

TAXREP 16/99

TAX LAW REWRITE: TRADING INCOME OF INDIVIDUALS

Memorandum submitted in June 1999 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Inland Revenue in response to exposure draft 4 entitled: Trading income of individuals: Part 2 issued in March 1999

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TAX LAW REWRITE: TRADING INCOME OF INDIVIDUALS

A. General comments

Overall

1. We welcome the opportunity to comment on the exposure draft issued in March 1999.
2. Once again, the rewrite is a valuable exercise which has been well executed. The redrafting of the legislation on basis periods is particularly successful, and we welcome the bringing together and rationalising of the various reliefs for films and sound recordings. However, the herd basis rules, though a considerable improvement, still present a number of problems.

Claims or deductions?

3. Whilst in general we favour giving relief for expenses as a deductible item without the need for a formal claim (see paragraphs 4 to 6 of the Commentary on 3.2a on page 20), this policy does give rise to certain difficulties. If the purpose of requiring a claim is to allow the taxpayer to exercise an option whether to claim the relief or not, then it is necessary to distinguish between deductible items which are deducted in the self-assessment return and which those which are not. Where they are not deducted in the return, it is arguable either:
 - that the return is incorrect because a deduction has been omitted in the same way as it would be incorrect if an item of income had been omitted; or
 - that failure to claim a deduction reflects a decision not to make the claim and so does not allow an error or mistake claim to be made if it is sought to have the sum deducted after the time limit has expired for altering the return; this would be contrary to what is suggested in paragraph 5 to the Commentary on 3.2d.1, for example.
4. This is a major point of principle which, so far as we are aware, has not seriously been discussed and which has implications for the whole of the rewrite project.

Is deduction of trading expense optional?

5. Following on from this, we question whether it is right to say, as in 3.2a.1 (retraining and counselling) and 3.2a.7 (personal security expenses), that a deduction 'may be made' or 'is allowed' in calculating trading profits. That suggests that the deduction is optional for the taxpayer or even discretionary for the Revenue. We think that anything that is deductible in arriving at trading profit *should* be deducted. The original is more definite - it 'shall be deductible' or 'nothing shall prevent the deduction' - which seems correct as a matter of law. See also our comment under D below with reference to 3.2c.7(4). Perhaps the wording should be 'a deduction is given'.

Application to companies

6. We assume that it will be made clear when rewriting the trading deductions for companies whether the specific rules on trading deductions relate only to individuals or apply to companies as well, or whether there will be parallel and sometimes identical rules for companies. For instance, 3.2a.1 (counselling expenses) presumably will apply to companies too but 3.2a 10 (contributions to local enterprise organisations) seems directed at individuals and partnerships only but does not say so.

Basis periods

7. We endorse what is said in paragraphs 5 and 6 of the Commentary on the introduction on page 188. The existing legislation sets economy of words above any other consideration, and jumbles the concepts in such a way that it is necessary continually to jump from point to point in order first to locate them and then to interpret them, making the legislation practically incomprehensible. For this reason, we can only agree it is better to have legislation that is long and comprehensible than what we have at present (para 10 of the Commentary).
8. In conclusion, the rewrite is a vast improvement on the original. It will be seen below that practically all our comments on this part of the exposure draft are on points of detail.

Herd basis rules

9. It is astonishing that such a specialist area of tax legislation can dominate such a large section of the rewrite of the trading income rules. This illustrates how ill thought out the original is. Whilst it is not within the terms of reference of the rewrite project, we suggest that, given the current low rates of inflation and the introduction of self assessment, the time has come to consider whether the rules continue to be appropriate, and whether some simpler method might be substituted that is equally acceptable to the farming community.
10. Aside from this matter of principle, it will be seen that we are not altogether happy about the structure chosen for the rewrite of the herd basis rules.

B. Proposed rewrite changes

1 Changes in the statute but not in the underlying law (page 13)

We are content with all the proposals.

2 Changes to the law and policy (page 14)

We are content with all the proposals except the following:

3.2b.14 Herd basis rules: time limit for election (change (15))

We agree that it is anomalous that partnerships are excluded from the extended time limits on commencement but doubt if it is satisfactory to say simply that this is because it preserves the current position. The anomaly could be removed by extending the time limit for partnerships. This would not appear to be a major concession.

3.2d.1 Waste disposal: site preparation (change (22))

See our general comments under A, para 3 above.

3.3c.1 Enterprise allowance (change (24))

We agree in principle that there should be less reliance on Case VI as a 'sweep-up' provision. Bringing the enterprise allowance within Case I/II but preventing it from being taxed twice is acceptable, therefore, particularly as the relief might be given earlier, by reference to the basis period rather than the tax year (as per the Commentary at paragraph 6). It also simplifies the NIC position (Commentary, paragraph 7). We imagine that few recipients of the allowance would have Case VI losses that would otherwise have been offset against the allowance. We find it hard to imagine, however, circumstances in which (Commentary, paragraph 5) people would have brought forward trading losses that they could now set against the allowance; it is given for the first year of trading.

It follows that we welcome the proposal to tax the allowance by reference to the first basis period.

3 Changes to law but not to policy (page 15)

We are content with the proposals except the following:

3.2a.6 Payment for a restrictive undertaking (change (25))

We doubt if the deduction of a payment for a restrictive undertaking in the period in which it is paid is implicit in the existing legislation, quite apart from the interpretation of ICTA 1988 s74(1)(d) in the *Jenners* case. In any case, we would prefer the consistent application of the accruals concept in business accounts except where there is good reason to depart from it. This does not seem to be such an occasion.

3.2a.10 Contributions to LEOs (change (25))

We agree that it is helpful to enact this practice on contributions to LEOs. It would be even more helpful, though possibly beyond the scope of the rewrite, if (taking this example) the disallowance was limited to £5,000 even if the benefit were conferred on the trader's son for reasons unconnected with the trade.

3.2b.10 Acquisition of new herd begun within five years (change (27))

The Exposure Draft states that the five-year period in question is calculated from the date on which the last of the old herd is sold. Whilst this might seem a logical approach it will not necessarily be favourable to the farmer. The farmer would often want the replacement period to end as soon as possible so that new acquisitions would not remove the tax-free status of previous sales.

3.2b 16 Five-year gap when no herd (change (32))

We agree that the irrevocable election for herd basis rules under existing paragraph 4 should be explicitly over-ridden, though we would have thought that this accorded with the better interpretation of the existing law.

3.3a.11 Basis period: accounting date near year end (change (36))

& &

3.3a.12 Basis period: middle accounting date (change (37))

We admire the dedication that has been given to putting into statutory form the practice on the treatment of accounting dates near the year-end, but we doubt if the end result justifies it. As pointed out in the Commentary, it is extremely complex, and this makes it difficult to follow. We attempted to redraft these provisions to put them into more specific and abbreviated terms but did not arrive at a satisfactory solution. We suggest that it should be left to practice, as under SAT1.

If it is still felt that legislation is required we would be willing to review it in greater detail than we have done so far (we have noted certain drafting points under E below).

3.2c.1 Expenditure on films etc (change (43))

Explicitly denying relief for the incidental costs of borrowing may be 'helpful', but only in the context of simplification. It precludes relief where the borrowing is taken out specifically for production and acquisition expenditure. Unlike the interest on the borrowing, it is arguable that the incidental costs are allowable at present.

4 Removal of unnecessary material (page 17)

We are content with all the proposals.

C. Replies to other specific questions

3.2a.3 Retraining

We agree that the administrative rules should be kept with the operative provisions rather than put with other administrative rules.

3.2c.3 Films and sound recordings

It is proposed in the Commentary that the taxpayer should have a choice for a period between the basic allocation method and the special rules for certified films. We are not certain if he has to chose the same option for all films or recordings or whether he can choose differently for different ones. He may prefer the latter for bona fide commercial reasons. If the former is intended, we would be grateful for clarification why this is necessary. (See also our comments under 3.2c.7(2) below.)

D. Specific comments

3.2a Profits of trade: other general rules

3.2a.1 Deduction for expenses of retraining and counselling

- (1) We are not convinced that 'expenses incurred' does justice to 'incurs expenditure in paying or reimbursing' in ICTA 1988 s588(1).

3.2a.2 Qualifying retraining expenses

3 We agree that it is worth repeating the rules under both Schedule D and Schedule E.

3 It would be helpful to have, in an appropriate part of the redrafted legislation, a consistent definition of 'full-time or substantially full-time'.

(5)(b) As is pointed out in paragraph 5 of the Commentary, 'gainful employment' will need clarifying. This also applies to 3.2a.4. In any case, 'gainful employment' should include self-employment, as in ICTA 1988 s589(1)(a).

(5)(d) We question the necessity to retain the inconsistent requirement for *all* the retraining but only *part* of the counselling to take place in the UK as per 3.2a.4(7).

(7) The phrase 'but this will no longer apply if the employee is employed again by the employer ...' needs to convey more clearly that the relief is retrospectively withdrawn in these circumstances (assuming that this is intended).

3.2a.3 Recovery of tax

(2) Elsewhere, the project has tended to substitute the self assessment time limit of 31 January rather than 5 April. For consistency, we think the same should apply here.

3.2a.6 Payments for restrictive undertakings

2 We agree that the detail should be in the Schedule E chapter and does not need to be replicated in the trading expense chapter.

3.2a.7 Personal security expenses

(2) We have a problem with the provision of a security asset. Under (6), this can include equipment and a structure such as a wall. These are obviously capital items, and neither the existing legislation nor the rewrite has an over-ride of the non-deduction of capital expenditure. We would welcome clarification of how expenditure on improving the security of (say) a wall can be deducted under this section.

In any case, it would be useful to have a cross-reference to the parallel capital allowance provision.

(3)(a),
(4) (3)(a) requires the *sole* object of the expense to be the meeting of a threat, whereas (4) allows a security asset to be used *partly* for personal security. It is difficult to imagine why the distinction in the original needs to be perpetuated.

3.2a.8 Employees seconded to charities

- (2) We are not sure if this adequately reflects the original. ICTA 1988 s86(1) says that the employee's services are treated as continuing to be available for the employer's trade. Subclause (2) of the rewrite says that one is to ignore the fact that his services are made available to the charity. This does not necessarily make it deductible. To take an extreme example, the Revenue could suggest he might have otherwise served as a personal servant to a principal shareholder. We think something along the original lines would be better.
- (2) If an employee is seconded to a charity to design a computer system for it, the Revenue could argue (indeed have argued when an employee is so used in the employer's own trade) that the expenditure is capital. In the existing legislation, any disallowance under ICTA 1988 s74(1)(f) is over-ridden. This protection has been taken away in the rewrite. We believe that it (and all other protections relating to s74) should be reinstated by suitable reference to the rewritten provisions in ED1.

3.2a.10 Contributions to local enterprise organisations expenses

- (1) The same point arises as we have made under 3.2a.8(2). The contribution, if capital etc, would be allowed under existing legislation but not under the rewrite.
- (1) We are not convinced that 'making a contribution' covers one made in kind as well as in cash, as per the original.
- (3) It would be helpful to know when the clawback is to be charged.

3.2a.12 Approval of local enterprise organisations

- General We are pleased to see so much 'clutter' removed from the existing legislation.
- (3), 3 Section 79(6) ends with 'or otherwise *howsoever by way of profit*'. Is it clear that the limitation implied by the words we have italicised is effectively taken up in the rewrite?

3.2a.14 Unpaid remuneration

- (2) We would welcome clarification that if remuneration is paid more than nine months after the end of the period and after the trade has ceased, a deduction will be allowed as post-cessation expenses under ICTA 1988 s105.
- There is the further point that if there are no post-cessation receipts, there is no relief for the remuneration. It does not fall within the category of expenses for which relief can be given under section 109A. Insolvencies and other circumstances where there is a cessation of a trade are not infrequently occasions where the administration suffers, including the timely payment of (say) bonuses. It would be unreasonable not to allow a deduction for late-paid remuneration in these circumstances. We appreciate, of course, that the defect is in the existing legislation, and to make such a change would go beyond the remit of the rewrite – unless the Revenue have a suitable practice to deal with such a situations.
- (4) In order to deal with section 202B, and depending upon how it is to be

rewritten, should ‘or treated as’ be added after ‘received’?

3.2.[] Animals kept for purposes of trade

(p.69) This moves the treatment of animals, as trading stock to the part of the legislation which deals with general rules for trading income. We support this as people may not appreciate why farm animals that form part of the production herd are trading stock in the absence of an election for the herd basis rules.

3.2b Profits of trade: herd basis rules

Preliminary

Despite the considerable improvements in the redraft, we find the rules are still quite impenetrable. To make them easier to understand, it might help the reader if they were set out as follows:

1. General rule about cost of herd (initial herd and additions that are not replacements).
2. General rule about replacements, including a definition of what is a replacement (ie costs allowable, sale proceeds of replaced animal deductible).
3. General rule about sales without replacement, using the definition of replacement as above (ie sale proceeds taxable, less original cost of that animal).
4. Special rule for substantial reductions, ie proceeds not taxable under 3 above.
5. Clawback rule if new animals acquired within five years such that 2 above is applied (ie they are treated as replacements), except that the proceeds of sale are deemed to be received when the additional animal is purchased.
6. Further clawback rule if the new animals in 5 above are so significant that, overall, there is no substantial reduction. If this happens 4 is disapplied to the animals sold and not replaced, such that they are taxable under 3

Over-view

In general, an overview paragraph is useful to show the intention of these complex rules. However, we think there may be too much detail in paragraphs 5 and 6. Paragraph 6 in particular states that ‘there are further rules that apply when the replacement of the whole herd or a substantial part of it is begun within five years of its sale’. In fact the five- year rule in Schedule 5 makes no reference to the replacement being of the whole herd or a substantial part of the herd.

3.2b.1 Election for herd basis rules

9 We agree that the application of the election to partnerships needs careful consideration. In RI 19, the Revenue say that when a partner joins he has the opportunity to make a personal election for the herd basis rules. This is very complicated to apply to certain partners’ computations only, and

from different dates. It contrasts with different basis periods for partners joining and leaving, where at least the basic computation is unaffected. It does not fit in easily with the concept of a continuous, deemed person carrying on the partnership trade under ICTA 1988 ss 111(2). An alternative could be to have 'continuation elections' for the herd basis whenever there is a partnership change, though this is a complication which, generally, we are glad has been dispensed with. Unfortunately we can see no simple solution to this problem.

3.2b.4 Replacement of animals in herd

2 The stated explanation appears to be the wrong way round. Goats are of a different species from cows so they cannot be in the same herd. What Schedule 5 paragraph 8 is trying to say is that, for instance, cows kept for milking are of a different class from suckler cows kept for producing beef cattle. It does not need to repeat the requirement for the animals to be of the same species. Given this, the clause would be clearer if written more briefly, and in the singular, along the following lines: 'For the purposes of this Chapter, a production herd is of a particular class if, and only if, the products for which it is kept are of the same kind.' This would fit in well with 3.2b.16, which refers to 'a particular class' before mentioning 'that class'.

3.2b.5 Initial cost and value

2 We agree that the lack of definition of 'initial cost' and 'value of the herd' has not caused any problem.

3.2b.7 Replacement of animals

(5), 7 Where a new animal has been taken from trading stock, it is not immediately obvious how a deduction can be given for it. The answer is of course that the animal is not in the closing stock so the stock is written down. We would prefer an indication in the legislation that the intention is not to prevent a deduction, although we appreciate the difficulty in phrasing this. Perhaps there should be a footnote to this effect.

3.2b.8 Sale of animals from herd

(1) It would be useful to have a definition of 'replacement'. We believe the Revenue's policy is that animals would be matched within a 12-month period such that the sale followed by an acquisition within 12 months would constitute a replacement. This might be an appropriate basis for a definition. It is possible, however, that it is Revenue policy to allow a period longer than 12 months where appropriate replacements are not available (eg a small herd where only a limited number of replacements are produced in any year). If so, the definition could allow a longer period in circumstances accepted by the Revenue as reasonable.

3.2b.10 Acquisition of new herd within five years of sale

General The rules have now been separated out into circumstances where a whole herd is sold (3.2b.10) and where there is a sale of substantial part of the herd (3.2b.11). The rules are very similar here and we doubt if they need to be separated.

3.2b.11 Replacement of part within five years of sale

As mentioned, it might be possible to merge this with 3.2b.10.

We are not sure what happens if a farmer starts to replace some animals within five years but the majority of the replacements take place outside the five-year period. It has never been clear whether the profit is taxable. The legislation seems to imply that it is, but it would be useful to have it clarified.

3.2b.20 Immature animals

- (1) We are not sure what this is aimed at, and we wonder if it is applied in practice. The cost of rearing immature animals is carried forward in any event (Business Economic Note 19). When the decision is taken to use those immature animals to replace existing animals, the costs are either deducted at that time (where the animal is a replacement) or added to the herd (when the animal is not). Subsection (1) seems to complicate the issue without adding real benefit.
- (1)(b) To say that animals are kept for replacement begs the question 'replacement of what?'. Perhaps 'of animals in the herd' or even, more to the point, 'of mature animals in the herd'.

3.2c Profits of trade: films or sound recording

General A definition is needed for 'period of account', taking into account that for 'relevant period' in section 68(3). The footnote references to definitions in 3.2c.5 and 3.3a.19 are in any case incorrect.

3.2c.1 Meaning of film etc

- (3)(a) The requirement for the expenditure to be 'reasonably incurred' is different from and narrower than the existing requirement in section 41(2) that the expenditure 'can reasonably be said to have been incurred with a view to enabling a decision to be made'. The draft takes simplification further than appears justified in this case.

3.2c.7 Basic method of allocation

- (2) It is not clear whether this rule is intended to apply on a film-by-film basis or by reference to the taxpayer's position as a whole. The Commentary suggests the former, but both the original and the redraft could arguably be interpreted as implying the latter.
- (3) We believe it would be helpful to bring in expenditure incurred in the period as well as unallocated expenditure from a previous period.
- (4) It is interesting that, here, 'may be allocated' is intended to be optional. This reinforces our general comments under A above on the meaning of 'may be made' in 3.2a.1, which is probably not intended to be optional.

3.2c.9 Certified films: completion of film

- (2) This rule does not appear correctly to reproduce the existing legislation. First, it does not make it sufficiently clear that it should be done on a film-by-film basis. Secondly, the amount to be deducted under s42(4)(b) would appear to be the amount deducted under s41 in all previous periods rather than, as this subclause suggests, in the current period as well.

3.2c.11 When expenditure is incurred

- General We have considered whether it is necessary to spell out the rules on timing of expenditure here, as has been done, or there might simply be a reference to the capital allowance rules. We prefer the approach that has been taken because it is preferable not to have to refer to a capital allowance definition when dealing with an income tax deduction.
- 3.2d **Profits of trade: waste disposal**
[No points of principle]
- 3.2e **Profits of trade: other**
[No points of principle]
- 3.3a **Basis periods**
- 3.3a.16 **Conditions for basis period to end with new date**
- (1) The note appears to be wrong; under 3.3a.15(3), the basis period ends 12 months after the end of the previous one. We doubt if it is needed, in any case; this section is self contained, merely setting out the conditions referred to in 3.3a.15.
- In fact the only note that appears useful in this section is note 1 to subsection (4).
- 3.3a.19 **Year after ineffective change of date**
- (1), (2) This does not appear to make it clear that if a change of accounting date is ineffective in year one it becomes ineffective in year two and all subsequent years so long as the necessary conditions are still not satisfied.
- 3.3b **Averaging for farming and market gardening**
- 3.3b.1 **Claim for averaging**
- (3) In the original, there is no deduction for any losses in any year. The Exposure Draft has now provided for the deduction of current year losses other than in the farming trade. This appears to be a change of principle that would affect a farmer who made a loss in (say) a bed and breakfast trade.
- 3.3c **Enterprise allowance**
[No points of principle]
- 3.6a **Supplementary provisions**
[No points of principle]

E. Detailed comments on drafting

3.2a Profits of trade: other general rules

3.2a.1 Deduction for expenses of retraining and counselling

- (1) The definition of employees applies ‘in the following sections’. Without qualification, might this mean the whole of the rest of the Act? It requires narrowing.

3.2a.2 Qualifying retraining expenses

- (8) The reference to 3.2a.2 should of course be to 3.3a.3.

3.2a.3 Recovery of tax

- (4) This is a very long sentence. It would help if the part about the minimum of 60 days was separated out

3.2a.4 Qualifying counselling expenses

- (1) We doubt if the start date of 16 March 1993 will become necessary when the relevant Rewrite Bill is enacted - though we appreciate the subtlety with which subsections (1), (2) and (10) of s589A have been elided. We note that the similar start date of 30 November 1993 has been omitted from 3.3a.10 for contributions to certain business organisations (ICTA 1988 s79A(7)).
- (7) It is not clear whether the text following the line space and starting with 'but if they are provided' is meant to be part of the existing sentence or a separate one.

Origins The origins of many of the subsections do not appear to be correct.

3.2a.9

- (1)(a) A reference to ‘Give As You Earn’ might be more helpful than to ‘Payroll deduction scheme’, which sounds like PAYE.

3.2a.10 Contributions to LEOs

- (1) The reference in note 2 should be to 3.2a.12(6).

3.2a.14 Unpaid remuneration

- (1) In accounting terms, ‘provided’ is more appropriate than ‘reserved’.

3.2b Profits of trade: herd basis

3.2b.6 Additions

- (3) 'Balancing amount' is a new concept, defined a long way ahead. Perhaps either it should be defined here or there should be a signpost to 3.2b.12. (The term appears again in 3.2b.10 and 11.)

Origin Schedule 5 paragraph 9(1) does not seem to be the right origin for subs (3).

3.2b.7 Replacements

2 The reference to sale as including death or destruction is a long way away and not even included in the defined terms. It would be helpful for some assistance to be provided here.

3.2b.9 Sale of substantial part of herd

(1) The note refers to 3.2b.7 and 8, which do not just deal with the sale of a herd or of a substantial part of one: they deal with replacements and sales generally. The note could be made to reconcile these points but not if it is to remain simple. We believe it would be better to dispense with it altogether.

3.2b.13 Elections

(1) There does not seem much point in having the time limit for the election in a separate section (3.2b.14).

(3) We do not think that (a) and (b) are necessary.

3.2b.14 Time limits

(2), 13 Referring to a period 'in which' the farmer carries on the trade is certainly simpler, but 'at any time in which' would also be clearer

3.2b 16 Five-year gap

(2) The word 'again' inserted before the word 'farmer' would make it clear that reference is being made to the second herd, not the first.

3.2b.20 Immature animals

6 There is of course a superfluous 'not' in the last sentence of the Commentary.

3.2c Profits of trade: films or sound recording

3.2c.2 Meaning of film

This could be incorporated in 3.2c.1.

3.2c.3 Meaning of original master version

(2) It would be more convenient to include this definition within 3.2c.2(3) and also to avoid the inconsistency between including and excluding 'if any'.

3.2c.4 Expenditure treated as revenue

(2)(a) In the interests of simplification, the draft has arguably converted receipts that are *actually* trading receipts into ones that are *treated as* trading receipts. We doubt if this change will have any effect on actual trading receipts, but we appreciate a review that this is so.

3.2c.5 Trades to which allocation rules apply

Origin The origin for (1) appears wrong.

2 We note that it will be considered in due course how to deal with non-traders.

3.2c.7 Basic method of allocation

(2) 'That period' might sound more natural than 'the same period'.

3.2c.10 Limited-budget films

(2) Here and elsewhere, although '2nd July' etc (with the 'nd' in superscript) is traditionally correct and becomes easier with modern word processing, it looks rather affected compared with the more common '2 July'. There is also an inconsistency in 3.3b.2(5) (and elsewhere?), which says that a claim has to be made before *the* 31st January. We prefer dropping the 'the', which accords with common usage.

4(a) Strictly, an adverb qualifies a verb. Should it not read 'transaction *undertaken* directly or indirectly between that person and ...'?

3.2c.11 When expenditure is incurred

(2)-(6) We appreciate that this is an early draft, but is 'an amount of expenditure needed? And in (5), can the second 'that amount' be replaced by 'it'?

(4) Like the original, the redraft is not really appropriate for expenditure incurred by a particular date rather than in a particular period. We suggest that '1 July 2002' should be substituted for 'the end of a period of account'.

3.2c.12 Election for capital treatment

(1) The redraft refers to 'certified films', whereas the original adds 'tapes or discs'.

(2), (3) There might appear to be a dichotomy between these two subsections: (3) refers to certain past expenditure, so (2) might, incorrectly, seem to refer to current and future expenditure only. Such ambiguity would be avoided by substituting 'if expenditure' for 'in respect of expenditure that' in (3).

3.2d Profits of trade: waste disposal

3.2d.1 Site preparation

(4), 2 'WD' and 'SC' are indeed more memorable than single letters (or SC would be if we knew what it stood for), but by the same token so would be (say) TE (total expenditure) and PD (previous deductions) in place of E and F.

3.2e Profits of trade: other

3.2e.1 Mineral exploration

(1) In other circumstances we might suggest that the availability of mineral extraction allowances might be mentioned in a footnote, but as this area is so specialised this is probably not necessary.

3.2e.2 Pools payments

(2)(a) The original refers to safety *or* comfort, which has been changed to safety *and* comfort. It is not entirely clear that (say) expenditure on safety alone qualifies.

Should it be capital 'expenditure' rather than 'expenses' for consistency?

3.3a Basis periods

Over-view In paragraph 6, presumably the draft is intended to mean that the accounting date is ‘shortly before’ rather than ‘near’ the year end – eg 31 March, not 10 April.

3.2.1 The amount to be calculated

(2) It would be more natural to write this in reverse: 'What are the taxable profits of the year? They are those of the basis period of the year.' Not 'What are the profits of the basis period? They are the taxable profits of the year. We have had to make similar comments on almost all the redrafts we have seen before.

3.3a.1 Accounting date

General A signpost to 3.3a.12 (middle accounting date) would be helpful.

Origin We are not sure if s62(2) is the right reference.

3.3a.3 First tax year

Note Is it really necessary to spell out that a tax year ends on 5 April? If here, why not in many other places too?

3.3a.5 Tax year in which no accounting date

Note 1 would be clearer if it used wording similar to the Commentary, viz ‘when there is a change of accounting date effected by a period of account which entirely spans the year in question’ rather than ‘a tax year in which a change of accounting date occurs’. The latter phrase can only be understood in this context by working through the further statutory definition in 3.3a.13(1).

3.3a.7 Apportionment of profit

(1) 'Period of account' is a new concept. It would help to have it defined here, particularly since the definition in 3.3a.21, so far away, is a simple one. When it is used again in 3.3a.16, there can be a reference back to 3.3a.7.

(3) We suggest substituting ‘Any such splitting as is mentioned in subsection (2)(a) must be done ...’ for ‘These steps must be taken by reference to ...’.

(4) The language is difficult to follow here. Instead we suggest something like ‘Alternatively, any such splitting may be made by reference to another measure of the length of the period concerned, for example months or fractions of months, provided that it is reasonable to do so and the same measure is used ...’.

3.3a.8 Meaning of overlap period and overlap profit

General It would be helpful to say that there is no such thing as an overlap loss.

(2)(b) It seems logically incorrect to include sub-clause (2)(b) as part of the definition of an overlap profit. An overlap profit is simply a profit which arises in an overlap period; the profit of the period is apportioned to decide how much the overlap profit is. The draft

suggests that there might have been some prior apportionment for some other purpose, which is unlikely to be the case.

3.3a.9 Deduction for overlap profit in final year

- (2) It would help to say what happens if there is a loss in the final year.
- (3) We are not convinced that the rewritten draft is easier to read than the original. In particular, Step 1 is incomplete since it assumes that the aggregate overlap profit of all previous periods has already been calculated.

3.3a.10 Restriction on bringing losses in twice

We have a slight unease about using the term 'overlapping basis periods' when 'overlap' is a defined term but 'overlapping' is used in the general sense.

Presumably the reference in (a) and (b) should be to 'calculating the profits *or losses* of the ... basis period'.

3.3a.11 Accounting date near end of tax year

Head- As we indicated in relation to the overview, the heading would be more accurate, and helpful, if it referred to an accounting date ending 'shortly before' the end of the tax year.

- (5)(b) This would be clearer if it said that the basis period 'would otherwise end' after the accounting date. This would also avoid confusion with (c), where the basis period is the substituted one, and which would be improved by substituting 'will in consequence be' for 'is'.
- (8) Similarly, this sub-clause fails to explain that the reference to 'the profits or losses of the trade of the tax year' here means those that really arose in that year as distinct from any deemed nil figure imposed by the previous sub-clause.

3.3a.12 Treatment of middle date as accounting date

Gen- We would like it to be made more clear that, for (say) a 368-day eral period, there is no 3-day overlap period.

This clause seems also not to cater for the position where the taxpayer first moves into the system if his middle date happens not to coincide with his actual accounting date for the previous year.

- (5) It is not clear if the 'accounting date' in the previous year is the actual one or the deemed one (eg in a leap year), or what this subsection is seeking to achieve.

3.3a.13 When change of accounting date occurs

- 2 If this Commentary is required in a subsequent draft, it is worth noting that the 'But' at the beginning of the second sentence interrupts the sequence.

3.3a.14 Change of accounting date in third year

- (1) Where the accounting date in the year falls more or less than 12 months after the end of the basis period for the second tax year, it would be more helpful to deal with the two possible cases as explicit alternatives within the body of the legislation. Unlike 3.3a.14, one of them has been

relegated to a footnote.

3.3a.15 Change of accounting date after third year

- (2) The reader may have an initial doubt whether subsections (3) and (4) are those of 3.3a.15 or 16.

3.3a.16 Conditions for change of date

- (2) Like the original, this sub-clause fails to specify which tax year is being referred to.

3.3a.19 Year after ineffective change of accounting date

- (3) Should it not be 'the', not 'that', change of accounting date?

3.3a.20 Deduction for overlap profit in year of change

Head- Although it is better to avoid lengthy headings, this one could put
ing people on the wrong track. An alternative would be to refer to a
lengthening of the period beyond 12 months, so as to eliminate
shortenings.

- (3) We find the step-by-step approach easier to use than the original. In the original formula, D was particularly difficult to interpret. The original is simpler, however, in referring just to the *aggregate* overlap profit. The same applies to the days in the overlap periods in Step 3.

- (3) Step Would it not be clearer if the final version referred to deductions made
2 in *previous* periods?

- (4)(b) Should not the second part of this sub-clause, starting with 'as those sections apply', not be on a lower line, since it governs (a) as well as (b)? This is done in (6).

3.3b Averaging profits of farming and market gardening

Over- In an overview we would have thought the general phrase 'carries on a
view trade' preferable to the precise 'is or has been carrying on a trade'.

3.3b.1 Claim for averaging

- (1) We recognise that it is difficult to avoid using the same term 'farmer' here but with a different meaning from that used in the herd basis rules.

3.3b.2 When claim may be made

- (2) On the face of it, this appears not to be an accurate rewrite of section 96(2), which provides for averaging where the profits of one year are *70% or less* than those of the other year, not *less than 75%*. On reading 3.3b.3, however, it becomes clear that 3.3b.3 is merely setting the parameters for an averaging claim. To avoid people being misled initially, 3.3b 2(1) should be incorporated into 3.3b.3 (which, incidentally is very clearly written). However, the difficulty arises only when comparing the rewrite with the original whereas, for most people, the rewrite will stand on its own, so there is probably no need to make any change.

- (3) On the face of it, this subsection is not needed. If years one and two have been averaged, years two and three can also be averaged under subsection (2); years one and three cannot be averaged, regardless of subsection (3), because subsection (1) prevents the averaging of two years that are not consecutive. The purpose, no doubt, is to prevent a farmer from first averaging years two and three and then averaging years one and two. We believe the intention could be made clearer.

3.3c Enterprise allowance

[No comments]

3.6a Supplementary provisions

[No comments]

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