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 6: Trade Profits: Receipts

Section 96: Capital receipts

388. This section corresponds to section 33 of this Act (capital expenditure) for capital receipts. It is new.

389. *Subsection (1)* sets out the general rule that items of a capital nature are not to be treated as receipts of a trade.

390. It is a long established principle that capital receipts are ignored in calculating the profits of a trade for income tax purposes. The principle that income tax applies only to receipts of a revenue nature is set out by Lord MacNaghten in Attorney General v London County Council (1900), 4 TC 265 HL:

"Income Tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else.

391. Decisions in subsequent cases on whether a receipt is in the nature of income or capital have taken as their starting point Lord MacNaghten's principle that only receipts of a revenue nature fall to be included in the computation of the profits of a trade. See, for example, the comments of Lord Dundas and Lord Ormidale in Glenboig Union Fireclay Co, Ltd v CIR (1922), 12 TC 427 HL on whether a sum received as compensation for not working certain seams:

"…"the sum under consideration was surely of the nature of capital not revenue….the compensation was paid for the loss of a capital asset…the sum can surely not be described as profits arising from the Appellant's trade or business. (Lord Dundas)

…the sum received as compensation…falls to be dealt with as capital….it seems to me to be impossible to predicate of the £15,000 that they were profits arising or accruing from the trade or business of the company. (Lord Ormidale)

392. And, after recalling Lord MacNaghten's dictum in the London County Council case, Lord Moncreiff commented in Trustees of Earl Haig v CIR (1939), 22 TC 725 CS as follows:

"I accordingly proceed on the assumption, (which moreover appears to me to be a sound assumption) that all profits from trade, being the profits dealt with in Case I, are profits which have an "income" and not a "capital" quality.

393. More recently, the principle that capital receipts are not subject to income tax was restated by Lord Templeman in Beauchamp v F W Woolworth (1989), 61 TC 542 HL[1]:

"[Section 1 ICTA 1988] … directs … that income tax shall be charged in respect of profits described in Schedule D set out in [section 18 ICTA 1988]. That section directs … that tax shall be charged in respect of the annual profits arising or accruing to any person … from any trade. … The expression 'annual profits' confirms that income tax is to be charged on profits of an income nature as opposed to capital profits …

394. The question of whether a receipt is of a capital or a revenue nature falls to be determined by reference to the nature of the trade. This principle was set out by Lord MacMillan in Van den Berghs Ltd v Clark (1935), 19 TC 390 HL after reviewing the early authorities on distinguishing between income and capital receipts:

"…the nature of a receipt may vary according to the nature of the trade. The price of the sale of a factory is ordinarily a capital receipt, but it may be an income receipt in the case of a person whose business it is to buy or sell factories.

395. *Subsection (2)* disapplies the general rule in subsection (1) where there is statutory provision for a capital sum to be taken into account as a receipt in calculating the profits of a trade. See, for example, section 106 of this Act (sums recovered under insurance policies etc.).

1 STC [1987] 510