

**EXPLANATORY MEMORANDUM TO
THE INCOME TAX ACT 2007 (AMENDMENT) ORDER 2009
2009 No. 23**

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

- 2.1 This instrument makes amendments to the Income and Corporation Taxes Act 1988 ("ICTA"), the Finance Act 1994 ("FA 1994"), the Taxation of Chargeable Gains Act 1992 ("TCGA 1992") and the Income Tax Act 2007 ("ITA 2007").

- 2.2 The instrument makes a consequential amendment to section 256 of TCGA 1992 that was inadvertently omitted from ITA 2007. It also corrects four minor errors in ITA 2007, one of which also affects ICTA. That error concerns both section 504 of ITA 2007 and section 469(2) of ICTA. The other errors concern sections 821, 904 and 1007 of ITA 2007 respectively.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

The amendments that are contained in the instrument take effect retrospectively from the date on which ITA 2007 came into force. The authority for this is contained in sections 1028(4) and 1029(4) of ITA 2007.

4. **Legislative Context**

- 4.1 The Tax Law Rewrite project was established in 1996. ITA 2007 was the project's fourth Act and the third relating to income tax.

- 4.2 The project's aim is to rewrite the United Kingdom's primary direct tax legislation to make it clearer and easier to use, without changing the law (apart from minor identified changes).

- 4.3 The amendments made by the instrument concern the following.

Section 256 of TCGA 1992

- 4.4 Section 256(3) to (5) and sections 256A and 256B were inserted in TCGA 1992 by paragraphs 326 and 327 of Schedule 1 to ITA 2007. The new subsections and sections of TCGA 1992 make provision in relation to charitable trusts. They are based on the capital gains tax aspects of the provisions of section 505(4) and (7) of ICTA. The income tax aspects of the provisions of section 505(4) and (7) of ICTA are rewritten in Part 10 of ITA 2007 (see sections 539 to 542).

- 4.5 ITA 2007 introduced the term "charitable trust" to cover charities that are subject to income tax. The term is defined for the purposes of Part 10 of

ITA 2007 in section 519 of that Act. The term was not previously used in TCGA 1992 and the amendments made to TCGA 1992 by ITA 2007 did not include a definition of the term for the purposes of TCGA 1992. Article 3 of the instrument makes a further amendment to section 256 of TCGA 1992 applying the definition in section 519 of ITA 2007 in sections 256(3) and (4), 256A and 256B of TCGA 1992.

Section 469(2) of ICTA and section 504 of ITA 2007

- 4.6 Section 469 of ICTA (other unit trusts) sets out a special regime for unit trust schemes which are neither authorised unit trusts nor umbrella schemes. Prior to ITA 2007, section 469(2) of ICTA included the words “and the trustees (and not the unit holders) shall be regarded as the persons to or on whom allowances or charges are to be made under the provisions of those Acts [*that is the Tax Acts*] relating to relief for capital expenditure”.
- 4.7 In rewriting that subsection for income tax purposes in section 504 of ITA 2007 it was concluded that those words were otiose as under self-assessment allowances and charges form part of the calculation of income. They were accordingly omitted from ITA 2007 and a consequential amendment was made omitting them from section 469(2) of ICTA which remains in force for corporation tax purposes.
- 4.8 On further consideration, doubt has arisen whether, in the absence of those words, provisions of the Capital Allowances Act 2001 relating to ownership of assets and the carrying on of a qualifying activity are properly to be construed as applying to the trustees of an unauthorised unit trust rather than to the unit holders. To put the matter beyond doubt and restore the position prior to ITA 2007, article 2(3) of the instrument reinstates the words in section 469(2) of ICTA for corporation tax purposes and article 5(2) of the instrument adds new section 504A of ITA 2007 containing the equivalent provision for income tax purposes.

Section 821 of ITA 2007

- 4.9 Section 821 of ITA 2007 is based on section 127(5) of the Finance Act 1995 and paragraph 4(3) of Schedule 26 to the Finance Act 2003. It defines “relevant disregarded income” for the purposes of the limits on liability to income tax of non-UK resident companies and of non-UK residents other than companies in respect of investment transactions carried out through an investment manager in the United Kingdom.
- 4.10 In relation to non-UK resident companies the wording of section 821(4) of ITA 2007 mistakenly adopts wording based on section 127(5) of the Finance Act 1995 where it should have followed the wording of paragraph 4(3) of Schedule 26 to the Finance Act 2003. Paragraph 4(3) of that Schedule applies to any transactions, not just investment transactions as defined in paragraph 3(3) of that Schedule, so carried out and requires that in relation to them the investment manager does not (apart from the

requirements of the 20% rule) fall to be treated as a permanent establishment of the non-UK resident company. This error is similar to the error in section 816 of ITA 2007 which was corrected by Article 3(4) of the Income Tax Act 2007 (Amendment) (No. 3) Order 2007 (SI 2007/3506).

- 4.11 This error has the effect that, for the purposes of the requirements of the 20% rule, instead of income from any transactions carried out on behalf of a non-UK resident company by an investment manager, only income from investment transactions (as defined in section 827(2) of ITA 2007) so carried out is to be taken into account as relevant disregarded income. Article 5(3) of the instrument introduces a new section 821(5) of ITA 2007, based on paragraph 4(3) of Schedule 26 to the Finance Act 2003, in relation to non-UK resident companies, while retaining the existing provision in section 821(4) of ITA 2007, based on section 127(5) of the Finance Act 1995, in relation to non-UK residents other than companies.

Section 904 of ITA

- 4.12 Section 904 of ITA 2007 (annual payments for dividends or non-taxable consideration) rewrites section 125(2) to (4) of ICTA for income tax purposes. Section 904 applies for two purposes.
- 4.13 Section 904 applies, and is expressed in subsection (1) to apply, for the purposes of sections 899(5)(f) and 903(2)(b) of ITA 2007. Together those provisions rewrite section 125(1) of ICTA so far as it provides for a payment to which section 125(1) applies to be made without deduction of income tax. Section 125(2)(a)(i) of ICTA contains an exclusion for payments charged with income tax as “relevant foreign income” (as defined in section 830(1) of the Income Tax (Trading and Other Income) Act 2005). But in section 904(2)(a) of ITA 2007, which rewrites section 125(2)(a)(i) of ICTA, it was considered unnecessary to rewrite the exclusion for relevant foreign income, because sections 899(2) and 903(3) of ITA 2007 already provide that payments to which those sections apply must arise in the United Kingdom (and “relevant foreign income” by definition does not arise in the United Kingdom).
- 4.14 Section 904 also applies for the purposes of section 843 of ITA 2007, although not expressly stated to do so in section 904 itself. Together, those sections provide the income tax rewrite of section 125 of ICTA so far as it prohibits a deduction for a payment to which section 125(1) of ICTA applies in computing the income or total income of the person who makes the payment. As the prohibition in section 843 of ITA 2007 applies to an annual payment from any source, the effect of omitting the exclusion for relevant foreign income from section 904(2)(a) of ITA 2007 is that the prohibition in section 843 extends to annual payments arising outside the United Kingdom.
- 4.15 So, while the words “otherwise than as relevant foreign income” may not be necessary in section 904 of ITA 2007 as it applies for the purposes of

section 899(5)(f) and 903(2)(b) of that Act, their omission has the unintended effect that the prohibition in section 843 of ITA 2007 goes further than in the source legislation. Article 5(4) of the instrument ensures that the scope of the prohibition in section 843 of ITA 2007 is brought into line with the source legislation (which continues to apply for corporation tax purposes) by re-instating the omitted words in section 904(2)(a) of ITA 2007.

Section 1007 of ITA 2007

- 4.16 Section 1007 of ITA 2007 defines “unit trust scheme” in the Income Tax Acts. ITA 2007 also amended the definition of “unit trust scheme” in the Corporation Tax Acts in section 832(1) of ICTA, which previously cross-referred to the meaning given by section 469 of ICTA, to apply instead the definition in section 1007 of ITA 2007.
- 4.17 Section 469(7) of ICTA, which has been repealed by ITA 2007, provided that in section 469 “unit trust scheme” had the same meaning as in the Financial Services and Markets Act 2000 and included power for the Treasury to provide by regulations that any scheme of a specified description was to be treated as not being a unit trust scheme “for the purposes of this section”, that is section 469 of ICTA.
- 4.18 Section 1007 of ITA 2007 includes power for the Treasury to make regulations to the like effect as in section 469(7) of ICTA “for the purposes of this section”, that is section 1007 of ITA 2007.
- 4.19 The words “for the purposes of this section” in section 1007 of ITA 2007 have the inadvertent consequence of extending the scope of the power conferred by section 469(7) of ICTA, which was previously limited to unit trust schemes which are neither authorised unit trusts nor umbrella schemes, as it operated only for the purposes of section 469.
- 4.20 No regulations have been made under the power in section 469(7) of ICTA or under the power in section 1007(2) of ITA. The amendment to section 1007(2) of ITA 2007 made by article 5(5) of the instrument restores the scope of the Treasury’s power to what it was before the enactment of ITA 2007.
- 4.21 Article 2(2) of the instrument makes a related amendment to section 469(1) of ICTA and article 2(4) omits section 469(6A) of ICTA which as a consequence of the amendment of subsection (1) by article 2(2) is otiose. Article 4 of the instrument omits section 113(3) of FA 1994 which amended section 469 of ICTA by substituting the words in subsection (1) for which article 2(2) makes substitution and by inserting subsection (6A) which article 2(4) omits.

5. Territorial Extent and Application

The instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to The Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Income Tax Act 2007 (Amendment) Order 2008 are compatible with the Convention rights.

7. Policy Background

- 7.1 ITA 2007 completed the main work of the Tax Law Rewrite project in relation to the rewrite of income tax. The powers in sections 1028 and 1029 were included to ensure that amendments could be made quickly and easily and without recourse to a Finance Bill.
- 7.2 The amendments that are contained in the instrument take effect retrospectively from the date on which ITA 2007 came into force. The insertion of the missed consequential amendment in TCGA 1992 is purely clarificatory. The correction of the errors restores the generally understood meaning of the provisions. Making the instrument retrospective ensures that there will be no period of time during which the law is unclear.

8. Consultation outcome

- 8.1 At the meeting of the Joint Committee on Tax Law Rewrite Bills on 24 January 2007 the then Financial Secretary to the Treasury, John Healey, gave an assurance that the power in section 1029 of ITA 2007 would not be used without the agreement of the Tax Law Rewrite Consultative and Steering Committees. Equally, as stated in Explanatory Notes to section 1028 of ITA 2007, the project is committed to obtaining the agreement of those Committees to the exercise of the power contained in that section.
- 8.2 Papers explaining the reasons for the amendments made by this instrument have been considered by those Committees and their agreement has been obtained to the exercise of these powers.

9. Guidance

A copy of the instrument and this explanatory memorandum will be placed on the Tax Law Rewrite section of the HMRC website.

10. Impact

- 10.1 No impact on the private or voluntary sectors is foreseen.
- 10.2 There is no impact on the public sector.
- 10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

- 11.1 The legislation applies to small business.
- 11.2 To minimise the impact of the requirements on businesses, including firms employing up to 20 people, the approach taken is to introduce these amendments with retrospective effect, so that there is no uncertainty at any

time about the effect of the rewritten legislation. This fulfils the aim of the TLR project which is to make the legislation clearer and easier to use, without changing the law (apart from minor, identified changes).

- 11.3 The basis for the final decision on what action to take to assist small business includes consideration by the Tax Law Rewrite Consultative Committee of the impact on such businesses. The membership of this committee includes representatives of a number of organisations and professional bodies which represent, or whose members' clients include small businesses.

12. Monitoring & review

No monitoring or review is required as a result of this instrument.

13. Contact

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