) reproduce the previous rules about following the ITC Statement of Recognised Practice (SORP) in old paragraph 1A(2).
110. Paragraph 39 amends paragraph 2A Schedule 10 (Authorised unit trusts - AUTs). Paragraph 39(1) is introductory.
111. Paragraph 39(3) omits references to section 84(2)(b) FSA 1996 which is repealed.
112. Paragraph 39(4) inserts a new paragraph 2A(1A) Schedule 10. Paragraph 2A(1A)(a) applies the existing sub-paragraphs (2) to (4) where the AUT uses UK GAAP. If it uses IAS, then the meaning is that given by Treasury Order – paragraph 2A(1A)(b). This reflects that the accounting for AUTs under IAS is still undecided.
113. Paragraph 39(5) and (6) make consequential amendments
114. Paragraph 39(2) then amends the heading.
115. Paragraph 40 amends paragraph 2B Schedule 10 (Open-ended investment companies – OEICs). Paragraph 40(1) is introductory.
116. Paragraph 40(3) omits references to section 84(2)(b) FSA 1996 which is repealed.
117. Paragraph 40(4) inserts a new paragraph 2B(1A) Schedule 10. Paragraph 2A(1A)(a) applies the existing sub-paragraphs (2) to (4) where the OEIC uses UK GAAP. If it uses IAS, then the meaning is that given by Treasury Order – paragraph 2B(1A)(b). This reflects that the accounting for OEICs under IAS is still undecided.
118. Paragraph 40(5) and (6) makes consequential amendments
119. Paragraph 40(2) then amends the heading.

120. Paragraph 41(1) provides for amendments to paragraph 4 Schedule 10 FA 1996 (holdings in certain bond funds treated as loan relationships)
121. Paragraph 41(2) replaces the existing paragraph 4(3). It now requires companies which hold a relevant interest to depart from the accounting basis used in their accounts in accordance with GAAP where that basis is an amortised cost basis of accounting. They must instead compute the credits and debits for tax purposes as if a fair value basis of accounting had been used. Paragraph 41(3) makes a consequential change to paragraph 4(4).
122. Paragraph 42 provides for the amendment of paragraph 1 Schedule 11 (life insurance companies). It omits the reference in paragraph 1(1A) of that Schedule to sections 92 and 93 FA 1996 which are repealed.
123. Paragraph 43 amends section 440(2A) ICTA. This section deals with transfers of assets representing loan relationships between different categories of life assurance business. It replaces references to authorised accounting methods by a simple reference to Chapter 2.
124. Paragraph 44 amends section 730A (price differential in repos) by removing the reference to an authorised accruals method in section 730A(6). The question of bases of accounting for repos is now left to be answered by reference to GAAP.
125. Paragraph 45 updates the language in certain paragraphs of Schedule 28A ICTA (loss buying)
126. Paragraph 46 amends paragraph 7(3) Schedule 26 Transport Act 2000 to update the language.

*Part 2*

127. Part 2 Schedule 10 covers amendments to the derivative contracts rules in Schedule 26 FA 2002. The main purpose of the amendments is to modernise the language of the Chapter to reflect the use of International Accounting Standards and of revisions likely to be made to UK Generally Accepted Accounting Practice.
128. In particular, because IAS and expected revised UK GAAP provide for the first time a comprehensive set of measurement standards for derivative financial instruments, the need for the concept of “authorised accounting methods”, as set out in paragraph 17 Schedule 26 FA 2002, substantially recedes.
129. Accordingly the Schedule will now take the credits and debits that form the building blocks of the profits and losses to be taxed and allowed directly from the use of GAAP, whether IAS or UK GAAP (see Notes on clause 49).

130. Paragraph 47 amends paragraph 15 Schedule 26, the main rule providing for debits and credits to be brought into account – paragraph 47(1). It omits references to an authorised accounting method from paragraph 15(1) – paragraph 47(2) - and repeals paragraph 15(6) – paragraph 47(3) - which dealt with amounts which could not be directly attributed to either of the two authorised accounting methods and is no longer needed in the absence of the concept of authorised accounting methods.
131. Paragraph 47(3) also omits paragraph 15(2) and (3) as their function is now performed by new paragraph 17B.
132. Paragraph 47(4) amends paragraph 15(9) so that the paragraph has effect subject to more than just paragraph 16.
133. Paragraph 48 amends paragraph 16 Schedule 26 (exchange gains and losses) – paragraph 48(1).
134. Paragraph 48(2) replaces paragraph 16(3) with two new subsections.
135. New paragraph 16(3) recasts the previous paragraph 16(3)(a) and (b) and (4) to (7) in a simpler way. It now only requires that the exchange gains arise from a currency contract or the translation of a “branch” operation and is reflected in the STRGL or the statement of changes in equity.
136. New paragraph 16(3A) replaces paragraph 16(3)(c), allowing the Treasury to prescribe other cases where exchange gains and losses are disregarded. This power will be used to prescribe exchange gains and losses on liabilities to finance share etc acquisitions where the cover method in paragraph 51 of SSAP 20 cannot be used because the company uses IAS. It will also be used to prescribe gains and losses arising where a company has a functional currency which is not sterling and a presentation currency which is.
137. Paragraph 48(3) omits paragraph 16(4) to (7) which are replaced by new paragraph 16(3) and (3A). Paragraph 48(4) and (5) makes some other consequential amendments, and allow the regulation making power to be subject to an election.
138. Paragraph 49 gives a new heading to Part 4 of Schedule 26
139. Paragraph 50 inserts new paragraphs 17A and 17B Schedule 26 which replace paragraphs 17 to 20 as well as paragraph 15(2).
140. New paragraph 17A(1) provides the general rule that amounts to be brought into account are those that are recognised in determining profit or loss in accordance with GAAP. This is subject still to the requirement that the credits and debits must fairly represent the profits and losses made.

141. New paragraph 17A(2) provides that if accounts are not drawn up in accordance with GAAP then the Chapter applies as if they were. This rule duplicates the requirement currently in section 42 FA 1998 and section 836A ICTA so far as trading transactions re concerned, but imposes the requirement for non-trading transactions as well. This rule mirrors that in paragraph 5(1) Schedule 29 FA 2002 (intangibles).
142. New paragraph 17A(3) ensures that the rule in paragraph 17A(2) applies continuously over a period of years. This rule mirrors that in paragraph 5(2) Schedule 29 FA 2002 (intangibles).
143. New paragraph 17A(4) says that paragraph 17A(2) and (3) also apply where there are no accounts. This rule mirrors that in paragraph 5(3) Schedule 29 FA 2002 (intangibles).
144. New paragraph 17B(1) expands on the meaning of “recognised in determining profit or loss” in paragraph 17A(1). As well as the profit and loss account, it includes the STRGL in UK GAAP and a statement of changes in equity (IAS) as well as any other similar statement such as a “revenue account”. This rule mirrors that in paragraph 134 Schedule 29 FA 2002 (intangibles) which is also amended – see Part 3.
145. New paragraph 17B(2) limits the meaning of recognised where a statement of changes in equity includes “fundamental errors”. Such errors are not included in a prior period adjustment under UK GAAP. Where such errors arise, the usual approach for tax purposes is to require a recalculation of the profits for the period in which the error occur, with interest and penalties (if appropriate) being sought.
146. New paragraph 17B(3)(a) allows the Treasury to make regulations allowing amounts to be disregarded despite the fact that they have been recognised in computing profit or loss. This will be used to disregard certain profits or losses on interest rate contracts and commodity contracts. New paragraph 17B(3)(b) also allows regulations to be made to deal with the bringing into account of amounts which are disregarded by any regulations made under paragraph (3)(a).
147. New paragraph 17B(4) allows regulations to be made to prevent gains and losses being brought in a second time when they are “recycled” from a statement of changes in equity to profits and loss account in accordance with IAS 39
148. New paragraph 17B(5) allows the regulations to make different provisions for different cases and to be subject to election or other prescribed conditions.
149. New paragraph 17B(6) makes it clear that the regulations under this section do not apply to exchange gains and losses (as paragraph 16 contains the power to make regulations there)

**BOARD OF INLAND REVENUE  
RESOLUTION 35**

**FINANCE BILL 2004  
CLAUSE 52  
SCHEDULE 10**

150. Paragraph 51 amends paragraph 21 (basis of accounting for certain derivative contracts). Paragraph 21(2) is replaced by a new version, but to the same effect. It requires companies which hold derivative contracts to which paragraphs 6, 7 or 8 Schedule 26 apply to depart from the accounting basis used in their accounts in accordance with GAAP where that basis is not a fair value basis of accounting. They must instead compute the credits and debits for tax purposes as if a fair value basis of accounting had been used. “Fair value basis of accounting” is defined in paragraph 54 Schedule 26 – see paragraph 193 below.
151. Paragraph 52 gives a new heading to Part 5 of Schedule 26
152. Paragraph 53 amends paragraph 22 Schedule 26. Paragraph 22(1) to (4) is repealed by paragraph 53(3) as impairment losses will simply be reflected in the accounting basis used.
153. That leaves paragraph 22 dealing only with releases, and paragraph 53(4) amends the paragraph 22(5) accordingly. Paragraph 53(2) amends the heading of paragraph 22 to reflect that fact that paragraph 22 now only deals with releases.
154. Paragraph 54 repeals paragraph 22A(5) Schedule 26 That paragraph defines fair value, and is not needed for accounting periods beginning on or after 1 January 2005 as the definition is placed in paragraph 54 Schedule 26 and is therefore of general application in the Chapter.
155. Paragraph 55 amends paragraph 23 Schedule 26 (unallowable purposes) to remove the unnecessary references to authorised accounting methods.
156. Paragraph 56 amends paragraph 25 Schedule 26 (capital expenditure). Paragraph 56(1) is introductory.
157. Paragraph 56(2) omits the references to authorised accounting methods in paragraph 25(1).
158. Paragraph 56(3) introduces a new paragraph 25(4) which gives a “no second bite of the cherry” rule, similar to that in paragraph 8(4) Schedule 29 FA 2002.
159. Paragraph 57 amends paragraph 30 Schedule 26 (tax neutral transfers between group members). It changes the heading to the paragraph – paragraph 57(a) – and a reference to an authorised mark to market method becomes a reference to a fair value basis of accounting – paragraph 57(b).
160. Paragraph 58 amends paragraph 31A(2) Schedule 26 (amounts imputed under Schedule 28AA ICTA – transfer pricing) to remove the unnecessary references to authorised accounting methods.

**BOARD OF INLAND REVENUE  
RESOLUTION 35**

**FINANCE BILL 2004  
CLAUSE 52  
SCHEDULE 10**

161. Paragraph 59 amends paragraph 32 Schedule 26 (Authorised unit trusts - AUTs). Paragraph 59(1) is introductory.
162. Paragraph 59(2) omits references to paragraph 15 Schedule 26.
163. Paragraph 59(3) inserts a new paragraph 32(1A) Schedule 26. Paragraph 32(1A)(a) applies the existing sub-paragraphs (2) to (4) where the AUT uses UK GAAP. If it uses IAS, then the meaning is that given by Treasury Order – paragraph 32(1A)(b). This reflects that the accounting for AUTs under IAS is still undecided.
164. Paragraph 59(4) makes consequential amendments
165. Paragraph 60 amends paragraph 33 Schedule 26 (Open-ended investment companies – OEICs). Paragraph 60(1) is introductory.
166. Paragraph 60(2) omits references to paragraph 15 Schedule 26.
167. Paragraph 60(3) inserts a new paragraph 33(1A) Schedule 26. Paragraph 33(1A)(a) applies the existing sub-paragraphs (2) to (4) where the OEIC uses UK GAAP. If it uses IAS, then the meaning is that given by Treasury Order – paragraph 33(1A)(b). This reflects that the accounting for OEICs under IAS is still undecided.
168. Paragraph 60(4) makes a consequential amendment.
169. Paragraph 61 amends paragraph 34 Schedule 26 so that the power there to amend the definition of capital profits and losses relates only to UK GAAP cases, as there is a power to amend for IAS inserted in paragraphs 32 and 33.
170. Paragraph 62 amends paragraph 36 Schedule 26 (relevant contracts in certain bond funds treated as derivative contracts). Paragraph 62(1) is introductory.
171. Paragraph 62(2) replaces the existing paragraph 36(2) with a new paragraph 36(2) and (2A). It now requires companies which hold a relevant contract falling within the paragraph to depart from the accounting basis used in their accounts in accordance with GAAP where that basis is an amortised cost basis of accounting. They must instead compute the credits and debits for tax purposes as if a fair value basis of accounting had been used.
172. Paragraph 63 substitutes a new paragraph 38 Schedule 26 (investment trusts - ITCs).
173. New paragraph 38(1) now follows the same approach as for authorised unit trusts and simply provides for capital profits, gains and losses to be left out of account for tax purposes.

174. New paragraph 38(2) signposts definitions of capital profits, gains and losses. If the ITC uses UK GAAP, then sub-paragraphs (3) and (4) apply. If it uses IAS, then the meaning is that given by Treasury Order. This reflects that the accounting for ITCs under IAS is still undecided.
175. New paragraph 38(3) and (4) reproduce the previous rules about following the ITC SORP in old paragraph 38(3).
176. Paragraph 63 also substitutes a new paragraph 38A Schedule 26 (VCTs).
177. New paragraph 38A(1) follows the same approach as for ITCs.
178. New paragraph 38A(2) signposts definitions of capital profits, gains and losses. If the VCT uses UK GAAP the sub-paragraphs (3) and (4) apply. If it uses IAS, then the meaning is that given by Treasury Order. This reflects that the accounting for VCTs under IAS is still undecided.
179. New paragraph 38A(3) and (4) reproduce the previous rules about following the ITC SORP in old paragraph 38(2).
180. Paragraph 64 replaces the existing paragraph 48(4) (election to treat a single contract as two) with a new sub-paragraph (4). It now requires companies which hold a derivative contract falling within the paragraph to depart from the accounting basis used in their accounts in accordance with GAAP where that basis is an amortised cost basis of accounting. They must instead compute the credits and debits for tax purposes as if a fair value basis of accounting had been used.
181. Paragraph 65 updates the reference to a reserve in paragraph 49(4)(c), replacing it by a reference to the STRGL or statement of changes in equity.
182. Paragraph 66 amends paragraph 50 Schedule 26 (partnerships) by creating 2 sub-paragraphs. New paragraph 50(1) now requires companies with interests in partnerships which are fair valued to follow fair value accounting for their share of the partnership profits, and replaces the references to “mark to market”. New paragraph 50(2) signposts the definition of terms used in paragraph 50 back to paragraph 49.
183. Paragraph 67 inserts a new paragraph 50A into Schedule 26. It deals with changes of accounting approach, where the change is from UK GAAP to IAS or vice versa. These changes cannot safely be left to paragraph 17B as there is no guarantee that under IFRS 1 (First time application of IAS) that a full prior period adjustment will be recorded in a statement of changes in equity in the right period.
184. New paragraph 50A(1) provides the case. It is where there is a relevant change of accounting approach between one period of account and the next. A “relevant” change is-

- either where IAS is used in the later period, but not the earlier, or
  - where UK GAAP is used in the later period but not the earlier.
185. New paragraph 50A(2) is the operative rule. Where the change is a relevant change the difference between the closing accounting value in the first period and the opening value in the second is treated as a credit or debit (as the case may be) brought into account in the second period.
186. New paragraph 50A(3) defines “accounting value” as the carrying value for accounting purposes. New paragraph 50A(4) prevents Schedule 22 FA 2002 from also operating where the paragraph applies.
187. Paragraph 68 omits paragraph 52 Schedule 26 which defines “statutory accounts”, a term no longer appearing in the Schedule. And Paragraph 69 amends paragraph 54 Schedule 26 – the interpretative paragraph for the Schedule.
188. Paragraph 69(a) and (c) omits definitions that are no longer used.
189. Paragraph 69(b) inserts definitions covering the new terms for accounting bases. “Fair value” has the same meaning as it has already as given by paragraph 17(6) Schedule 26 which is repealed. “Fair value accounting” is given a corresponding meaning.
190. Paragraph 70 amends section 440(2B) ICTA. This section deals with transfers of assets representing derivative contracts between different categories of life assurance business. It replaces references to authorised accounting methods by a simple reference to Schedule 26.

*Part 3*

191. Part 3 Schedule 10 covers amendments to the intangible fixed assets rules in Schedule 29 FA 2002.
192. Paragraph 71 inserts a new paragraph 73A in Part 10 (excluded assets) of Schedule 29. This is necessary because under the ASB’s Urgent Issue Task Force Report 29 certain expenditure on websites is classified as a tangible fixed asset and so falls within FRS 15. In some cases capital allowances have been given on such expenditure on the basis that it represents expenditure on plant and machinery.
193. Under IAS 38 (intangible fixed assets), such expenditure falls to be treated as an intangible fixed asset and so would come within the scope of Schedule 29 FA 2002 by virtue of paragraph 2(1) and 3(1). However to bring it into Schedule 29 could involve complex adjustments both to Schedule 29 and to the capital allowances rules. It is considered easier to keep the asset out of Schedule 29.
194. New paragraph 73A(1) is introductory, and provides that an intangible asset does not fall within Schedule 29 in certain circumstances.

195. New paragraph 73A(2) sets out the circumstances – it is where:
- a company in its accounts treats the asset as an intangible asset,
  - but in a previous period it was treated as a tangible asset and
  - an allowance was made under Part 2 Capital Allowances Act 2001
196. Paragraph 72 inserts a new paragraph 116A into Part 13 (supplementary provisions) of Schedule 29. It deals with changes of accounting approach, where the change is from UK GAAP to IAS or vice versa. The paragraph is necessary because under UK GAAP certain goodwill is amortised at a constant rate, whereas under IAS amortisation is not permitted, but an impairment allowance may be made. There would therefore be a danger of the same expenditure being allowed twice, first as amortisation and then as impairment. There are two possible ways of preventing that double deduction. Either the write back could be taxable, thus allowing the deductions to start again with a clean sheet, or the asset could effectively be held for tax purposes at its amortised cost, and impairment only allowed so far as it reduced the carrying cost of the asset below the amortised cost on entry to IAS.
197. The first seems the simpler, especially as under IFRS 1 (first time application of IAS) it is to be noted that a company which has amortised goodwill under UK GAAP need not write the amortisation back, but may continue with the amortised cost as the basis for further impairment. New paragraph 116A applies only where the goodwill is written back to cost.
198. New paragraph 116A(1) provides the case. It is where there is a relevant change of accounting approach between one period of account and the next. This wording follows that in section 64 FA 2002. That section might be thought to apply in these circumstances where the goodwill is held for the purposes of a trade. But it is not at all clear that IFRS 1 will produce a prior period adjustment in terms of section 64, and it was thought advisable to provide a specific rule for the change to IAS and vice versa.
199. New paragraph 116(2) says what a “relevant” change is-
- either where IAS is used in the later period, but and UK GAAP in the earlier, or
  - where UK GAAP is used in the later period but IAS in the earlier.
200. New paragraph 116A(3) is the operative rule. Where the change is a relevant change the difference between the closing value in the first period and the opening value in the second is treated as a credit or debit (as the case may be) brought into account in the second period.
201. New paragraph 116A(4) defines the amount of the credit or debit, using a formula. The formula takes into account the fact that the tax value and the accounting value of the asset may be different.

202. New paragraph 116A(5) prevents the change applying where a fixed rate election for amortisation has been made under paragraph 10.
203. New paragraph 116A(6) provides that the paragraph does not operate where a credit or debit is brought into account by an existing paragraph of Schedule 29.
204. New paragraph 116A(7) ousts Schedule 22 FA 2002 (the general rule for changes in accounting approach) in such a case.
205. Paragraph 73 amends paragraph 134 Schedule 29. Paragraph 73(1) is introductory.
206. Paragraph 73(2) inserts the IAS concept of “statement of changes in equity” after the mention of STRGL.
211. Paragraph 73(3) ensures that fundamental errors are not recognised as prior period adjustments under IAS.
212. Paragraphs 74 to 76 make consequential amendments to paragraphs 15, 20 and 27 Schedule 29 FA 2002 as a result of new paragraph 116A(3) and (4)

*Part 4*

213. Paragraph 77 substitutes a new series of sections into FA 1993 replacing sections 92 to 94AB which deal with foreign currency accounting.
214. New section 92(1) FA 1993 restates the previous version of section 92 as the basic rule for corporation tax – that a company’s profits must be computed and expressed (and hence returned) in sterling.
215. New section 92(2) applies GAAP when the basic rule is used to translate amounts expressed or denominated in a currency which is not sterling into sterling, where that currency is the company’s functional currency (see Notes on new section 93 below). This means that if SSAP 20 continues in force for periods beginning on or after 1 January 2005, it will apply. If IAS is used in drawing up accounts, IAS 21 will apply. If as a result of the ASB Convergence exercise IAS 21 is adopted as a UK standard then it will apply to companies not using IAS as well.
216. New section 92(3) makes this basic rule subject to new sections 93 to 93B.
217. New section 93 provides rules for the determination of a company’s functional currency.
218. New section 93(1) requires a company’s functional currency to be used to compute profits or losses of its business whether or not sterling is the functional currency.

219. New section 93(2) states that in a case where the accounts identify that the functional currency is different from the presentation currency (as required by IAS 21) the functional currency is that identified currency, and in any other case, the functional currency is the presentation currency.
220. New section 93(3) covers the case where a non resident company submits a return of accounts for its UK permanent establishment. Its functional currency is the currency in which that return of accounts is prepared.
221. New section 93(4) signposts particular further provisions about functional currency in sections 93A and 93B
222. New section 93(5) repeats the rule in old section 93(7) that in sections 93 to 93B profits and losses do not include chargeable gains and allowable losses for the purposes of the Taxation of Chargeable Gains Act 1992.
223. New section 93A deals with the case, likely to be unusual, where a company's functional currency is sterling, but its presentation currency, the currency in which the accounts are prepared, is not. In this case the profits and losses are the ones that would have arisen had the accounts been prepared in sterling as well.
224. New section 93B(1) covers the more common case where a company's functional currency is not sterling. There are two rules, depending on whether or not the presentation currency is the same as the functional currency. If it is, then new section 93B(2)(a) simply requires the profits of a period to be found by taking the sterling equivalent of the foreign currency accounts. But if the presentation currency is not the same as the functional currency, the profits and losses are the ones that would have arisen had the accounts been prepared in the functional currency – new section 93B(2)(b)
225. New section 93B(3) deals with the case where the functional currency is not sterling, and there is a part, or parts, of the business where the records are prepared in a different currency. This is the case where under SSAP 20 the closing rate/net investment method is used, but the case also applies where IAS 21 is used which does not refer to that method. Note that this rule does not apply where the functional currency is sterling – in such a case the gains and losses of the part of the business will be determined in accordance with GAAP.
226. Amounts taken to the STRGL in accordance with SSAP 20 paragraphs 19 and 20, or taken to the statement of changes in equity in accordance with IAS will not be brought into account for the purposes of Chapter 2 Part 4 FA 1996 or Schedule 26 FA 2002 (derivative contracts) because of section 84A(3) FA 1996 and paragraph 16 Schedule 26 respectively. Nor will any other amounts taken to reserve or the statement of changes

in equity in this way be brought into account for the purposes of corporation tax (section 42 FA 1998 applies where Case I or Case V of Schedule D applies to a trade).

227. New section 93B(3) applies before new section 94B(2) (mirroring old section 93A(5))
228. New section 93B(4) mirrors old section 93A(7). It applies where there is more than one part of the business for which new section 93B(3) applies, and there are different currencies. Each part using a different currency is treated as a separate part, and the provisions of section 93B(3) apply to each separately.
229. New section 93B(5) mirrors old section 93A(8). It reflects SSAP 20 paragraph 37 and allows a “collection of assets and liabilities” to qualify as part. This may apply to e.g. airlines which may regard each plane as a separate “branch”, or to insurance companies where a book of US dollar business written from London will be treated as a separate part. IAS 21 is somewhat stricter about identifying separate parts of the business.
230. New section 93B(6) generalises old section 93A(6) which allowed various monetary limits in capital allowances legislation and the rules on hire charges for expensive cars to be expressed in their currency equivalents in working out the tax profits or losses in the relevant foreign currency. New section 93(7) applies this rule to any legislation in the Tax Acts.
231. New section 94 gives the translation rules where section 93B applies (and replaces section 94AB).
232. New section 94(1) provides that amounts must be translated at the appropriate rate. New section 94(2) defines that rate as the average rate for the relevant period. Where amounts are brought forward from an earlier period (e.g. trading losses) the period concerned is that earlier period, but otherwise is the period for which the profits are being computed.
233. New section 94(3) gives rules for the case where a company’s functional currency changes. In that case, the amounts brought forward from the earlier period, and any capital allowances, are translated using the London closing rate for the last day of the old period.
234. New section 94(4) reproduces old section 94AA(7). It overrides paragraph 88 Schedule 18 FA 1998. That paragraph requires the figure determined for one year to be used for a later year. But where an amount is translated into sterling for the purposes of CT for a period, using the rate set out in section 94, that does not prevent the amount expressed in foreign currency from being carried forward to a subsequent period and being translated using a rate for that later year.

235. New section 94A defines a couple of terms.
236. New section 94A(1) defines “accounts” by reference to the Companies Act 1985 (or its Northern Ireland equivalent), accounts prepared under the law of another territory or accounts corresponding to Companies Act accounts.
237. New section 94A(2) defines “return of accounts” by reference to Schedule 18 FA 1998.
238. Paragraph 78 makes some amendments to section 730BB ICTA (exchange gains and losses on repos) as a consequence of the changes made by paragraph 76. Paragraph 78(1) is introductory.
239. Paragraph 78(2) amends section 730BB(2)(c) so that section 730BB(2) applies where a company’s functional currency is sterling.
240. Paragraph 78(3) amends section 730BB(3) so that it applies where a company’s functional currency is not sterling, and also amends other references to currency so that they refer to a company’s functional currency.
241. Paragraph 78(4) omits section 730BB(12) which defined “relevant foreign currency equivalent”, a term no longer used as a result of the amendments made by paragraph 78(3).

### **BACKGROUND NOTE**

242. In 2002 the European Union approved a Regulation (having direct effect in member states) that requires the consolidated (group) accounts of listed (on a stock exchange) companies to be drawn up using IAS from 2005. These consolidated accounts are not used for tax purposes
243. In August 2003 the DTI announced that the UK would take up an option in the Regulation to permit, but not require, all UK companies to use IAS to draw up their accounts, also from 2005.
244. IAS differ from UK GAAP in a number of specific areas. The main area where there is a difference is in the field of financial instruments where IAS 39 applies. There is no UK Standard dealing with the holder of financial instruments. Parts 1 and 2 of the Schedule adapt the loan relationships and derivative contracts legislation to bring them into line with the concepts used in IAS 39 and with the way it is expected that revised UK GAAP will work.
245. The standard on intangible assets is also different and Part 3 of the Schedule covers this area. Part 4 deals with foreign currency accounting as IAS 21 differs from SSAP 20, and SSAP 20 may itself be replaced by a new UK standard based on IAS 21.

## **EXPLANATORY NOTE**

### **CLAUSE 53: TREATMENT OF EXPENDITURE ON RESEARCH AND DEVELOPMENT**

#### **SUMMARY**

1. This clause provides for immediate relief to companies and other entities which add research & development (R & D) expenditure to the cost of an intangible asset in accordance with International Accounting Standards (IAS) or UK Generally Accepted Accountancy Practice (UK GAAP). Before this change, relief for such expenditure could only be given as the cost of the asset was amortised through the profit and loss account. The clause applies from a date to be given by a commencement order.

#### **DETAILS OF THE CLAUSE**

2. Subsection (1) is the operative rule. Revenue expenditure incurred on research and development (R&D) is treated as deductible in computing profits even though it is added to the value of an intangible asset in the company's accounts, rather than being expensed in the profit and loss account.
3. Subsection (2) applies this rule in four related provisions. They are the standard rule allowing a deduction for R&D and the schemes allowing either a superdeduction or a tax credit for expenditure on R&D. In all these provisions there is a requirement that to qualify for relief, the expenditure must be deductible in computing profits of the period. That means that the expenditure must feature in the company's profit and loss account. Subsection (1) modifies this rule.
4. Subsection (3) is a "no second bite" rule. It prevents relief being given again where it has already been given by virtue of subsection (1). This could be relevant when the expenditure added to an asset was subsequently amortised through the profit and loss account.
5. Subsection (4) prevents relief being given again if it has already been allowed because it was expensed in a profit and loss account drawn up under UK GAAP, and is then treated as expenditure on an asset on the adoption of IAS.

6. Subsection (5) provides definitions for the purposes of the clause. “Intangible asset” has the same meaning it has in accountancy (in FRS 10 (UK GAAP) or IAS 38 (IAS)). “Research and development” has the same meaning as in section 837A ICTA.
7. Subsection (6) gives the starting date from which this clause applies – from a date to be determined. This is because some of the R & D schemes are subject to notification to the European Commission where changes are made.

### **BACKGROUND NOTE**

8. In 2002 the European Union approved a Regulation (having direct effect in member states) that requires the consolidated (group) accounts of listed (on a stock exchange) companies to be drawn up using IAS from 2005. These consolidated accounts are not used for tax purposes.
9. In August 2003 the DTI announced that the UK would take up an option in the Regulation to permit, but not require, all UK companies to use IAS to draw up their accounts, also from 2005.
10. IAS differ from UK GAAP in a number of specific areas. In the area of R & D expenditure, IAS 38 makes the treatment of some development expenditure as an asset rather than as an expense mandatory. In the UK SSAP 13 makes asset treatment optional.

## **EXPLANATORY NOTE**

### **CLAUSE 54: TAXATION OF TRADING PROFITS ETC.: TREATMENT OF AMOUNTS TAKEN TO RESERVES**

#### **SUMMARY**

1. This clause prevents a company whose business includes dealings in shares and other securities from escaping tax on its profits if it uses International Accounting Standards (IAS) and treats any of its investments as “available for sale” rather than as trading assets.

#### **DETAILS OF THE CLAUSE**

2. Subsection 1 inserts a new section 472A into the Income & Corporation Taxes Act 1988 (“ICTA”).
3. New section 472A(1) sets out the case. It concerns securities where a company carries on a banking or insurance business or a business of, or including, dealing in securities, and any profits on the sale of the securities is a trading profit.
4. New section 472A(2) is the operative rule. It provides that if changes in fair value of the securities are taken to the company’s statement of recognised gains and losses (STRGL) where it uses UK Generally Accepted Accounting Practice, or its statement of changes in equity where it uses IAS, the profits and losses are nonetheless taken into account in computing profits under the rules of Case I of Schedule D.
5. New section 472A(3) allows any such profits or losses to be disregarded if they are recycled through the profit and loss account in a later period, or arise as a result of the correction of a fundamental error in accordance with IAS 8.
6. New section 472A(4) defines securities. It includes shares, rights in a unit trust and other non share membership rights in a company but not a loan relationship (as they fall within the provisions of Chapter 2 Part 4 FA 1996 which already provides that profits taken to the STRGL or equity are taxable).
7. Subsection (2) gives the commencement rule. It applies for accounting periods beginning on or after 1 January 2005, and to any periods where

the company has used section 223 Companies Act 1985 to advance its accounting date.

**BACKGROUND NOTE**

8. In 2002 the European Union approved a Regulation (having direct effect in member states) that requires the consolidated (group) accounts of listed (on a stock exchange) companies to be drawn up using IAS from 2005. These consolidated accounts are not used for tax purposes.
9. In August 2003 the Department of Trade and Industry (DTI) announced that the UK would take up an option in the Regulation to permit, but not require, all UK companies to use IAS to draw up their accounts, also from 2005.
10. The DTI is currently consulting on implementing changes to the Companies Act 1985 to permit companies to choose whether to switch to IAS (Modernisation of Accounting Directives/IAS Infrastructure – A Consultation Document – March 2004).
11. IAS differ from UK GAAP in a number of specific areas. The main area where there is a difference is in the field of financial instruments where IAS 39 applies. There is no UK Standard dealing with the holder of financial instruments. This clause makes a minor adaptation to the treatment of dealers in shares etc. to prevent tax being avoided by using “available for sale” accounting.

**EXPLANATORY NOTE**

**CLAUSE 55: DUTY OF COMPANY TO GIVE NOTICE OF  
COMING WITHIN CHARGE TO CORPORATION TAX**

**SUMMARY**

1. This clause introduces an obligation on companies coming within the scope of corporation tax (CT) for the first time, or coming back into the scope of CT following a period of dormancy, to notify the Inland Revenue and to provide prescribed information about the company and its directors.

**DETAILS OF THE CLAUSE**

2. Subsection (1) introduces an obligation on a company to notify the Revenue when its first corporation tax accounting period (AP) begins, and again when any subsequent AP begins that does not follow on immediately from the end of a previous AP (what this does is to oblige companies to notify the Revenue when they start in business and again if they restart in business after a period of being dormant).
3. Subsection (2) says that the notice must:-
  - be in writing;
  - state when the AP began;
  - contain prescribed information;
  - be given within 3 months of the beginning of the AP, and
  - may be given to any officer of the Board.
4. Subsection (3) provides that “prescribed” information in subsection (2) means prescribed by regulations made by the Board.
5. Subsection (4) says that a company which fails to give the required notice will not be considered to have failed if it has a reasonable excuse for failing, and if it then gives the required notice without unreasonable delay once the excuse has passed.
6. Subsection (5) defines terms. The definition of a “company” excludes unincorporated associations and partnerships.
7. Subsection (6) inserts this section into the second column of the Table in section 98 Taxes Management Act 1970, bringing both failing to give

**BOARD OF INLAND REVENUE      FINANCE BILL 2004**  
**CLAUSE 55**

notice and the giving of a fraudulently or negligently incorrect notice within the scope of the penalty provisions.

8. Subsection (7) is the commencement provision: the obligation introduced by this section will apply to APs beginning on or after the day on which this Finance Act is passed.

**BACKGROUND NOTE**

9. This clause provides statutory backing for a company to notify the Inland Revenue of its existence.
10. It places a statutory obligation on companies to notify the Board within 3 months of when they first come within the scope of CT (and within 3 months of coming back into the scope of CT following a period of dormancy). The intention is that the information that must be provided to the Inland Revenue will include details of the company and its directors, similar to those on the form that each company is presently requested to complete but for which there is no statutory backing. Precise details of the prescribed information will be set out in secondary legislation (regulations).
11. The clause prescribes a penalty for failure to comply with the obligation. Subsection (6) brings this clause within list 2 of section 98 Taxes Management Act 1970. The penalties in section 98 apply to a variety of returns and notices. The potential penalties in this instance are:
  - up to £300 for initial failure;
  - up to £60 per day for continued failure, after an initial penalty has been imposed;
  - up to £3,000 for fraudulently or negligently providing incorrect information.
12. The clause will not apply to unincorporated associations, which have been excluded on the grounds that the obligation would be disproportionate in the case of clubs and similar bodies with small amounts of income.

**EXPLANATORY NOTE**

**CLAUSE 56: RELIEF FOR COMMUNITY AMATEUR  
SPORTS CLUBS**

**SUMMARY**

1. This clause will increase the existing thresholds for corporation tax exemption on the trading and property income of community amateur sports clubs (CASCs) registered with the Inland Revenue.

**DETAILS OF THE CLAUSE**

2. Subsection (1) of this clause amends Schedule 18 to the Finance Act 2002 as follows.
3. Subsection (2) increases the corporation tax exemption threshold for the trading income of CASCs contained within paragraph 4(1)(b) of Schedule 18. It ensures that registered CASCs with a trading turnover of less than £30,000 will pay no corporation tax on that income.
4. Subsection (3) increases the corporation tax exemption threshold for the property income of CASCs contained within paragraph 6(1)(b) of Schedule 18. It ensures that registered CASCs with gross rental income of less than £20,000 will pay no corporation tax on that income.
5. Subsection (4) sets out the commencement date from which the new corporation tax exemption thresholds will have effect. The new limits will take effect on 1 April 2004.
6. Subsection (5) provides transitional arrangements for accounting periods that begin and end either side of the commencement date. It treats the period before the commencement date and the period after the commencement date as separate accounting periods for tax purposes and apportions a relevant proportion of the trading and property income of the CASC to each of the accounting periods.
7. Subsection (6) defines “property income” and “trading income” for the purposes of this clause as having the same meaning as is given in Schedule 18 to the finance Act 2002. Paragraph 4 to Schedule 18 defines “trading income” as that which would, but for the exemption, be chargeable to tax

under case I of Schedule D. Paragraph 6 to Schedule 18 defines “property income” as that which would, but for the exemption, be chargeable to tax under Schedule A.

### **BACKGROUND NOTE**

8. This measure is intended to remove from more amateur sports clubs the need to complete an annual tax return. It will ensure that where clubs registered with the Inland Revenue as a CASC have trading and property income below the new thresholds they will have no corporation tax to pay on those sources.

### **THE EXISTING LEGISLATION**

9. Schedule 18 to Finance Act 2002 introduced a new scheme to help CASCs that make a positive contribution to their local communities. The scheme provides a range of tax exemptions for clubs registered with the Inland Revenue as CASCs and tax incentives to encourage individuals in the local community to support their community sports clubs.
10. Registered CASCs receive exemption from corporation tax on:
  - trading income below £15,000;
  - bank and building society interest;
  - property income below £10,000; and
  - chargeable gains,provided that the club uses the income from these sources for the benefit of the club.
11. There is currently an exemption from corporation tax on trading profits provided that the club has a turnover of no more than £15,000 in a given accounting period. Where the accounting period is less than 12 months the legislation requires the exemption threshold to be proportionately reduced. If a clubs trading turnover exceeds the threshold then all of the trading profit is potentially taxable subject to existing corporation tax rates.
12. Relief from corporation tax on property income is currently given where the gross rental income in an accounting period is less than £10,000. Where the accounting period is less than 12 months, the legislation requires the threshold to be reduced proportionately. If a clubs gross property income exceeds the threshold then all of the clubs profit from that source is potentially taxable.

## **EXPLANATORY NOTE**

### **CLAUSE 57: INTRODUCTION**

#### **SUMMARY**

1. This clause contains certain definitions for Chapter 3. That Chapter introduces a new scheme providing for deductions to be made on account of tax from certain payments made in the construction industry.

#### **DETAILS OF THE CLAUSE**

2. Sub-section (1) provides for certain payments under construction contracts to be subject to deductions on account of tax.
3. Sub-section (2) defines the meaning of "construction contract" for the purpose of the Chapter.
4. Sub-section (3) applies the meaning of "the contractor" to sections 60 and 61.
5. Sub-section (4) defines certain references for the purposes of the Chapter.
6. Sub-section (5) provides for the Chapter to be taken to form part of the Tax Acts.

#### **BACKGROUND NOTE**

7. Since the early 1970s there has been a specialised taxation scheme for the construction industry to combat the general culture of non-compliance inherent in the construction industry's attitude towards taxation matters. The first such scheme, the Construction Industry Tax Deduction Scheme (CITDS), was introduced in 1971 and was a simple process which allowed genuine businesses with a good track record to be granted gross payment status (714 certificate). All other sub-contractors suffered a flat rate deduction at source on the labour elements of their contracts. However, the number of 714 certificates spiralled out of control to the point where the majority of sub-contractors working in construction held a certificate. This defeated the object of the scheme of preventing those who lacked the discipline required to operate a business in a professional manner from obtaining gross payment status.

8. To correct this, the Construction Industry Scheme (CIS) was legislated in 1995 and introduced in August 1999. The criteria for gaining gross payment status were expanded to include a minimum level of turnover. In addition, sub-contractors receiving net payments were, for the first time, required to register for the scheme. Both these measures proved successful, with the former safeguarding the flow of funds to the Exchequer, and the latter identifying more than 70,000 subcontractors who were previously unknown to the Inland Revenue.
9. Despite the success of the CIS, industry complained that it placed an administrative burden on them. This, together with the terms of the Modernising Government initiative (which required all Government departments to be able to communicate electronically with their customers by 2005), prompted a review of the scheme.
10. The Government asked the Inland Revenue to review CIS and put forward proposals that would satisfy three main objectives:
  - To reduce the regulatory burden of the scheme on construction businesses;
  - To improve the level of compliance by construction businesses with their tax obligations;
  - To help construction businesses to get the employment status of their workers right.
11. A consultation document entitled "*The Inland Revenue and the Construction Industry: Working together for a New Scheme*" was published in November 2002 and made the following recommendations:
  - *To replace the registration card and tax certificates with a verification service.* This will dispense with the need for sub-contractors holding a CIS4 registration card or CIS6 tax certificate to travel to present their documents in person to the contractor, a task they find particularly onerous. The verification service can be accessed over the telephone or via the Internet.
  - *To introduce a new employment status declaration* . It is already a requirement that all those who engage workers (whether or not in the construction industry) consider the employment status of those they engage. This measure is simply designed to highlight the fact that this responsibility must be taken seriously.
  - *To replace the vouchers in the current scheme with periodic returns.* The vouchers and end of year returns required under CIS represent a large part of the administrative burden of which the industry complains. This paper-based approach is also incompatible with the move towards electronic business. The new periodic return should address both these problems.
  - *To replace the computer system with a new system capable of supporting the use of 'e' services, eg communication over the Internet, which would allow the Revenue to ensure the scheme was being complied with.* The new system will (a) increase the communication

options when the industry needs to contact the Revenue, and (b) will provide the Revenue with an improved level of risk assessment and management information which, in turn, will enhance the Department's policing capabilities.

12. Responses received to these proposals indicated that there was broad agreement that CIS needed to be replaced. The Government therefore announced that a new scheme, based on the consultation document proposals, would replace CIS in April 2006.

**EXPLANATORY NOTE**

**CLAUSE 58: SUB-CONTRACTORS**

**SUMMARY**

1. This clause defines a sub-contractor for the purposes of Chapter 3.

**DETAILS OF THE CLAUSE**

2. This section sets out that a party to a contract is a sub-contractor if he is under a duty himself, or through others, to carry out operations under the contract or to provide his own, or others', labour to carry out operations (in the case of companies, the labour of employees or officers of the company). A party is also a sub-contractor if he is answerable, under a contract, to the contractor for the carrying out of operations by others.

## **EXPLANATORY NOTE**

### **CLAUSE 59: CONTRACTORS**

#### **SUMMARY**

1. This clause defines who is a contractor. In addition to persons carrying on a business including construction operations, it defines a number of other bodies and businesses, under certain conditions, as being contractors for the purposes of the scheme.

#### **DETAILS OF THE CLAUSE**

2. Sub-section (1) sets out who is a contractor. In addition to persons carrying on a business which includes construction operations, the section applies to a range of public bodies. The Inland Revenue have powers to apply the section to other public bodies by regulations. It also applies to any person carrying on a business, if average annual expenditure on construction operations over a period of three years exceeds £1 million.
3. Sub-section (2) provides that the section only applies to a specified range of public bodies if, in any period of three years, annual expenditure on construction operations is more than £1 million. It only ceases to apply where the body has had three consecutive years in which such expenditure was below £1 million.
4. Sub-section (3) provides that, where the section applies to a person carrying on a business by reason of his spending more than £1 million on construction operations, it only ceases to apply where he has had three consecutive years in which such expenditure was below £1 million.
5. Sub-section (4) provides for apportionment of expenditure where the whole, or part, of a trade is transferred by a company to another company.
6. Sub-section (5) defines certain bodies referred to within the clause.
7. Sub-section (6) brings an office or department within references to body or person.
8. Sub-section (7) provides powers to remove from the section bodies which have ceased to exist.

## **EXPLANATORY NOTE**

### **CLAUSE 60: CONTRACT PAYMENTS**

#### **SUMMARY**

1. This clause defines a "contract payment" for the purposes of the Chapter and provides for certain payments to be excepted from the definition.

#### **DETAILS OF THE CLAUSE**

2. Sub-section (1) defines a "contract payment" as any payment made by a contractor to a sub-contractor or his nominee.
3. Sub-section (2) allows for the following exceptions to the definition.
4. Sub-section (3) excepts a payment which is treated as earnings as an agency worker.
5. Sub-section (4) excepts a payment where the recipient, or a nominee, is registered for gross payment, subject to sub-sections (5) and (6).
6. Sub-section (5) provides that a person registered for gross payment as a partner in a firm is only excepted in relation to payments made to the firm, as sub-contractor.
7. Sub-section (6) provides that a person registered for gross payment in his own right is not excepted in relation to payments made to the firm, as sub-contractor.
8. Sub-section (7) excepts any payment prescribed in regulations.
9. Sub-section (8) includes within the Chapter a payment made to a third party, who is not a sub-contractor, in discharge of an obligation to a sub-contractor within the scheme

#### **BACKGROUND NOTE**

10. Regulations under sub-section (7) will prescribe circumstances in which certain payments will be excepted, including small payments made by deemed contractors, reverse premiums, payments by local authority schools under devolved budgets and payments made by certain businesses in respect of property used in their own business and by their own staff.