

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

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## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### **Part 2: Trading income**

##### ***Chapter 2: Income taxed as trade profits***

#### **Overview**

42. This Chapter:
- explains what is taxed as profits of a trade;
  - identifies different types of trade;
  - treats certain activities which do not constitute a trade as the carrying on of a trade for tax purposes; and
  - treats certain receipts which are not trading receipts on first principles as receipts of a trade for tax purposes.

##### ***Section 5: Charge to tax on trade profits***

43. This section charges the profits of a trade, profession or vocation to tax. It is based on section 18(1) and (3) of ICTA.
44. **Part 2** of Schedule 4 to this Act defines “trade” by reference to section 832(1) of ICTA. Section 832(1) of ICTA defines trade so as to include every “manufacture, adventure or concern in the nature of trade”. This brings within the meaning of trade an isolated transaction (or a small number of transactions) which, while in the nature of trade, is not sufficiently extensive to amount to a trade.

##### ***Section 6: Territorial scope of charge to tax***

45. This section sets out the territorial limits of the charge on trade profits. It is based on section 18(1)(a)(i) and (ii) of ICTA.
46. Trades within Schedule D Case I are those “carried on in the United Kingdom or elsewhere”. That expression appears wide enough to include trades carried on wholly abroad. But *Colquhoun v Brooks* (1889), 2 TC 490 HL explained that the charge under Schedule D Case I covers only trades carried on at least partly in the United Kingdom. Trades carried on wholly abroad are within Schedule D Case V.
47. The distinction between Schedule D Cases I and V is important because only a person who is resident in the United Kingdom is chargeable on trade profits under both Cases. A person who is not resident in the United Kingdom is chargeable on trade profits only

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under Schedule D Case I. The abbreviated descriptions “UK resident” and “non-UK resident” are defined in section 878(1) of this Act.

48. *Subsection (1)* sets out the position for a person resident in the United Kingdom: the charge to tax covers all trade profits, wherever the trade is carried on.
49. *Subsection (2)* sets out the position for a person not resident in the United Kingdom: the charge to tax is restricted to profits from a trade carried on at least partly in the United Kingdom. In the case of a trade carried on partly in the United Kingdom, the charge is further restricted to the profits from the part of the trade carried on in the United Kingdom.

### **Section 7: Income charged**

50. This section sets out the amount charged to tax. It is based on section 60(1) and (2) of ICTA (United Kingdom trades) and sections 65(3) and 68(1) of ICTA (foreign trades). See *Change 1* in Annex 1.
51. *Subsection (2)* makes the link to basis periods. Although the charge to tax under subsection (1) is on the profits of the tax year, traders calculate commercial profit by reference to their period of account. The basis period rules identify the profits that are taxed as the profits of the tax year.
52. In most cases the basis of assessment for the profits of a foreign trade is the same as that for a trade carried on wholly or partly in the United Kingdom. So the charge is on the full amount of the profits of the tax year (subsection (1)).
53. In the case of Irish income, section 68 of ICTA has two special rules.
54. First, section 68(3)(b) of ICTA allows the inspector to direct that the income should be assessed on the basis of an average of a period. And the subsection allows the Commissioners to review the inspector’s decision. This rule is a relic of the tax system before Self Assessment. It is not rewritten.
55. Second, section 68(3) of ICTA provides that the income is computed as if it had arisen in the United Kingdom. In practice this rule puts Irish trading income on the same basis as other foreign trading income. So this second special rule for Irish income is not rewritten.

### **Section 8: Person liable**

56. This section states who is liable for any tax charged. It is based on section 59(1) of ICTA.
57. This Act does not rewrite section 59(2) of ICTA. Section 59(2) of ICTA provides that income tax charged “in respect of any of the concerns mentioned in section 55 [of ICTA] shall be assessed and charged on the person carrying on the concern, or on the agents or other officers who have the direction or management of the concern or receive the profits thereof”.
58. Section 55 of ICTA provides that the profits arising from certain concerns such as mines and quarries shall be taxed under Schedule D Case I. Section 55 of ICTA is rewritten as section 12 of this Act.
59. The origins of section 59(1) and (2) of ICTA can be traced back to the Income Tax Act 1842. There is no longer any reason to maintain the distinction between the two subsections.
60. Section 59(2) of ICTA identifies two classes of person on whom the profits of a section 55 concern should be taxed. These are:
  - the person carrying on the concern; and

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- the agents or other officers who have the direction or management of the concern, or receive the profits.
61. Both these classes of person are likely to be covered by the section 59(1) test that they are “receiving or entitled to the profits”. But if they are not, there is no reason why a wider category of persons should be liable in respect of section 55 concerns than are liable in respect of any other trades.
62. Also, applying the “person receiving or entitled” test to the profits of a section 55 concern would not include persons who would not be chargeable through the application of section 59(2) of ICTA.

***Section 9: Farming and market gardening***

63. This section has two functions. First, it treats all farming or market gardening carried on in the United Kingdom as a trade. Second, it treats all farming carried on in the United Kingdom by a particular person as a single trade. It is based on section 53(1) and (2) of ICTA.
64. *Subsection (1)* deals with the first function. In most cases there will be no doubt that farming is a trade on first principles. Like section 10 of this Act this section can trace its origins back to the time when there was a charge to income tax under Schedule B on the occupation of land. Farming was originally charged under Schedule B. The purpose of section 53 of ICTA and its predecessor provisions was to take the charge on farming out of Schedule B and into Schedule D. With the abolition of Schedule B that function is now spent.
65. But section 53 of ICTA does make clear that even uncommercial farming is treated as a trade. This section preserves that effect.
66. *Subsection (2)* deals with the second function of the section. It provides that all farming carried on by a person in the United Kingdom is treated as a single trade. Farming carried on as part of another trade is not included in the single trade of farming.
67. The restriction of subsection (2) to farming in the United Kingdom is derived from the definition of “farming” in section 832(1) of ICTA.
68. Section 53(2) of ICTA uses the expression “particular person or partnership or body of persons” to make clear that the single trade rule applies also to a firm and to a body of trustees. It follows that farming carried on by a person as a member of a firm or a body of trustees is separate from any farming carried on by that person alone.
69. This section does not rewrite this rule as it applies to firms. That is dealt with in section 859 of this Act.
70. Nor does this section rewrite the reference to “body of persons” in section 53(2) of ICTA. It is generally understood that a body of persons acting as trustee, or in some other representative or fiduciary capacity, is not the same entity for tax purposes as one of those persons acting on their own behalf. So, for instance, section 15(1)1(3) of ICTA refers only to “a particular person or partnership”; there is no need to refer to a “body of persons”. Retaining a reference to a “body of persons” in this section would cast doubt on the meaning of sections where the phrase is not used.
71. The definition of “farming” and “market gardening” is in section 876 of this Act.

***Section 10: Commercial occupation of land other than woodlands***

72. This section deals with the commercial occupation of land for purposes other than farming or woodlands. It is based on section 53(3) and (4) of ICTA.

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73. The section treats the commercial occupation of land in the United Kingdom as the carrying on of a trade. It provides certainty of treatment if land is occupied on a commercial basis in circumstances that do not amount to the carrying on of a trade on first principles.
74. The origins of section 53 of ICTA go back to the time when there was a charge to income tax under Schedule B on the occupation of land. The purpose of the Schedule B charge was to tax the profit that an occupier of the land could earn from the land itself, for example, by farming it. The tax was charged whether or not the occupier actually exploited the land.
75. The Schedule B charge was calculated by reference to the annual value of the land. This amount could be considerably less than the amount of profit an occupier could in fact derive from the land. For this reason the basis of charge was switched from Schedule B to Schedule D Case I if the land was farmed or otherwise managed on a commercial basis.
76. The last remnant of Schedule B was repealed by FA 1988. Schedule 6 to FA 1988 exempted any profits and losses from the occupation of commercial woodlands from income tax.
77. The provisions of section 53 of ICTA relating to farming are rewritten as section 9 of this Act. The provisions relating to the occupation of commercial woodlands are rewritten as section 11 of this Act.

***Section 11: Commercial occupation of woodlands***

78. This section provides that the commercial occupation of woodlands is not treated as a trade for any income tax purpose. It is based on section 53(4) of ICTA and paragraph 3(2) of Schedule 6 to FA 1988.
79. *Subsection (3)* makes clear that when this section is read together with related sections any profits and losses arising from the commercial occupation of woodlands are wholly outside the income tax system.
80. This section prevents any charge to tax as trading income and denies any claim for relief for a trade loss. Section 267(b) of this Act performs a similar function in relation to property income. Section 768 of this Act prevents there being any charge to tax under Part 5 of this Act as miscellaneous income. Section 392(1)(b) of ICTA prevents any claim for a loss against miscellaneous income because it requires that for a loss to be allowed any profit on the same transaction should be taxable.

***Section 12: Profits of mines, quarries and other concerns***

81. This section treats the profits and losses of certain concerns as if they were the profits and losses of a trade. It is based on section 55 of ICTA.
82. The feature most of the concerns have in common is that they exploit land for its natural resources. The section applies only if the activity carried on by the concern does not amount to a trade on first principles. If the activity is a trade on first principles the profits and losses will be taxed in accordance with section 5 of this Act.
83. *Subsection (1)* provides the profits and losses of the concern are calculated as if the concern were a trade. See *part (A) Change 2* in Annex 1.
84. The section does not deem the concern to be carrying on a trade. This means the profits will not be liable to Class 4 national insurance contributions as they are not immediately derived from the carrying on or exercise of a trade. Nor will the taxpayer qualify for capital gains tax roll-over relief under section 152 of TCGA. That section requires the taxpayer to be carrying on a trade as defined in section 158(2) of TCGA.

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85. *Subsection (2)* provides that the profits and losses of the concern are charged to tax as if the concern were a trade carried on in the United Kingdom. See *part (B) Change 2* in Annex 1.
86. This rule applies even if the activity is carried on outside the United Kingdom. But subsection (2) makes clear that this territorial extension applies only to UK residents.
87. *Subsection (3)* provides that the normal loss rules apply. See *part (C) Change 2* in Annex 1.
88. *Subsection (4)* lists the concerns to which the section applies. It updates the reference to “fishings” to “rights of fishing”.
89. *Subsection (5)* makes clear that section 10 of this Act has priority over section 12. This is because section 10 treats the activity as if it were a trade. This contrasts with the approach of this section, which is to treat the profits and losses as trade profits and losses. Section 10 may be more beneficial for the taxpayer. For example, the activity would qualify as a trade for capital gains tax purposes. See section 158(2) of TCGA.

***Section 13: Visiting performers***

90. This section has two functions. It treats certain activities as trades and it treats those trades as carried on in the United Kingdom. It is based on sections 555 to 558 of ICTA.
91. Section 555 of ICTA requires deduction of tax from certain payments to entertainers and sportsmen. The rules about deduction of tax are not rewritten in this Act. But there is a cross-reference in the definition of “payment” in subsection (8) to the rule about deduction of tax to identify the sort of payment with which the section is concerned.
92. A visiting performer may not be in the United Kingdom long enough to become resident for tax purposes. And any relevant activities may not be part of a trade, profession or vocation carried on in the United Kingdom. So, without this section, there would be no liability to tax on the activities in the United Kingdom.
93. *Subsection (1)* sets out the circumstances in which the section applies. A non-resident person performs “a relevant activity” in the United Kingdom. In accordance with subsection (8), that expression means activities prescribed by regulations. The regulations are those (currently [SI 1987/530](#)) made under sections 555 to 558 of ICTA or under section 14.
94. *Subsection (2)* creates a United Kingdom trade that includes the “relevant activity”.
95. *Subsection (4)* makes clear that this section creates a trade carried on in the United Kingdom only to the extent that such a trade would not otherwise exist. If a visiting performer’s activities in the United Kingdom amount to a trade on first principles, this section does not create a trade because one already exists. But a trade is not created if the activities are part of an employment. In that case, tax is charged on the payments as employment income (see section 7 of ITEPA).
96. *Subsection (5)* deals with the case where payments for the relevant activity are made to a person other than the performer - typically, a company controlled by the performer. As in subsection (2), the “relevant activity” is treated as part of a United Kingdom trade. In addition, the payments are treated as made to the performer (instead of to the “other person”).
97. *Subsection (7)* treats the performer’s deemed trade as separate from any other trade actually carried on by the performer.

***Section 14: Visiting performers: supplementary***

98. This section sets out the regulation-making powers that are needed for the operation of section 13. It is based on sections 556 and 557 of ICTA.

99. *Subsection (1)* is a regulation-making power to deal with the consequences of including in the performer's profits payments made to another person. It may be appropriate to allow a deduction for expenses incurred by another person (typically, but not necessarily, the person to whom the payments are made). And, if the payments are treated as receipts of the performer's trade, they may be excluded from the calculation of the other person's profits.
100. Section 556(5) of ICTA apparently means that the regulation-making power in section 556(3) of ICTA is itself capable of being disapplied by a regulation. This is illogical. So the reference to section 556(3) in section 556(5) of ICTA is not rewritten in this Act.
101. *Subsection (2)* is a regulation-making power to deal with calculation of the performer's profits.

### ***Section 15: Divers and diving supervisors***

102. This section deals with activities which are strictly the duties of an employment but which, if certain conditions are met, are taxed as if they were the carrying on of a trade. It is based on section 314 of ICTA.

### ***Section 16: Oil extraction and related activities***

103. This section provides that certain oil-related activities are treated as a single, separate trade. It is based on section 492(1) of ICTA.
104. **Section 492** is in Chapter 5 of Part 12 of ICTA. Most of that Chapter is concerned with corporation tax and is not rewritten in this Act. The section deals with oil (and gas) exploration and extraction activities in the United Kingdom and in the United Kingdom sector of the continental shelf.
105. The main consequence of treating these oil-related activities as a separate trade is that losses from other trading activities cannot be set against oil profits. That consequence is set out in section 492(2) of ICTA.

### ***Section 17: Effect of becoming or ceasing to be a UK resident***

106. This section deals with the consequence of an individual trader moving to or from the United Kingdom. It is based on section 110A of ICTA.
107. *Subsection (1)* sets out the circumstances in which the section applies. In accordance with section 6 of this Act a non-resident individual who carries on a trade at least partly outside the United Kingdom is charged to tax only on the profits of any part of the trade carried on in the United Kingdom. Without this section it would be possible for a taxpayer to be charged to tax on profits which accrue in part of a basis period when the taxpayer is not resident in the United Kingdom.
108. If the trade is carried on in partnership and one of the partners changes residence, the rule in this section does not apply. But there is a special rule that applies only to the partner. See sections 852(6) and 854(5) of this Act.
109. *Subsection (2)* sets out the consequences of a change of residence. The trade is treated as ceasing and, if appropriate, a new one is treated as starting. There is no explicit rule in section 110A of ICTA to say when the trade is treated as ceasing or starting. The only sensible inference is that it is the date of the change of residence. The section makes this clear.
110. *Subsection (3)* ensures that losses are still available to be carried forward.



**Section 18: Effect of company starting or ceasing to be within charge to income tax**

111. This section applies only to companies and deems a trade commencement or cessation to take place in particular circumstances. It is based on section 337 of ICTA.
112. Section 337 of ICTA is primarily a corporation tax rule: it applies only to companies and originates from the introduction of corporation tax. However it can be relevant to income tax.
113. That is because non-resident companies are within the charge to income tax in respect of United Kingdom trade profits (when the trade is not carried on through a permanent establishment in the United Kingdom) and UK property business income. Section 337 of ICTA applies in cases of either inward or outward company migration. Where that involves a continuing trade or UK property business there will be a change of taxing regime from income tax to corporation tax or vice versa.
114. **Section 18** says what happens when a company enters or leaves the income tax regime: then its trade profits are calculated as though it had commenced or discontinued the trade. The obverse case of the company exiting or entering the corporation tax regime is proper to the rewrite of section 337 of ICTA in the corporation tax provisions.

**Section 19: Tied premises**

115. This section treats rent received by a trader for premises let to persons to whom the trader supplies goods sold or used on those premises as a receipt of the trade rather than a receipt of a property business. It is based on section 98 of ICTA.
116. Section 98 of ICTA is expressed in general terms. But it most commonly applies to rent received by a brewer who lets premises to tied tenants.

**Section 20: Caravan sites where trade carried on**

117. This section allows a person who carries on a trade associated with the operation of a caravan site to include in the receipts of that trade income from letting pitches or caravans where the letting does not itself constitute a trade. It is based on ESC B29. See *Change 3* in Annex 1.
118. See section 875 and *Change 148* in Annex 1 for the definition of “caravan”.

**Section 21: Surplus business accommodation**

119. This section allows income from letting surplus business accommodation to be treated as a trade receipt instead of as rent. It is based on the practice known as “Revenue Decision 9” set out in Inland Revenue publication *Tax Bulletin* of 15 February 1994. See *Change 4* in Annex 1.

**Section 22: Payments for wayleaves**

120. This section applies if a trader receives rent from a wayleave granted in respect of land on which a trade is carried on. It is based on section 120 of ICTA.
121. Rent received in respect of a wayleave is normally taxed as property income either by Chapter 2 of Part 3 of this Act (property businesses) or by section 344 (charge to tax on rent receivable for a UK electric-line wayleave). But if the rent is received in respect of land on which a trader carries on a trade and the trader receives no other rent in respect of the same land the rent, and any associated expenses, can be included in the calculation of the trade profits. See *Change 5* in Annex 1.
122. *Subsection (2)* applies if the rent is received in respect of a UK electric-line wayleave. A taxpayer is not required to include the rent and expenses in the calculation of the trade profits.

123. *Subsection (3)* applies if the rent is received in respect of any other type of wayleave. A taxpayer is not required to include the rent and expenses in the calculation of the trade profits.
124. *Subsection (4)* defines “rent”. Section 120 of ICTA uses the definition of “rent” in section 119(3) of ICTA (rent etc. payable in connection with mines, quarries and similar concerns). Section 119 of ICTA is rewritten as Chapter 8 of Part 3 of this Act. The definition of rent in that Chapter and in this section must be the same. See the commentary on section 336 of this Act for a fuller description of the rewrite of the word “rent” in Chapter 8 of Part 3 of this Act.
125. *Subsection (5)* defines “wayleave”. Section 120 of ICTA uses the word “easement” as defined in section 119(3) of ICTA to describe the nature of the right for which the rent is paid. This section uses “wayleave” as that is how most of the payments covered by this section are usually described in practice. The definition of “easement” in section 119(3) of ICTA gives that word a meaning that is much wider than its usual legal meaning. See the comments of Uthwatt J at pages 329 and 330 of *Mosley v George Wimpey Ltd (1945)*, 27 TC 314 CA.
126. The definition of “wayleave” preserves the generality of the words in section 119(3) of ICTA and includes a reference to the Scottish equivalent, “servitude”.
127. The definition has no territorial limitation. So the section covers services other than UK electric-line wayleaves.

### ***Section 23: Rent-a-room and foster-care relief***

128. This section modifies the normal calculation rules when an individual is eligible for rent-a-room or foster-care relief under Part 7 of this Act. It is new.
129. When rent-a-room relief or foster-care relief applies the income may, depending on the total amount, be either exempt from tax or subject to a special calculation rule. This section ensures that, when appropriate, the rent-a-room and foster-care rules take priority over the usual trading profit calculation rules.