Income Tax (Trading and Other Income) Act 2005

2005 CHAPTER 5

PART 2

TRADING INCOME

CHAPTER 16

AVERAGING PROFITS OF FARMERS AND CREATIVE ARTISTS

221 Claim for averaging of fluctuating profits

(1) This Chapter enables an individual (a "taxpayer") to make a claim (an "averaging claim") if—

(a) the taxpayer is, or has been, carrying on a qualifying trade, profession or vocation (alone or in partnership), and

(b) the taxpayer's profits from it ("the relevant profits") fluctuate from one tax year to the next.

(2) A trade, profession or vocation is a "qualifying trade, profession or vocation" if—

(a) it is farming or market gardening in the United Kingdom,

(b) it is the intensive rearing in the United Kingdom of livestock or fish on a commercial basis for the production of food for human consumption, or

(c) the taxpayer's profits from it are derived wholly or mainly from creative works.

(3) For this purpose "creative works" means—

(a) literary, dramatic, musical or artistic works, or

(b) designs,

created by the taxpayer personally or, if the qualifying trade, profession or vocation is carried on in partnership, by one or more of the partners personally.

(4) For the purposes of this Chapter references to the relevant profits of a tax year are to profits before making any deduction for a loss made in any tax year.

(5) If the taxpayer makes a loss in the qualifying trade, profession or vocation in a tax year, the relevant profits of the tax year for the purposes of this Chapter are nil.

222 Circumstances in which claim may be made

(1) An averaging claim may be made in relation to two consecutive tax years in which a taxpayer is or has been carrying on the qualifying trade, profession or vocation if—

(a) the relevant profits of one of the tax years are less than 75% of the relevant profits of the other tax year, or

(b) the relevant profits of one (but not both) of the tax years are nil.

(2) An averaging claim may be made in relation to a tax year which was the later year on a previous averaging claim.

(3) An averaging claim may not be made in relation to a tax year if an averaging claim has already been made in relation to a later tax year in respect of the trade, profession or vocation.

(4) An averaging claim may not be made in relation to the tax year in which—

(a) the taxpayer starts, or permanently ceases, to carry on the trade, profession or vocation, or

(b) in the case of a trade, profession or vocation within section 221(2)(c), it begins or ceases to be a qualifying trade, profession or vocation.

(5) An averaging claim must be made on or before the first anniversary of the normal self-assessment filing date for the second of the tax years to which the claim relates.

(6) But see section 225(4) (extended time limit if profits adjusted for some other reason).

223 Adjustment of profits

(1) If a taxpayer makes an averaging claim, the amount taken to be the taxpayer's profits of each of the tax years for which the claim is made is adjusted in accordance with this section.

(2) But this is subject to paragraph 3 of Schedule 1B to TMA 1970 (claim given effect in the second of the two tax years).

(3) If—

(a) the relevant profits of one of the tax years are 70% or less of the relevant profits of the other tax year, or

(b) the relevant profits of one (but not both) of the tax years are nil,

the amount of the adjusted profits of each of the tax years is the average of the relevant profits of the two tax years.

(4) If the relevant profits of one of the tax years—

(a) are more than 70%, but

(b) are less than 75%,

of the relevant profits of the other tax year, the amount of the adjusted profits of each of the tax years is calculated as follows, so as to reduce the variation between them.

Step 1

Calculate the amount of the adjustment by applying the formula—

$$(D \times 3) - (P \times 0.75)$$

where—

D is the difference between the relevant profits of the two tax years, and

P is the relevant profits of the tax year of which those profits are higher.

Step 2

Add the amount of the adjustment to the relevant profits of the tax year of which those profits are lower.

The result is the amount of the adjusted profits of that tax year.

Step 3

Subtract the amount of the adjustment from the relevant profits of the tax year of which those profits are higher.

The result is the amount of the adjusted profits of that tax year.

224 Effect of adjustment

(1) The adjusted profits are taken to be the relevant profits of the tax years to which the claim relates for all income tax purposes, including the further application of this Chapter.

(2) This is subject to—
- (a) subsection (3) of this section and section 225(2), and
- (b) paragraph 3 of Schedule 1B to TMA 1970.

(3) If the relevant profits of one of the tax years are nil, this Chapter does not prevent the taxpayer from obtaining relief under the Income Tax Acts for a loss made by the taxpayer in the tax year in question or any other tax year.

(4) A claim by the taxpayer for relief under any other provision of the Income Tax Acts for either of the tax years to which an averaging claim relates (“the other claim”)—
- (a) is not out of time if made on or before the last date on which the averaging claim could have been made, and
- (b) if already made, may be amended or revoked on or before that date.

(5) For this purpose—
- (a) references to a claim include an election or notice, and
- (b) if the other claim is made in a return, the reference to amending or revoking the other claim is to amending the return by amending or omitting the other claim.

(6) For provision determining in which tax year a claim, amendment or revocation made as a result of subsection (4) has effect, see paragraph 4 of Schedule 1B to TMA 1970 (claim, amendment or revocation given effect in the second of the two tax years).

225 Effect of later adjustment of profits

(1) This section applies if, after the taxpayer has made an averaging claim, the relevant profits in either or both of the tax years to which the claim relates are adjusted for another reason.

(2) The averaging claim is ignored.

(3) But this does not prevent a further averaging claim from being made in relation to the taxpayer's profits as adjusted for the other reason.

(4) A further averaging claim is not out of time as long as it is made on or before the first anniversary of the normal self-assessment filing date for the tax year in which the adjustment for the other reason is made.