

EXPLANATORY NOTE

**CLAUSE 92 AND SCHEDULE 6: CAPITAL
ALLOWANCES: RENOVATION OF BUSINESS PREMISES
IN DISADVANTAGED AREAS**

SUMMARY

1. Clause 92 and Schedule 6 provide 100 per cent capital allowances for the costs of renovating or converting business property that has been unused for at least a year, in any of the 1997 designated, disadvantaged areas of the UK.
2. The scheme will provide immediate, full tax relief to any individual or company who incurs capital expenditure on bringing qualifying business premises (whether owned or let) back into productive use. For the applicant, the 100 per cent rate of initial allowance will provide: (a) an enhanced rate of allowance, for expenditure that would otherwise have qualified for plant and machinery capital allowances (normally at 25 per cent a year, or 40 per cent, in the first year, in the case of expenditure by small or medium-sized enterprises (SMEs)) or industrial or agricultural building allowances (at 4 per cent a year), plus (b) a new tax relief, for expenditure on commercial buildings (such as offices and shops) that does not currently qualify for any capital allowances.
3. The scheme is based around existing provisions for capital investment in converting flats over shops and capital investment in industrial buildings. However, the scheme is different from the industrial buildings allowances code. In particular, no balancing charges or allowances are made provided that, throughout a period of seven years from the premises being first brought back into use or being made suitable and available for letting, there is no disposal event. And the allowances are not transferable to a subsequent purchaser of an interest in the property.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

4. The scheme is part of the government's holistic approach to regeneration. Because it will apply only to the most disadvantaged areas of the UK it is a State aid and it will be brought into operation by Treasury order after State aid approval has been granted.

DETAILS OF THE CLAUSE

5. Clause 92 brings Schedule 6 into effect in relation to expenditure incurred on or after such day as the Treasury may by order appoint as the start date of the scheme, and before the "expiry date", which means the fifth anniversary of the start date or such later as the Treasury may prescribe by regulations.

DETAILS OF THE SCHEDULE

Part 1 – New Part 3A of the Capital Allowances Act 2001

6. Schedule 6 inserts the new Part 3A into the Capital Allowances Act 2001 (CAA 2001). Part 3A comprises new sections 360A to 360Z4 and contains the rules for business premises renovation allowances.
7. Section 360A provides for business premises renovation allowances to be made under Part 3A.
8. Subsection (1) of Section 360A provides that allowances will be available if a person incurs qualifying expenditure in respect of a qualifying building.
9. Subsection (2) defines the person to whom the allowances are to be given as being the person who incurred the qualifying expenditure and who has the relevant interest in the qualifying building.
10. Section 360B defines "qualifying expenditure".
11. Subsection (1) of Section 360B defines qualifying expenditure as capital expenditure incurred before the expiry date on, or in connection with, the conversion or renovation of a "qualifying

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

building” into “qualifying business premises”, or on capital repairs incidental to such conversion or renovation.

12. Subsection (2) defines the “expiry date” as the fifth anniversary of the start date as determined in accordance with section 130, or such later date as the Treasury may prescribe by regulations.
13. Subsection (3) defines certain types of expenditure that are not qualifying expenditure. They comprise expenditure incurred on, or in connection with, the acquisition of land or rights in or over land (thus the acquisition costs of the qualifying building itself, or a leasehold interest in it, are excluded), the extension of a qualifying building (unless the extension is for the purpose of providing access to the qualifying business premises), the development of land next to the qualifying building, or the provision of plant and machinery, other than plant or machinery which is or becomes a fixture, as defined by section 173(1) of the Capital Allowances Act 2001.
14. Subsection (4) defines capital expenditure on repairs for the purposes of section 360B. It comprises any expenditure that would not be allowed as a deduction in calculating the profits of a property business, or of a trade, profession or vocation, for tax purposes.
15. Subsection (5) provides that the Treasury may, by regulations, make further provision as to the definition of expenditure that is or is not qualifying expenditure.
16. Section 360C defines a “qualifying building”.
17. Subsection (1) of Section 360C defines a qualifying building as one that meets five conditions. First, it must be situated in a disadvantaged area, on the date when the conversion or renovation work began. Second, it must have been unused throughout the period of one year ending immediately before that date. Third, on that date, it must have been last used for the purposes of a trade, profession or vocation, or as an office or offices. Fourth, it must not have last been used as a dwelling or as part of a dwelling. Fifth, in the case of part of a building or structure, on that date that part must not have been occupied and used in common with any other part, except either a part that had also been unused throughout the period of one year ending before that date, or a part that had last been used as a dwelling.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

18. Subsection (2) defines “disadvantaged area”. The term means either an area designated as a disadvantaged area for the purposes of Section 360C by regulations made by the Treasury or, if no such regulations are made, it means an area for the purposes of Schedule 6 of the Finance Act 2003 (stamp duty land tax: disadvantaged areas relief).
19. Subsection (3) provides that the regulations under subsection (2) may either designate specified areas as disadvantaged areas or may provide that areas of a specified description are to be designated as disadvantaged areas.
20. Subsection (4) provides that those regulations may provide a duration for the designation of areas as disadvantaged areas.
21. Subsection (5) provides that the regulations may also make different provision for different cases and contain such incidental, supplementary, consequential or transitional provision as appears to the Treasury to be necessary or expedient.
22. Subsection (6) provides that where a building or structure, which would otherwise be a qualifying building, is on the date mentioned in subsection (1)(a), situated partly in a disadvantaged area and partly outside it, only so much of the expenditure incurred as, on a just and reasonable apportionment is attributable to the part situated in the disadvantaged area, shall be treated as qualifying expenditure.
23. Subsection (7) provides for the definition of “qualifying building” to be amended by Treasury regulations.
24. Section 360D defines “qualifying business premises”.
25. Subsection (1) of Section 360D lists the detailed conditions that must be met for premises to be “qualifying business premises”. The premises must be a qualifying building. They must also be either used, or available and suitable for letting for use, for the purposes of a trade profession or vocation or as an office or offices. And the premises must not be used or available for use as a dwelling or part of a dwelling.
26. Subsection (2) explains that “premises” means any building or structure or part of a building or structure.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

27. Subsection (3) provides that premises will not cease to be qualifying business premises during a period of temporary unsuitability for use or letting, provided that they were qualifying business premises immediately before that period.
28. Subsection (4) provides for the definition of qualifying business premises to be amended by Treasury regulations.
29. Section 360E contains the general rules as to what is the relevant interest.
30. Subsection (1) of Section 360E provides that the relevant interest in the qualifying building at the time the expenditure is incurred is the interest in the qualifying building to which the person who incurred the qualifying expenditure was entitled at that time.
31. Subsection (2) makes the general rule in subsection (1) subject to the rest of the provisions of section 360E, section 360F and section 360Z3, which contains special provisions on the termination of a lease.
32. Subsection (3) provides that where the person who incurred the qualifying expenditure is entitled to more than one interest and one of those interests is reversionary on all the others, the reversionary interest is the relevant one.
33. Subsection (4) provides that an interest does not cease to be the relevant interest if a lesser interest is created that is subject to the interest.
34. Subsection (5) provides that where the relevant interest is a leasehold interest, and it is extinguished by the holder acquiring the reversionary interest, the merged interest becomes the relevant interest when the leasehold interest is extinguished.
35. Section 360F provides that a person who incurs expenditure on the conversion of a qualifying building into qualifying business premises and who is entitled to an interest in the qualifying building on or as a result of completion of the conversion, is treated as having had the interest when the expenditure was incurred.
36. Section 360G contains rules relating to initial allowances.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

37. Subsections (1) and (2) of Section 360G provide that a person who has incurred qualifying expenditure on a qualifying building is entitled to an initial allowance of 100 per cent of the qualifying expenditure.
38. Subsection (3) provides that the claimant may require the initial allowance to be reduced to a specified amount.
39. Subsection (4) provides that the initial allowance is made for the chargeable period in which the qualifying expenditure is incurred.
40. Section 360H provides what is to happen if the premises are not qualifying business premises or the relevant interest is sold before the premises are first used or let.
41. Subsection (1) of Section 360H prevents an initial allowance being made in such circumstances. Subsections (2) and (4) provide that, if made, any initial allowance should be withdrawn, if at the time when the premises are first used by the person with the relevant interest, or when they are suitable for letting for business use, the qualifying building does not constitute qualifying business premises. An initial allowance is also withdrawn, if the person to whom the allowance was made, sells the relevant interest before that time. Subsections (3) provides for all necessary assessments and adjustments to be made to give effect to Section 360H.
42. Section 360I provides the entitlement to writing-down allowances.
43. Subsection (1) of Section 360I sets out the conditions that have to be met for a person to be entitled to a writing-down allowance for a chargeable period. These are that the person must have incurred qualifying expenditure in respect of a qualifying building and, at the end of the chargeable period, the person must be entitled to the relevant interest in the qualifying building, the person must not have granted a long lease of the qualifying building out of the relevant interest in return for a capital sum, and the qualifying building must constitute qualifying business premises.
44. Subsection (2) and (3) define what is meant by a long lease. This is a lease with a duration in excess of 50 years, as defined in accordance with section 303 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA), but without regard to section 360Z3(3), which treats a new lease granted as a result of the exercise of an option as if it were the continuation of the old lease.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

45. Subsection (4) provides that a person claiming a writing-down allowance may require the allowance to be reduced to a specified sum.
46. Section 360J determines the amount of the writing-down allowance.
47. Subsection (1) and (2) of Section 360J set the writing-down allowance for a chargeable period at 25 per cent of the qualifying expenditure, but this is increased or decreased proportionately if the chargeable period is more or less than one year.
48. Subsections (3) and (4) provide that the writing-down allowance cannot exceed the residue of qualifying expenditure. The residue of qualifying expenditure is to be ascertained immediately before writing off the writing-down allowance at the end of the chargeable period.
49. Section 360K defines the residue of qualifying expenditure as the amount of qualifying expenditure that has not yet been written off.
50. Section 360L provides how grants may affect entitlement to allowances.
51. Subsection (1) of Section 360L provides that no initial or writing-down allowances under Sections 360G or 360I are to be made to the extent that the expenditure is taken into account for the purposes of a relevant grant or relevant payment.
52. Subsection (2) explains that a grant or payment is relevant if it is a notified State aid (other than an allowance under sections 360G or 360I) or if it is declared, by Treasury Order, to be relevant for the purposes of withholding those allowances.
53. Subsection (3) defines a notified State aid as one that has been notified to and approved by the European Commission.
54. Subsections (4) to (7) provide that if a relevant grant or payment is made after the making of the allowance, the allowance is to be withdrawn to that extent, and that if the relevant grant or payment is repaid, it is to be treated, to that extent, as never having been made. Provision is made for all necessary assessments and adjustments to be made for these purposes. Such assessments and adjustments are not to be out of time if made within three years of

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

the end of the chargeable period in which the grant, payment or adjustment was made.

55. Section 360M defines the circumstances in which a balancing adjustment is made.
56. Subsection (1) of Section 360M provides for a balancing adjustment to be made if qualifying expenditure has been incurred and a balancing event occurs.
57. Subsection (2) defines a balancing adjustment as either a balancing allowance or a balancing charge, and provides that the adjustment is made for the chargeable period in which the balancing event takes place.
58. Subsection (3) provides that the balancing allowance or balancing charge is made on the person who incurred the qualifying expenditure.
59. Subsection (4) prevents a balancing adjustment being made if the balancing event takes place more than seven years after the time when the qualifying building was first used or suitable for letting for use for either of the purposes mentioned in section 360D(1)(b).
60. Subsection (5) provides that where more than one balancing event occurs, only the first gives rise to a balancing adjustment.
61. Section 360N lists the various balancing events that give rise to balancing adjustments, providing definitions as necessary.
62. Section 360O lists the proceeds from balancing events.
63. Subsection (1) of Section 360O defines the proceeds to be taken into account from a balancing event. This is done by reference to a Table, which lists the proceeds from each balancing event in turn.
64. Subsection (2) restricts the proceeds from the event to those received or receivable by the person who incurred the qualifying expenditure.
65. Subsection (3) defines the term, “commercial premium”, used in the table in subsection (1) as the premium that would have been given if the transaction had been at arm’s length.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

66. Section 360P contains the rules for calculating balancing adjustments.
67. Subsection (1) of Section 360P provides for a balancing allowance to be made if there are either no proceeds from the balancing event, or the proceeds are less than the balance of unrelieved qualifying expenditure, immediately before the event.
68. Subsection (2) defines the amount of the balancing allowance. If there are no proceeds from the event it is the residue of any unrelieved qualifying expenditure. If there are proceeds, it is the excess of the residue over the proceeds.
69. Subsection (3) provides for a balancing charge to be made if the proceeds are more than the residue of unrelieved qualifying expenditure immediately before the balancing event.
70. Subsection (4) defines the amount of the balancing charge as the difference between the proceeds and any residue of qualifying expenditure, or the proceeds, if the residue of unrelieved qualifying expenditure is nil.
71. Subsection (5) provides that the balancing charge cannot exceed the total of any initial allowance and writing-down allowances, made in respect of the expenditure, and given in the chargeable periods, ending on or before the date of the balancing event that gives rise to the balancing adjustment.
72. Section 360Q determines when qualifying expenditure is to be written off and to what extent.
73. Section 360R deals with the writing off of initial and writing-down allowances.
74. Subsection (1) of Section 360R provides that initial allowances, if made, are written off at the time when the qualifying business premises are first used or suitable for letting for use for the specified business purposes.
75. Subsections (2) and (3) provide that where a writing-down allowance is made, that amount is written off at the end of the chargeable period. But where a balancing event takes place at the end of a chargeable period, the amount written off in the period is to be taken into account in computing any balancing adjustment.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

76. Section 360S deals with the treatment of demolition costs.
77. Subsections (1) to (3) provide that, where a qualifying building is demolished, and the cost is met by the person who incurred the conversion or renovation expenditure, the net cost of the demolition is added to the residue of qualifying expenditure immediately before the demolition. The net costs are those costs incurred on demolition less any monies received for the remains of the qualifying building.
78. Subsection (4) provides that neither the costs nor the net costs of demolition are to be treated as expenditure on any property replacing the demolished qualifying building.
79. Section 360T to 360Y: In broad terms, these sections provide how additional VAT liabilities and rebates should be taken into account for the purposes of initial allowances, writing-down allowances and balancing adjustments, in respect of qualifying expenditure under the scheme.
80. Section 360T specifies the sections in the Capital Allowances Act 2001 where the terms “additional VAT liability” and “additional VAT rebate” are defined (section 547) and where the timing of each, and the chargeable period in which each accrues, is laid down (sections 548 and 549 respectively).
81. Section 360U provides how additional VAT liabilities are to be taken into account for the purposes of initial allowances.
82. Subsection (1) to (3) of Section 360U provide what is to happen if a person, who was entitled to an initial allowance in respect of qualifying expenditure on a qualifying building, incurs an additional VAT liability in respect of that expenditure, at a time when the qualifying building is still, or is about to be, qualifying business premises. In these circumstances, the person with the relevant interest is entitled to an initial allowance of 100 per cent of the amount of the additional VAT liability.
83. Subsection (4) provides that the person may require the initial allowance to be reduced to a specified sum.
84. Subsection (5) provides that the allowance is made for the chargeable period in which the additional VAT liability accrues.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

85. Section 360V provides how additional VAT liabilities are to be taken into account for the purposes of writing-down allowances.
86. Subsections (1) and (2) provide that if the person entitled to the relevant interest in relation to qualifying expenditure incurs an additional VAT liability in respect of that expenditure, the additional VAT liability is to be treated as qualifying expenditure and the amount of the residue of qualifying expenditure is to be increased by the amount of the liability.
87. Section 360W provides that if an initial allowance is made in respect of an additional VAT liability incurred after the qualifying business premises are first used, or suitable for letting for business use, the amount of the allowance is written off at the time when the liability accrues.
88. Section 360X provides how additional VAT rebates are to be taken into account for the purposes of balancing adjustments.
89. Subsections (1) to (4) provide that if an additional VAT rebate is made in respect of qualifying expenditure to the person entitled to the relevant interest in relation to that expenditure, the making of the rebate is a balancing event. A balancing charge arises if the amount of the additional VAT rebate is more than the amount of the residue of qualifying expenditure, at the time when the rebate accrues, or there is no such residue. The amount of the balancing charge is the amount of the difference or the amount of the rebate (if there is no residue).
90. Section 360Y provides that if an additional VAT rebate is made in respect of qualifying expenditure, an amount equal to the rebate is written off at the time when the rebate accrues.
91. Section 360Z provides how to give effect to allowances and charges in the case of profits from a trade.
92. Subsection (1) of Section 360Z provides that the allowance is to be treated as an expense of the trade, and the charge as a receipt of the trade.
93. Subsection (2) provides that in the case of a person who is entitled to an allowance or liable to a charge in respect of a qualifying building and who occupies that building in the course of a

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

profession or vocation, the allowance or charge is to be treated as an expense or charge respectively, of that profession or vocation.

94. Section 360Z1 provides how to give effect to allowances and charges in the case of lessors and licensees.
95. Subsections (1) to (3) provide what is to happen if a person is entitled to an allowance or liable for a charge for a chargeable period, but his interest in the building is or was subject to a lease or licence at any time in that period. In this situation, if the person's interest in the building is an asset of a property business, the allowance is given as an expense of the business, or charge is given as a receipt of the business. And if the person's interest is not an asset of a property business, the allowance or charge is to be given effect by treating him as if he had been carrying on a property business during the period.
96. Section 360Z2 contains rules for making apportionments if sums relate partly to non-qualifying assets.
97. Subsection (1) of Section 360Z2 provides that where a sum is paid for the sale of the relevant interest in a qualifying building and the sum relates partly to assets representing qualifying expenditure and partly to other assets, the proportion of the sum paid referable to the assets representing qualifying expenditure is found by making a just and reasonable apportionment of the total amount.
98. Subsection (2) applies this apportionment rule to any proceeds from a balancing event as it would to the sale of the relevant interest.
99. Subsection (3) ensures that these apportionment rules do not affect any other provisions in the CAA 2001 requiring the apportionment of the proceeds of a balancing event.
100. Section 360Z3 deals with termination of leases
101. Subsection (1) of Section 360Z3 applies the rules in the section if a lease is terminated.
102. Subsection (2) provides that if, with the consent of the lessor, a lessee remains in possession of the qualifying building after the lease has terminated, and without a new lease being granted, the

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

lease is treated as continuing as long as the lessee remains in possession.

103. Subsection (3) provides that a new lease is treated as a continuation of the first lease if it is granted as a result of the exercise of an option available under the terms of the first lease.
104. Subsection (4) provides that a lease is treated as if it had come to an end by surrender in consideration of the payment if, on termination, the lessor pays a sum to the lessee.
105. Subsection (5) provides that if on the termination of a lease, another lease is granted to a different person who pays the first lessee a sum in connection with the transaction, the two leases are treated as if they were the same lease, assigned by the first lessee to the second, in consideration of the payment.
106. Section 360Z4 defines the meaning of “lease” for the purposes of Part 3A to include agreement for a lease, if the term to be covered by the lease has begun, and any tenancy. It does not include a mortgage. The section also provides how the meanings of certain terms in Part 3A are to be interpreted and applied in Scotland.

Part 2 – Consequential Amendments

107. Paragraph 2 includes Part 3A business premises renovation allowances within the list of capital allowances covered by CAA 2001.
108. Paragraph 3 includes Part 3A business premises renovation allowances within the general rules for giving effect to allowances and charges.
109. Paragraph 4 inserts a reference to Part 3A business premises renovation allowances in section 3 of CAA 2001 relating to claims for capital allowances. The new subsection provides that any claim for an allowance under Part 3A must be separately identified as such in the tax return.
110. Paragraph 5 makes necessary amendments to ensure the provisions regarding contribution allowances are unaffected by the introduction of the new Part 3A business premises renovation allowances.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

111. Paragraph 6 provides that the interpretation provisions in the CAA 2001 concerning additional VAT liabilities and rebates will apply to Chapter 10 of Part 3A (business premises renovation allowances: additional Vat liabilities and rebates).
112. Paragraph 7 applies to Part 3A business premises renovation allowances the rules in section 567 that treat sales between connected persons, or sole or main benefit sales as taking place at market value.
113. Paragraph 8 excludes Part 3A business premises renovation allowances from the special provisions that permit connected persons to elect for transfers of assets between them to be treated to take place at an amount that gives rise to neither a balancing charge or a balancing allowance.
114. Paragraph 9 applies to Part 3A business premises renovation allowances the special rules in section 570A concerning avoidance affecting the proceeds of a balancing event.
115. Paragraph 10 applies to Part 3A business premises renovation allowances the provisions of section 573, transfers treated as sales.
116. Paragraph 11 introduces various terms used in Part 3A into the index of defined terms in Part 2 of Schedule 1 CAA 2001.

BACKGROUND NOTE

117. Capital allowances allow the cost of capital assets to be written off against taxable profits. They take the place of depreciation in the commercial accounts, which is not allowed for tax.
118. Different types of asset qualify for capital allowances at different rates. For example, expenditure on plant and machinery normally qualifies for allowances at 25 per cent a year, on the “reducing balance” basis, and capital expenditure on industrial buildings (including certain qualifying hotels) and agricultural buildings normally qualifies for allowances at 4 per cent a year on the “straight line” basis. Not all expenditure necessarily qualifies for allowances. For example, expenditure on commercial buildings (such as offices and shops) does not normally qualify for capital allowances.

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSE 92 AND
SCHEDULE 6

119. Thus the Business Premises Allowance (BPPA) scheme, which would provide 100 per cent initial capital allowances for the capital costs of renovating or converting premises that have been unused for a year or more, in any of the designated disadvantaged areas of the UK, potentially provides partly an enhanced rate of allowance and partly a new relief.

120. BPPA is part of the Government's holistic approach to regeneration. It is intended to increase private investment in disadvantaged communities, by bringing longer-term vacant business properties back into productive use. The 1997 designated disadvantaged areas, often called "Enterprise Areas", which are the target of measures like BPPA, were announced in the 2002 Pre-Budget Report. Other Enterprise Area measures include the Community Investment Tax Credit, the Phoenix Fund and the Bridges Community Venture Capital Fund.

EXPLANATORY NOTE

CLAUSE 93 AND SCHEDULE 7: TONNAGE TAX

SUMMARY

1. Clause 93 and Schedule 7 make a number of changes to the legislation that deals with tonnage tax. The changes implement the recommendations of the Government's post implementation report on the operation of tonnage tax and ensure continued compliance with European Community guidelines on state aid to the maritime transport industry.
2. The changes will give companies a new opportunity to elect in to tonnage tax. In addition, activities which qualify under the scheme will be extended to cover dredging, multi-function vessels and North Sea emergency response vessels. The changes also limit the access to the regime of non-EU flagged vessels, and exclude harbour towage operations.

DETAILS OF THE CLAUSE

3. The Clause introduces Schedule 7 which amends Schedule 22 of the Finance Act 2000.

DETAILS OF THE SCHEDULE

4. Paragraph 1 introduces the amendments.
5. Paragraph 2 amends paragraph 13 of Schedule 22 by inserting a new sub-paragraph 2A which provides that an election to be within the tonnage tax regime shall cease to be in force for a company or a group when a withdrawal notice takes effect under paragraph 15A of Schedule 22.

6. Paragraph 3 inserts new paragraphs 15A and 15B into Schedule 22. New paragraph 15A provides that a withdrawal notice may be given subject to the following conditions:
- the notice must be given between the passing of the Finance Act 2005 and 31 March 2006
 - a tonnage tax election must have been in force for the three years up to the passing of Finance Act 2005
 - the withdrawal notice is given by the company or group as appropriate

The withdrawal notice takes effect immediately before the start of the first accounting period of the company to begin after 1 July 2005.

Where the withdrawal notice relates to a group, sub-paragraph 5 applies to each company in the group according to its own accounting period.

7. New paragraph 15B provides that the Treasury can provide for further periods during which withdrawal notices may be given. They can amend the conditions that apply with regard to the period in which an election has to be given and the length of time a company or group has been subject to a tonnage tax election.
8. Paragraph 4 amends paragraph 19 of Schedule 22 (defining a qualifying ship for tonnage tax) by:
- making it clear that the four categories of use in sub-paragraph 19(1) only apply when carried out at sea
 - providing that sub-paragraph 19(1) is also subject to paragraphs 20A (relating to the use of tugs and dredgers) and paragraphs 22A to 22F (flagging rules)
 - by inserting new sub-paragraph 5 which qualifies the meaning of “sea”.
9. Paragraph 5 amends the list of vessels excluded from being qualifying ships in paragraph 20 of Schedule 22 by:
- inserting new sub-paragraph 1(f) which covers dredgers other than qualifying dredgers; and
 - inserting new sub-paragraph 7 which defines a qualifying dredger.
10. Paragraph 6 inserts new paragraph 20A into Schedule 22 which further defines what is meant by a qualifying dredger or a tug. The purposes of this paragraph are to ensure that:
- only dredgers carrying out significant transport activity will be qualifying ships, and

**BOARD OF INLAND REVENUE
RESOLUTION 43**

**FINANCE (No. 2) BILL 2005
CLAUSE 93
SCHEDULE 7**

- tugs operating primarily in and around ports and harbours will not be qualifying ships.
11. New paragraph 20A(1) provides that the paragraph is to apply where the company operates a dredger or tug in an accounting period that would, without the paragraph, be a qualifying ship.
 12. New paragraph 20A(2) provides that the ship shall not be a qualifying ship unless it is used for more than 50% of its operational time in that accounting period on activities mentioned in paragraph 19(1)(a) to (d) of Schedule 22.
 13. New paragraph 20A(3) defines “operational time” as meaning the time in an accounting period during which the ship is operated by the company and used for any activity.
 14. New paragraph 20A(4) provides that for the purposes of new paragraph 20A(2) (the 50% operational time test) assisting a self-propelled vessel into or out of a port or harbour is not regarded as an activity within paragraph 19(1)(c) (towage, salvage or other marine assistance).
 15. New paragraph 20A(5) provides that “operational time” for a tug includes any time spent waiting to perform a particular activity.
 16. Paragraph 7 amends sub-paragraphs 22(1), (2)(b) and (5) of Schedule 22 to change references to a qualifying ship being used as a “vessel of an excluded kind” to one being used for “non-qualifying purposes”. This change ensures that the benefit of the de minimis rule which disregards the first thirty days of use of a vessel as an excluded vessel is also available where a qualifying vessel is used for non-qualifying purposes.
 17. It also amends sub-paragraph 22(5) so that “non-qualifying purposes” means both use for any activity other than one of those mentioned in paragraph 19(1)(a) to (d) as well as use as a vessel of a kind referred to in Paragraph 20 (excluded vessels).
 18. Paragraph 7(5) inserts new sub-paragraph 6 so that the paragraph does not apply for the purposes of paragraph 20A (qualifying tugs and dredgers).
 19. Paragraph 8 inserts new paragraphs 22A to 22C which provide a flagging rule for ships other than dredgers and tugs. Under European Commission state aid guidelines, dredgers and tugs must be registered in a Member State to qualify for tonnage tax or other

state aids. Other ships may be registered under any flag, but operators bringing new ships into tonnage tax will have to do so under a Member State registration if all the relevant conditions are met. Non-Community registered ships caught by the rule can still qualify if they, or a substitute qualifying ship, are re-registered to a Community flag within three months of first operation.

20. New paragraph 22A provides that a ship other than a qualifying dredger or a tug, is not a qualifying ship if certain conditions are met
- The first condition is that on or after the later of the “reference date” (the end of the first accounting period in which the company or group became a tonnage tax company) or 1 July 2005, in a financial year which is not excepted, the company begins to operate the ship for the first time; or, where the company is a member of a group, operates it for the first time where it has not previously been operated by any member of the group.
 - The second is that less than 60% of its tonnage is Community flagged on average over the period from the beginning of the financial year to the day it begins to operate the ship.
 - The third is that when it begins to operate the ship its percentage of Community flagged tonnage over the same period as in condition 2 is less than when it became a tonnage tax company.
 - The fourth is that the ship is not registered in one of the Member States’ registers.

However the paragraph does not apply if within three months of the company beginning to operate the ship it is registered in one of the Member States’ registers. Nor does it apply if a ship of equivalent or greater tonnage which is already operated by the company is registered in one of the Member States’ registers within three months of starting to operate the first ship, and the company makes an election to this effect.

21. New paragraph 22B defines terms used in new paragraph 22A. In particular:
- The “reference date”
 - When a financial year is “excepted”
 - The calculation of the percentage of a company’s tonnage that is Community flagged
 - “Member States’ registers”

**BOARD OF INLAND REVENUE
RESOLUTION 43**

**FINANCE (No. 2) BILL 2005
CLAUSE 93
SCHEDULE 7**

22. New paragraph 22C provides provisions supplementary to new paragraphs 22A and 22B. In particular:
- Provision for the Treasury to make regulations designating a financial year for the purposes of new paragraph 22A
 - Provision for the Treasury to make regulations:
 - ◆ directing the way in which the percentage of Community flagged tonnage is to be calculated
 - ◆ requiring a company or group to provide information to enable the Treasury to calculate the percentage
 - ◆ imposing penalties for failing to supply information.
23. Paragraph 9 inserts new paragraphs 22D and 22E providing flagging rules for qualifying dredgers and tugs. Under European Commission state aid guidelines, dredgers and tugs must be registered in a Member State to qualify for tonnage tax or other state aids. Ships that fail to observe this rule will be barred from subsequent entry into tonnage tax.
24. New paragraph 22D provides that a qualifying dredger or a tug is not a qualifying ship if certain conditions are met:
- The first is that when the company begins to operate the ship it has not previously been operated by the company, or where the company is a member of a group, by a group company
 - The second is that the ship is not registered in one of the Member States' registers.
- However the paragraph does not apply if within three months of the company beginning to operate the ship it is registered in one of the Member States' registers.
25. New paragraph 22E provides that if a qualifying dredger or tug ceases to be registered in any of the Member States' registers it shall not at any time on or after that date be regarded as a qualifying ship operated by the company, or where the company is a member of a group a qualifying ship operated by any member of a company that is or becomes a member of the group.
26. Paragraph 10 inserts new paragraph 22F which provides restrictions to allowances where a qualifying dredger or tug ceases to be a qualifying ship because of re-flagging. It is intended as a deterrent to companies that wish to remove a particular ship from tonnage tax, either temporarily or permanently, in order to gain a tax advantage. In particular:

**BOARD OF INLAND REVENUE
RESOLUTION 43**

**FINANCE (No. 2) BILL 2005
CLAUSE 93
SCHEDULE 7**

- No notice may be given under s.130 CAA 2001 postponing first year or writing down allowance in respect of qualifying expenditure on the ship.
 - No claim may be made for the deferment of any balancing charge under s.135 CAA 2001 arising from a disposal on or after the date on which the ship ceased to be qualifying ship.
 - It restricts relief for losses incurred after the ship ceases to be a qualifying ship by only allowing them to be carried forward under s.393(1) ICTA 88.
27. Paragraph 11 inserts new paragraph 43A which gives the Secretary of State powers to make regulations requiring companies to provide evidence of compliance with safety matters etc.
28. Paragraph 12 amends paragraph 68 of Schedule 22 by substituting a new description of a company's position on leaving tonnage tax to take account of the amendments made by paragraph 13 described below.
29. Paragraph 13 amends paragraph 85 of Schedule 22 to provide new rules for capital allowances on plant and machinery by inserting new sub-paragraph 1A to 1C. These provide that the rules in paragraph 85(2) do not apply where a company leaves tonnage tax on the expiry of a tonnage tax election or the election ceasing to be in force by virtue of a withdrawal notice given as described in paragraph 15A. In these circumstances, for each asset used by the company in its tonnage tax trade the amount of qualifying expenditure shall be the lower of:
- The market value of the asset at the time of leaving tonnage tax; or
 - The amount incurred on the provision of the asset that would have been qualifying expenditure if the company had not been subject to tonnage tax.
30. Paragraph 14 amends paragraph 92 of Schedule 22, which restricts the capital allowances available to the lessor if a lease is part of a sale and lease-back arrangement. It inserts new sub-paragraph 3A which allows the lessor to get capital allowances if expenditure is incurred in enhancing a ship or converting it to another use and conditions are met as to the amount of the expenditure compared to the market value of the ship and also the timing of the transaction following completion of the enhancement or conversion. The purpose of this provision is to provide equivalent treatment for expenditure on ships that are subject to a major re-fit and new-build ships.

**BOARD OF INLAND REVENUE
RESOLUTION 43**

**FINANCE (No. 2) BILL 2005
CLAUSE 93
SCHEDULE 7**

31. Paragraphs 15 and 16 amend the special rules for offshore activities by deleting paragraph 105, the list of types of vessels to which the special rules do not apply, and inserting new subparagraphs 104(1A) and (1B). Sub-paragraph (1A) sets out a list of activities which are not to be regarded as offshore activities, and (1B) enables the Treasury to add to or vary any the list of excluded activities.
32. The change from type of vessel to type of activity ensures that where a vessel is used partly for an excluded purpose and partly for offshore activities, then the vessel can still qualify for tonnage tax to the extent that it is engaged in qualifying activities that are not offshore activities.
33. The list contains an additional entry relating to safety or rescue services, enabling a new class of vessel to qualify for tonnage tax for the first time.
34. Paragraph 17 updates the index of defined expressions in paragraph 47 of Schedule 22.
35. Paragraph 18 provides for commencement from 1 July 2005 for certain provisions, and from the date when the Finance Act 2005 is passed for the remainder, subject to the transitional rules in paragraphs 19 to 21 described below.
36. Paragraph 19 is a transitional provision. It provides that where a withdrawal notice under paragraph 15A is given by 31 March 2006, paragraphs 4 and 6 (in so far as the latter relates to tugs) shall not have effect until the first day of the first accounting period of the company to begin after 1 July 2005. It ensures that companies that would be adversely affected by the changes to the rules for qualifying ships which otherwise come into force on 1 July 2005 can choose to exit from the tonnage tax regime at the end of their current accounting period without the new rules applying.
37. Paragraph 20 is a transitional period for the financial year 2005. It provides that an order excepting the financial year 2005 as a year to which the flagging rules do not apply can be made after the commencement of the year.
38. Paragraph 21 ensures that the flagging rule for qualifying dredgers and tugs applies to all such vessels, including those first operated before 1 July 2005, by disregarding any use before that date.