

# **INCOME TAX (TRADING AND OTHER INCOME) ACT 2005**

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## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### **Part 10: General provisions**

##### *Chapter 3: Supplementary and general provisions*

##### *Section 873: Orders and regulations made by Treasury or Board*

3290. This section is based on section 828 of ICTA.

##### *Section 874: Activities in UK sector of continental shelf*

3291. This section is based on section 830 of ICTA.

##### *Section 875: Meaning of “caravan”*

3292. This section is based on sections 15 and 65A of ICTA, section 29 of the Caravan Sites and Control of Development Act 1960, section 13 of the Caravan Sites Act 1968, section 8 of the Mobile Homes Act 1975 and Schedule 9 to the Roads (Scotland) Act 1984.

3293. It effects a change in the law in two ways. First it provides a uniform definition of “caravan” for the whole of the United Kingdom. Second it applies that definition to all occurrences of “caravan” in this Act. See *Change 148* in Annex 1.

##### *Section 876: Meaning of “farming” and related expressions*

3294. This section defines “farming” and “market gardening” and clarifies the meaning of “forestry” and “woodlands”. It is based on section 832(1) of ICTA and section 154 of FA 1995.

3295. Section 832(1) of ICTA defines “farm land” and “market garden land”. It then goes on to say that “farming” and “market gardening” “shall be construed accordingly”. The reasons for this approach are largely historic and date from the time when the charge on farming and market gardening was under Schedule B. “Farm land” and “market garden land” are no longer terms used in the rules concerned with farming and market gardening; they remain only in the definition in section 832(1) of ICTA.

3296. The definitions in this section take a different approach. They define “farming” and “market gardening” by reference to the nature of the activity, not the land on which the activity is carried out. Farming excludes market gardening.

3297. Farming is an activity which is given differing taxation treatment depending on whether or not the land is situated in the United Kingdom. Section 832(1) of ICTA provides that

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the definitions of “farm land” and “market garden land” are confined to land occupied in the United Kingdom.

3298. There is no territorial restriction in the definitions in this Act. Instead the territorial restriction is included in the rewrite of section 53(1) and (2) of ICTA as section 9 of this Act and not in the definitions.
3299. *Subsection (1)* provides the definition of “farming”. It requires the land to be occupied wholly or mainly for the purposes of husbandry. This reflects a long-standing distinction in tax law between profits resulting from the taxpayer’s occupation of the land and profits from an activity in which occupation of the land is merely incidental.
3300. In the first case the trader exploits or uses the land, for example, by growing crops or grazing animals. In the second case the trader occupies the land only because a physical location, such as a shop or factory, is needed from which to carry on the trade. Factory farming, that is the intensive rearing of fish or livestock, is not farming for income tax purposes. This is because the animals do not live or draw their sustenance from the land.
3301. Husbandry is a fairly old-fashioned term but one that is the subject of a considerable body of case law. The status of any marginal case must be determined in the light of that case law subject to the clarification given in *subsection (2)*.
3302. The definition of “farm land” in section 832 of ICTA excludes “any dwelling or domestic offices”. This section does not repeat this exclusion of farmhouses.
3303. As originally enacted, the definition of farm land in section 832(1) of ICTA specifically included the farmhouse and farm buildings as part of the farm land. The House of Lords in *IRC v Korner and Others* (1969), 45 TC 287 HL, held that the effect of this provision was that a farmhouse was an asset of the trade for which a 100% deduction could be obtained. This applies even if the farmer also uses the farmhouse as a private residence. An amendment was introduced in FA 1969 to reverse the effect of that decision. This is why the definition of “farm land” in section 832(1) of ICTA excludes “any dwelling or domestic offices”.
3304. In practice a farmer is allowed to make deductions in respect of expenditure of a revenue nature on office buildings used purely for business purposes. Such expenditure has always been treated as being incurred wholly and exclusively for the purposes of the trade and not prohibited from being deducted under section 74(1)(a) of ICTA.
3305. Section 74(1)(c) of ICTA deals with the deduction of rent where only part of a dwelling house or domestic offices are used for trade purposes. Again, in practice, a taxpayer whose trade is farming is permitted to make deductions in respect of such houses and offices.
3306. In the case of any other expenses of a residential property which is subject to dual private and business use a trader is permitted to apportion these and the proportion attributable to trade use is allowed as a deduction. Again this treatment applies to farmers. See section 34 of this Act (expenses not wholly and exclusively for trade and unconnected losses).
3307. A farmer who wishes to claim a deduction for the proportion of expenses of his or her farmhouse attributable to trade rather than private purposes can do so through section 34. Omitting the exclusion of farmhouses and domestic offices from the definition of farming gives statutory effect to what occurs in practice.
3308. *Subsection (2)* identifies two specific types of activity as “husbandry” and therefore farming.
3309. *Paragraph (a)* is based on the definition of market garden land in section 832(1) of ICTA. Hop growing is generally recognised to be farming but is often spoken of as taking place in a garden. This could bring it within the definition of “market garden

land” in section 832(1) of ICTA but for the fact that hop growing is excluded from that definition. Subsection (2)(a) makes clear that hop growing is farming.

3310. *Paragraph (b)* is based on the ordinary meaning of the word farming. Stud farming has generally been assumed to be farming for income tax purposes. The reference to “the breeding and rearing of horses and the grazing of horses in connection with those activities” makes clear what that activity encompasses for the purposes of this Act.
3311. *Subsection (5)* defines “market gardening”. It makes it clear that the produce sold must have been grown on the relevant land rather than being bought in for resale.

### **Section 877: Meaning of grossing up**

3312. This section explains what is meant by “grossing up” for the purposes of this Act and provides a formula for calculating the gross amount to be taxed. It is new.

### **Section 878: Other definitions**

3313. *Subsection (1)* defines various terms.
3314. The definition of “houseboat” is based on section 15(1) of ICTA. It effects a change in the law because it applies a single definition of “houseboat” for the whole Act. See *Change 150* in Annex 1.
3315. The definition of “Inland Revenue” is new. See *Change 149* in Annex 1.
3316. The definition of “personal representatives” is new. See *Change 151* in Annex 1.
3317. *Subsection (3)* provides a general rule concerning the making of claims and elections. It is based on section 42(11) of TMA and paragraph 2 of Schedule 1A to TMA.
3318. In the source legislation some provisions specify that a claim or election has to be in writing while others are silent. But the effect of paragraph 2(3) to (5) of Schedule 1A to TMA is that claims and elections have to be in writing (unless a specific provision says otherwise).
3319. *Subsection (5)* defines whether persons are connected by reference to section 839 of ICTA. Section 839 of ICTA applies the following tests in determining whether persons are “connected”:
- “(1) For the purposes of, and subject to, the provisions of the Tax Acts which apply this section, any question whether a person is connected with another shall be determined in accordance with the following provisions of this section (any provision that one person is connected with another being taken to mean that they are connected with one another).
  - (2) A person is connected with an individual if that person is the individual’s wife or husband, or is a relative, or the wife or husband of a relative, of the individual or of the individual’s wife or husband.
  - (3) A person, in his capacity as trustee of a settlement, is connected with—
    - (a) any individual who in relation to the settlement is a settlor,
    - (b) any person who is connected with such an individual, and
    - (c) any body corporate which is connected with that settlement.

In this subsection “settlement” and “settlor” have the same meaning as in Chapter IA of Part XV (see section 660G(1) and (2)).

- (3A) For the purpose of subsection (3) above a body corporate is connected with a settlement if—
  - (a) it is a close company (or only not a close company because it is not resident in the United Kingdom) and the participators include the trustees of the settlement; or

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- (b) it is controlled (within the meaning of section 840) by a company falling within paragraph (a) above.
  - (4) Except in relation to acquisitions or disposals of partnership assets pursuant to bona fide commercial arrangements, a person is connected with any person with whom he is in partnership, and with the wife or husband or relative of any individual with whom he is in partnership.
  - (5) A company is connected with another company—
    - (a) if the same person has control of both, or a person has control of one and persons connected with him, or he and persons connected with him, have control of the other; or
    - (b) if a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person with whom he is connected.
  - (6) A company is connected with another person if that person has control of it or if that person and persons connected with him together have control of it.
  - (7) Any two or more persons acting together to secure or exercise control of a company shall be treated in relation to that company as connected with one another and with any person acting on the directions of any of them to secure or exercise control of the company.
  - (8) In this section—
    - “company” includes any body corporate or unincorporated association, but does not include a partnership, and this section shall apply in relation to any unit trust scheme as if the scheme were a company and as if the rights of the unit holders were shares in the company;
    - “control” shall be construed in accordance with section 416; and
    - “relative” means brother, sister, ancestor or lineal descendant.
3320. *Subsection (6)* applies the definition of “control” in section 840 of ICTA. Section 840 of ICTA defines “control” in relation to a body corporate as follows:
- “For the purposes of, and subject to, the provisions of the Tax Acts which apply this section, “control”, in relation to a body corporate, means the power of a person to secure—
- (a) by means of the holding of shares or the possession of voting power in or in relation to that or any other body corporate; or
  - (b) by virtue of any powers conferred by the articles of association or other document regulating that or any other body corporate,
- that the affairs of the first-mentioned body corporate are conducted in accordance with the wishes of that person, and, in relation to a partnership, means the right to a share of more than one-half of the assets, or of more than one-half of the income, of the partnership.

### ***Section 879: Interpretation: Scotland***

- 3321. This section incorporates the effect of the devolution settlement and deals with the application of certain terms used in the Act to Scotland.
- 3322. *Subsection (1)* is based on sections 24(5) and 539(2) of ICTA which provide that in applying the provisions of Schedule A and of Chapter 2 of Part 13 of ICTA to Scotland, “assignment” means “assignment”.

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3323. *Subsection (2)* is based on *Change 19* in Annex 1 and gives certainty to the meaning of “Act”.
3324. *Subsection (3)* is based on *Change 19* in Annex 1 and gives certainty to the meaning of “enactment”.

***Section 880: Interpretation: Northern Ireland***

3325. This section incorporates the effect of the devolution settlement and deals with the application of certain terms used in the Act to Northern Ireland. It is new.
3326. *Subsection (1)* is based on *Change 19* in Annex 1 and gives certainty to the meaning of “Act”.
3327. *Subsection (2)* is based on *Change 19* in Annex 1 and gives certainty to the meaning of “enactment”.
3328. *Subsection (3)* provides that section 631 of this Act does not extend to Northern Ireland legislation. It is improbable that “enactment” in section 660B(2) of ICTA, on which section 631 is based, includes Northern Ireland legislation and to include section 631 within *Change 19* as regards to Northern Ireland would be taxpayer adverse.

***Section 881: Disapplication of corporation tax: section 9 of ICTA***

3329. This section ensures that the provisions of this Act which apply for income tax purposes only are not applied by section 9 of ICTA for corporation tax purposes. It is new.

***Section 882: Consequential amendments***

3330. This section is new. It contains a subsection introducing Schedule 1 and a power to allow the Treasury to make by order consequential amendments.
3331. The power will not be invoked without the agreement of the Tax Law Rewrite Project’s Consultative and Steering Committees to the proposed modifications.
3332. *Subsection (1)* gives effect to Schedule 1.
3333. *Subsections (2) to (5)* contain the power. It is to be exercised by Treasury order and will where appropriate allow both amendments and repeals in consequence of this Act only. But those amendments and repeals are limited in effect by subsections (4)(a) and (5). Subsection (4)(b) allows appropriate transitional or savings provisions to be made in respect of any of those amendments or repeals.

***Section 883: Commencement and transitional provisions etc.***

3334. This section is new. It provides for the commencement of the Act and also provides for certain orders to take effect on passing of the Act. It also contains a power to make by order any further transitional provision or saving which might not have been dealt with in the Act.
3335. The power will not be invoked without the agreement of the Tax Law Rewrite Project’s Consultative and Steering Committees to the proposed transitional provision or saving.
3336. *Subsection (1)*, which sets out when the Act comes into force and has effect, deals with the position for both income tax and corporation tax. The Act is in substance an income tax only Act. But it makes numerous consequential amendments to the corporation tax code. Those consequential amendments do not change the law but do require a commencement provision.
3337. *Subsection (3)* provides that the certain provisions will come into force on the passing of the Act.
3338. *Subsection (5)* contains the power. It is to be exercised by Treasury order.

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***Section 884: Repeals and revocations***

3339. This provision gives effect to Schedule 3.

***Section 885: Abbreviations and general index in Schedule 4***

3340. This provision gives effect to Schedule 4.