

*These notes refer to the Income Tax (Trading and Other Income)
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 10: General provisions

Chapter 1: Introduction

Section 864: Overview of Part 10

3257. This section introduces Part 10. It is new.

Chapter 2: General calculation rules etc.

Overview

3258. *Chapter 2* contains a number of generally applicable rules modelled on similar rules in Parts 2 and 3 of this Act. They apply to income charged to income tax other than income within those Parts.
3259. These rules are included here to save repetition at numerous points in the Act. Some of the rules apply provisions from the Parts 2 and 3 equivalent rules, rather than repeat them here. Section 1 signposts at the beginning of the Act that there are general calculation rules in this Part.

Section 865: Unpaid remuneration: non-trades and non-property businesses

3260. This section is based on section 43 of FA 1989. That section applies where profits or gains are to be “charged under Schedule D for a period of account...”. Profits or gains may be calculated for a period of account in respect of a business which is neither a trade, profession or vocation nor a property business (for example, a business whose income is charged under Chapter 3 of Part 5 of this Act (films and sound recordings: non-trade businesses)).
3261. This section uses “profits or other income”, as do other sections in this Chapter, rather than “profits or gains”, to define the scope of the rule. See the commentary on the omission of “gains” in the overview to Chapter 2 of Part 2 of this Act.
3262. The section alters the claim procedure. See *Change 8* in Annex 1.
3263. See the related commentary on sections 36 and 37 of this Act.
3264. See also paragraph 154 of Schedule 2 to this Act which preserves the commencement rule for the amendment of the source legislation by Schedule 24 to FA 2003.

Section 866: Employee benefit contributions: non-trades and non-property businesses

3265. This section is based on Schedule 24 to FA 2003. The provisions in that Schedule apply where “a calculation is required to be made for tax purposes of a person’s profits for any period...”. Profits may be calculated for a period in respect of a business which is neither a trade nor a property business.
3266. This section applies sections 39 to 44 in Part 2 of this Act in calculating the profits of a business for the purpose of any income tax charge which is not in Parts 2 or 3 of this Act. For further detail, see the commentary for those sections.
3267. See also paragraph 155 of Schedule 2 to this Act which preserves the commencement rule for the amendment of the source legislation by Schedule 24 to FA 2003. And see paragraph 156 of Schedule 2 to this Act which preserves source legislation as it applies before the FA 2004 rules about pension schemes take effect from 6 April 2006.

Section 867: Business entertainment and gifts: non-trades and non-property businesses

3268. This section is based on section 577 of ICTA. That section denies a deduction for certain expenses “in computing profits chargeable to tax under Schedule D”. Profits chargeable to tax under Schedule D include profits of a business which is neither a trade, profession or vocation nor a property business. And section 577(7)(b) of ICTA indicates that references to a trade, for the purposes of the section, include references to a business.
3269. Although in theory the section is applicable to all profits or other income charged to income tax, other than profits charged in Parts 2 and 3 of this Act, some of which are not charged under Schedule D in the source legislation, the application of the section is qualified. *Subsection (1)* restricts its scope to profits or other income “which arise from the carrying on of a business”. In effect, this puts the scope of the rule in line with that of the source legislation.
3270. This section applies the same rules regarding business entertainment and gifts as are in sections 45 to 47 in Part 2 of this Act. For further detail, see the commentary for those sections.
3271. *Subsection (5)* contains a number of exceptions, using sections 46 to 47 for this purpose. Section 47(5) makes an exception for gifts to charities and named bodies. The source legislation, section 577(9) of ICTA, limits this exception to the computation of profits under Schedule D Cases I and II, that is, to income calculated under rules rewritten in Part 2 of this Act. It was not intended that the exception be applied narrowly to the disadvantage of a business other than a trade or property business. This subsection extends the exception to such businesses. See *Change 146* in Annex 1.

Section 868: Social security contributions: non-trades etc.

3272. This section prevents a deduction for most social security contributions in calculating profits or income. It is based on section 617 of ICTA.
3273. The rule is that there can be no deduction for a taxpayer’s own social security contributions. The section achieves this by prohibiting a deduction for any contributions and making an exception for contributions that an employer makes for employees.
3274. The rule in section 617 of ICTA applies generally for tax purposes. This Act splits the rule:
- This section sets out the income tax rule for non-trading income charged to tax by this Act (including rents from “concerns” charged to tax by Chapter 8 of Part 3 of the Act);

- Section 53 sets out the income tax trading income rule (applied also to property income by section 272);
- A new section 360A of ITEPA is introduced by this Act (see paragraph 594 of Schedule 1 to this Act) to set out the rule for employment income; and
- Section 617 of ICTA as consequentially amended (see paragraph 262 of Schedule 1 to this Act) continues to apply for corporation tax.

Section 869: Penalties, interest and VAT surcharges: non-trades etc.

3275. This section contains the general rule that tax penalties and interest are not to be deducted for tax purposes. It is based on section 90 of TMA and section 827 of ICTA.
3276. The section brings together all the rules prohibiting a deduction for penalties, interest and surcharges imposed by statute. So it deals with interest on unpaid income tax (imposed by TMA) in the same section as the penalties, interest and surcharges relating to the indirect taxes that are dealt with in section 827 of ICTA.
3277. The table in subsection (4) sets out the specific statutory references because a general description of the penalties etc would not be precise enough. But the second column of the table is a description of the tax to indicate what is involved.

Section 870: Crime-related payments: non-trades and non-property businesses

3278. This section is based on section 577A of ICTA. That section denies a deduction for certain crime-related expenses “in computing profits chargeable to tax under Schedule D...” Profits chargeable to tax under Schedule D include profits of a business which is neither a trade, profession or vocation nor a property business.
3279. The section applies to profits or other income charged to income tax other than in Parts 2 and 3 of this Act. Some of those profits or other income are not charged under Schedule D in the source legislation. But the prohibition of a deduction is not thought to have any practical effect on profits or other income which are not charged under Schedule D in the source legislation. The scope of the prohibition is therefore unchanged.
3280. See the related commentary for section 55 of this Act. See also paragraph 157 of Schedule 2 to this Act which preserves the commencement rule for the amendment of the source legislation by section 68 of FA 2002.

Section 871: Apportionment etc. of miscellaneous profits to tax year

3281. This section is based on section 72 of ICTA. That section applies where it is necessary to apportion profits or losses for a period of account between tax years “in the case of any profits or gains chargeable under Case I, II or VI of Schedule D...” The application of section 72 of ICTA is therefore not limited to profits or losses of a trade, profession or vocation.
3282. The section applies where income is chargeable under a provision to which section 836B of ICTA applies (that section is inserted by paragraph 340 of Schedule 1 to this Act). Although section 836B of ICTA does not apply to relevant foreign income, *subsection (2)* of this section qualifies the reference to that section so that the benefit of the apportionment rules extends to such income (that is, to income charged under Schedule D Case IV or V in the source legislation). See *Change 147* in Annex 1.
3283. The section uses “profits” rather than “profits or gains” to define the scope of the rule. See the commentary on the omission of “gains” in the overview to Chapter 2 of Part 2 of this Act.
3284. *Subsection (5)* reflects the practice of making the apportionment by reference to a factor other than a strict count of days, if it is reasonable to do so and the alternative basis

of apportionment is applied consistently. The subsection makes clear that the option to choose an alternative basis of apportionment is exercisable only by the taxpayer (not the Inland Revenue). See *Change 52* in Annex 1.

3285. See the related commentary for section 203 of this Act. See also paragraph 158 of Schedule 2 to the Act which provides for the situation where a period of account straddles end of the tax year 2004-05 and the beginning of 2005-06.

Section 872: Losses calculated on same basis as miscellaneous income

3286. This section is based on numerous provisions, including section 827 of ICTA.
3287. The application of the section is limited to “miscellaneous income”, defined in *subsection (3)* by reference to section 836B of ICTA (that section is inserted by paragraph 340 of Schedule 1 to this Act). The source legislation does not generally limit the scope of the rule. For example, section 827(1) of ICTA says “the payment shall not be allowed as a deduction in computing any income, profits or losses for any tax purposes”. But in practice these provisions affect only the calculation for income tax purposes of amounts, other than profits within Parts 2 or 3 of this Act, chargeable under a provision listed in the table in section 836B of ICTA.
3288. *Subsection (2)* ensures that this rule does not overturn any rules already provided for the computation of losses. For example, see section 398 of ICTA (which supplements the calculation of losses for the purposes of a claim under section 392 of ICTA).
3289. See the related commentary for section 26 of this Act.

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 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 1A 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
 - (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”.
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.

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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.

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.