

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Trading income

Chapter 3: Trade profits: basic rules

Section 24: Professions and vocations

130. This section makes it unnecessary to specify repeatedly that the rules in this Chapter (apart from section 30) apply to a profession or vocation as well as to a trade. It is new.

Section 25: Generally accepted accounting practice

131. This section sets out the starting point for the calculation of trade profits. It is based on section 42 of FA 1998, as amended by section 103(5) of FA 2002.
132. *Subsection (1)* is the general rule that requires profits to be calculated “in accordance with generally accepted accounting practice”, an expression defined in section 50 of FA 2004. In particular, such practice generally requires account to be taken of debtors and creditors and of the value of stock and work in progress. The general rule is subject to any special rule of law whether expressed in statute or explained by the courts.
133. The relevant statutory laws are mainly those that are rewritten in this Part. But there are also provisions not included in Part 2 of this Act which may affect the calculation of profits: for example, the pension contributions deductions provisions in FA 2004 and certain anti-avoidance provisions in ICTA that apply to all income types.
134. *Subsection (2)* makes it clear that subsection (1) does not bring with it any of the other accounting requirements, such as a formal audit.
135. *Subsections (3)* and *(4)* set out two exceptions to the general rule in subsection (1). Some barristers may use the “cash basis” of accounting (see section 160). And Lloyd’s underwriters have their own special rules (mostly in Chapter 3 of Part 2 of FA 1993).
136. The Inland Revenue does not believe that there are currently any non-resident companies liable to income tax in respect of insurance business or that there will be any in the future as the law stands at present. So this section does not reproduce the reference to companies carrying on life assurance mentioned in section 42(5) of FA 1998.
137. There are no other exceptions to the general rule. So this section does not reproduce the reference to “particular description of business” in section 42(5) of FA 1998.

Section 26: Losses calculated on same basis as profits

138. This section ensures that profits and losses are calculated on a consistent basis. It is based on section 46(2) of FA 1998.

Section 27: Receipts and expenses

139. This section is based on section 46(1) of FA 1998.

Section 28: Items treated under CAA 2001 as receipts and expenses

140. This section signposts the CAA rules. It is new.

141. In particular the CAA rules override the rules against the inclusion of capital items in sections 33 and 96 of this Act.

Section 29: Interest

142. This section sets out the basic rule that interest is of a revenue nature. It is based on section 74(1) of ICTA.

143. Section 74(1)(f) of ICTA provides that in computing the profits of a trade:

- no deduction is allowed in respect of any capital withdrawn from or employed, or intended to be employed, as capital in the trade; but
- the prohibition of any deduction in respect of capital should not be construed as disallowing the deduction of interest.

144. This section rewrites the second of these propositions by providing that for the purpose of calculating the profits of a trade, all interest is of a revenue nature.

145. The question of whether interest is deductible in arriving at the trade profits falls to be determined according to whether the interest meets the general criteria for the deduction of an expense of a revenue nature in calculating the profits of a trade.

Section 30: Animals kept for trade purposes

146. This section contains the basic rule for the income tax treatment of animals. It is based on paragraphs 1, 7(1) and 9(5) Schedule 5 to ICTA. The animals are treated as trading stock unless a herd basis election is made under Chapter 8 of Part 2 of this Act.

Section 31: Relationship between rules prohibiting and allowing deductions

147. This section makes clear the interaction between those provisions that allow a deduction and those provisions that prohibit a deduction. It is new. See *Change 6* in Annex 1.

148. The general principle is that a rule allowing a deduction takes priority over a rule prohibiting a deduction. But this is subject to a number of exceptions.