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 2: Trading income

Chapter 16: Averaging profits of farmers and creative artists

Overview

902. A person carrying on farming or market gardening or a creative artist may make an averaging claim. The claim is for the profits of two tax years to be adjusted. This is possible only if the profits of the two years differ to a material extent.

Section 221: Claim for averaging of fluctuating profits

903. This section sets out who may make an averaging claim. It is based on section 96 of ICTA (farmers) and Schedule 4A to ICTA (creative artists). In the case of creative artists a claim may be made in respect of the profits of a trade carried on wholly outside the United Kingdom. See *Change 58* in Annex 1.

904. In the case of a person assessed on the remittance basis, the assessment is on the amount of "sums received" rather than the profits. So a claim may not be made in respect of income assessed on the remittance basis.

905. *Subsection (2)* extends the meaning of farming to include market gardening and factory farming. See *Change 59* in Annex 1.

906. *Subsection (4)* makes it clear that "profits from a trade" means the amount before the deduction of losses. If a loss is sustained in the trade for the relevant tax year *subsection (5)* ensures that it does not create a negative profit for the purposes of averaging; it results in a profit of nil.

907. The reference in section 96(7)(c) of ICTA to any deduction for stock relief under Schedule 9 to FA 1981 is spent. Schedule 9 was repealed by ICTA. So this Chapter omits the reference.

Section 222: Circumstances in which claim may be made

908. This section sets out the circumstances in which an averaging claim may be made. It is based on section 96 of and Schedule 4A to ICTA.

909. *Subsection (2)* makes explicit the fact that a claim may be made in relation to a tax year which was the later year on a previous averaging claim. This rule is merely implicit in the opening words of section 96(1) of ICTA.

910. *Subsection (4)* is based on the rules in section 96(4)(b) of and paragraph 4(2) of Schedule 4A to ICTA. The rule in section 96 of ICTA provides that no claim is to be

made in respect of any tax year "in which the trade is (or by virtue of section 113(1) [of ICTA] is treated as) set up and commenced or permanently discontinued". The rule in this section follows the wording in Schedule 4A to ICTA.

911. There is some doubt whether "the trade" referred to in ICTA can mean a partner's "deemed trade" (see section 111(4) of ICTA). It is generally accepted that individual partners cannot make an averaging claim in relation to the year in which they start or permanently cease to carry on a qualifying trade in partnership. This subsection makes clear that the rule applies to a partner's deemed trade. See *Change 60* in Annex 1.

Section 223: Adjustment of profits

912. This section sets out the way in which the profits of each of the two tax years for which a claim is made are adjusted. It is based on section 96 of and Schedule 4A to ICTA. It also includes a signpost to Schedule 1B to TMA.

913. There are two methods for adjusting the profits.

914. *Subsection (3)* sets out the first method. The profits of the two years are added together and then averaged.

915. *Subsection (4)* sets out the second method. The subsection uses a method statement to show how a more complex calculation is made. The aim is to achieve a straight line taper from a full adjustment when the profits differ by 30% to no adjustment when they differ by 25%.

Section 224: Effect of adjustment

916. This section explains the effect of adjusting profits after a claim is made. It is based on section 96 of and Schedule 4A to ICTA.

917. *Subsection (4)* deals with the relationship between an averaging claim and claims for relief under any other provision of the Income Tax Acts.

918. Section 96(9)(a) of ICTA provides that the time limit for the making of these other claims is the last day of the period during which the averaging claim is capable of being revoked. This section describes the time limit as being the last date on which the averaging claim could have been made. The actual time limit remains unchanged.

Section 225: Effect of later adjustment of profits

919. This section explains the effect of adjusting profits after a claim is made. It is based on section 96(5) of and paragraph 10 of Schedule 4A to ICTA.

920. *Subsection (4)* sets out the rule for a further averaging claim. This section removes any doubt that the normal 22 month time limit applies. See *Change 61* in Annex 1.