

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Schedule 2: Transitionals and savings etc.

Part 3: Trading income

Paragraphs 22 and 23: Training courses for employees

3538. These two paragraphs ensure continuity in the training expenses tax recovery provisions in the source legislation which are rewritten in section 75. They are based on section 588 of ICTA.
3539. Paragraph 37 of Schedule 7 to ITEPA keeps sections 588(5)(a) and 589(3) and (4) of ICTA in force in relation to tax years before 2003-04. It also preserves the reference to section 589(3) and (4) of ICTA in section 588(6) of ICTA in relation to such tax years.
3540. The first paragraph ensures that the rewrite of section 588 of ICTA does not stop paragraph 37 of Schedule 7 to ITEPA from working: where section 588 has effect by virtue of paragraph 37 of Schedule 7 to ITEPA the amendments do not apply in relation to the section.
3541. The second paragraph ensures continuity in the case of determinations of an employer's income tax liability for the tax years between the dates that ITEPA and the rewrite of section 588 of ICTA come into force. Those determinations will be made on the assumption that a deduction is allowed under section 588(3) of ICTA. Doubt might arise whether section 75 applies in such cases: section 75(1) says that the section applies if an employer's liability has been determined on the assumption that a deduction is allowed under section 74.
3542. The effect of the transitional is that even though a deduction has been allowed under section 588(3) of ICTA, section 75 will operate if there is a later breach of section 311(4) (a) or (b) of ITEPA.
3543. If the expenditure is incurred on or after 6 April 2005, the employer's right to a deduction will arise under section 74 and section 75 will operate if there is a later breach of section 311(4)(a) or (b) of ITEPA.
3544. *Sub-paragraph (1)(c)* of the second paragraph makes it clear that this transitional does not apply if an assessment has already been made before the rewritten provisions come into force.

Paragraph 48: Apportionment of profits or losses to tax years before tax year 2005-06 – basis periods

3545. Section 883 provides that the Act takes effect for income tax purposes for the tax year 2005-06. For trade profits taxed under Chapter 2 of Part 2 of this Act the income chargeable for 2005-06 is determined by reference to the basis period for that tax year.
3546. Chapter 15 of Part 2 of this Act sets out the rules for relating basis periods to periods of account. In the case of an established trade the basis period for 2005-06 will usually be the 12 month period of account ending in the year 2005-06. That period of account will not normally form the basis period for any other tax year.
3547. But if the trade has just started it may be necessary to apportion the result of a period of account. For example, if a trade starts on 1 January 2005 and the first accounts are made up to 31 December 2005 that period of account will form the following basis periods:
- tax year 2004-05 basis period 1 January 2005 to 5 April 2005; and
 - tax year 2005-06 basis period 1 January 2005 to 31 December 2005.
3548. Section 72 of ICTA, rewritten as section 203 allows the profits for the basis period 1 January to 5 April 2005 to be arrived at by apportionment.
3549. In calculating the amount of overlap relief, (see section 204), it is important that the same figure of taxable profit is attributed to the period 1 January 2005 to 5 April 2005 for both tax years.
3550. The purpose of this paragraph is to allow the profits of a period of account that straddles 6 April 2005 to be calculated using the rewritten legislation even though tax years earlier than 2005-06 will be affected. This Act includes a number of minor changes in the law. Without this paragraph it would be necessary for traders to take account of those changes only for the tax year 2005-06.
3551. If a taxpayer does not want the new law to apply to a transaction that occurred before 6 April 2005 he or she can elect for the old legislation to continue to apply.

Paragraph 50: Profits or losses of a trade, profession or vocation previously chargeable in accordance with section 65(1) of ICTA

3552. This transitional provision relates to *Change 1* in Annex 1. The profits of a trade, profession or vocation may exceptionally not be charged in accordance with section 65(3) of ICTA (because they are not “immediately derived” from it). In that case this Act may produce a change from assessment on a tax year basis to assessment on the basis of the profits of a basis period. This transitional provision ensures that profits are not assessed twice.

Paragraph 51: Profits of mines, quarries and other concerns not chargeable by reference to a basis period

3553. Section 55 of ICTA, rewritten as section 12, provides that the profits of certain concerns are taxed under Schedule D Case I. It is not clear in the source legislation whether or not the basis period rules rewritten as Chapter 15 of Part 2 of this Act apply to these profits. It is possible that some taxpayers may be returning the profits by reference to the full amount arising in the tax year and not by reference to the period of account ending in the basis period for the tax year.
3554. Section 12 makes clear that all the Schedule D Case I rules apply including the basis period rules. This paragraph deals with the transition to that regime if the taxpayer has not used the basis period rules in the tax year 2004-05. Deeming the trade to start on 6 April 2005 means the taxpayer will be taxed on the full amount of the profit arising in the tax year 2005-06 and no part of that profit will also be taxed in the earlier year.

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

3555. If a taxpayer has arrived at the profits for the tax year by apportioning the profits of periods of account the paragraph also allows the taxpayer to use the rules in this Act to calculate the profits in any part of the period that straddles 6 April 2005.

Paragraph 55: Averaging profits of farmers and creative artists

3556. This transitional provision relates to *Change 60* in Annex 1. It preserves a taxpayer's right (if one exists under ICTA) to claim averaging for 2004-05 and 2005-06 even if one of those years is the year in which the taxpayer starts or ceases to carry on the trade, profession or vocation.

Paragraph 58: Adjustment on change of basis: paragraph 12 of Schedule 22 to FA 2002

3557. This transitional provision relates to *Change 62* in Annex 1. It preserves the FA 2002 spreading arrangements if an election has been made under the FA 2002 rules.

Paragraph 59: Adjustment on change of basis: section 104 of ICTA

3558. Section 109 of ICTA provides a special relief for individuals born before 6 April 1917 who are chargeable to tax under section 104 of ICTA. The relief takes the form of a fractional reduction in the amount charged under section 104 of ICTA. This transitional provision replaces the relief with an exemption. So section 109 of ICTA is repealed without being rewritten. See *Change 156* in Annex 1.