



Income Tax (Trading and Other Income) Act 2005

2005 CHAPTER 5

PART 2

TRADING INCOME

CHAPTER 4

TRADE PROFITS: RULES RESTRICTING DEDUCTIONS

Introduction

32 Professions and vocations

The provisions of this Chapter apply to professions and vocations as they apply to trades.

Capital expenditure

33 Capital expenditure

In calculating the profits of a trade, no deduction is allowed for items of a capital nature.

Wholly and exclusively and losses rules

34 Expenses not wholly and exclusively for trade and unconnected losses

(1) In calculating the profits of a trade, no deduction is allowed for—

- (a) expenses not incurred wholly and exclusively for the purposes of the trade, or

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(b) losses not connected with or arising out of the trade.

- (2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade.

Bad and doubtful debts

35 Bad and doubtful debts

- (1) In calculating the profits of a trade, no deduction is allowed for a debt owed to the person carrying on the trade, except so far as—
- (a) the debt is bad,
 - (b) the debt is estimated to be bad, or
 - (c) the debt is released wholly and exclusively for the purposes of the trade as part of a statutory insolvency arrangement.
- (2) If the debtor is bankrupt or insolvent, the whole of the debt is estimated to be bad for the purposes of subsection (1)(b), except so far as any amount may reasonably be expected to be received on the debt.

Unpaid remuneration

36 Unpaid remuneration

- (1) This section applies if, in calculating the profits of a trade of a period of account—
- (a) an amount is charged in the accounts for the period in respect of employees' remuneration, and
 - (b) a deduction for the remuneration would otherwise be allowable for the period.
- (2) No deduction is allowed for the remuneration for the period of account unless it is paid before the end of the period of 9 months immediately following the end of the period of account.
- (3) If the remuneration is paid after the end of that 9 month period, a deduction for it is allowed for the period of account in which it is paid.

37 Unpaid remuneration: supplementary

- (1) For the purposes of section 36 an amount charged in the accounts in respect of employees' remuneration includes an amount for which provision is made in the accounts with a view to its becoming employees' remuneration.
- (2) For the purposes of section 36 it does not matter whether an amount is charged for—
- (a) particular employments, or
 - (b) employments generally.
- (3) If the profits of the trade are calculated before the end of the 9 month period mentioned in section 36(2)—
- (a) it must be assumed, in making the calculation, that any remuneration which is unpaid when the calculation is made will not be paid before the end of that period, but

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- (b) if the remuneration is subsequently paid before the end of that period, nothing in this subsection prevents the calculation being revised and any tax return being amended accordingly.
- (4) For the purposes of this section and section 36 remuneration is paid when it—
- (a) is treated as received by an employee for the purposes of ITEPA 2003 by section 18, 19, 31 or 32 of that Act (receipt of money and non-money earnings), or
 - (b) would be so treated if it were not exempt income.
- (5) In this section and section 36—
- “employee” includes an office-holder and “employment” therefore includes an office, and
 - “remuneration” means an amount which is or is treated as earnings for the purposes of ITEPA 2003.

Employee benefit contributions

38 Restriction of deductions

- (1) This section applies if, in calculating the profits of a person's trade of a period—
- (a) the profits of the trade of the period are required to be calculated for income tax purposes, and
 - (b) a deduction would otherwise be allowable for the period for any employee benefit contributions made or to be made by the person (“the employer”) (but see subsection (4)).
- (2) No deduction is allowed for the contributions for the period except so far as—
- (a) qualifying benefits are provided, or qualifying expenses are paid, out of the contributions during the period or within 9 months from the end of it, or
 - (b) if the making of the contributions is itself the provision of qualifying benefits, the contributions are made during the period or within 9 months from the end of it.
- (3) An amount disallowed under subsection (2) is allowed as a deduction for a subsequent period so far as—
- (a) qualifying benefits are provided out of the contributions before the end of the subsequent period, or
 - (b) if the making of the contributions is itself the provision of qualifying benefits, the contributions are made before the end of the subsequent period.
- (4) This section does not apply to any deduction that is allowable for—
- (a) anything given as consideration for goods or services provided in the course of a trade or profession,
 - (b) contributions under a registered pension scheme or under a superannuation fund to which section 615(3) of ICTA applies,
 - (c) contributions under a qualifying overseas pension scheme in respect of an individual who is a relevant migrant member of the pension scheme in relation to the contributions, or
 - (d) contributions under an accident benefit scheme.

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For the purposes of paragraph (c) “qualifying overseas pension scheme” and “relevant migrant member” have the same meaning as in Schedule 33 to FA 2004 (see paragraphs 4 to 6 of that Schedule).

(5) See also—

- section 39 (making of “employee benefit contributions”),
- section 40 (provision of qualifying benefits),
- section 41 (timing and amount of certain qualifying benefits),
- section 42 (provision or payment out of employee benefit contributions),
- section 43 (profits calculated before end of 9 month period), and
- section 44 (interpretation of sections 38 to 44).

39 Making of “employee benefit contributions”

(1) For the purposes of section 38 the employer makes an “employee benefit contribution” if—

- (a) the employer pays money or transfers an asset to another person (“the third party”), and
- (b) the third party is entitled or required, under the terms of an employee benefit scheme, to hold or use the money or asset for or in connection with the provision of benefits to, or in respect of, present or former employees of the employer.

(2) For this purpose “employee benefit scheme” means a trust, scheme or other arrangement for the benefit of persons who are, or include, present or former employees of the employer.

40 Provision of qualifying benefits

(1) For the purposes of section 38 qualifying benefits are provided if there is—

- (a) a payment of money, or
- (b) a transfer of assets,

which meets condition A, B, C or D.

(2) Condition A is that the payment or transfer gives rise both to an employment income tax charge and to an NIC charge.

(3) Condition B is that the payment or transfer would give rise to both charges if—

- (a) the duties of the employment in respect of which the payment or transfer was made were performed in the United Kingdom, and
- (b) the person in respect of whose employment the payment or transfer was made met at all relevant times the conditions as to residence or presence in Great Britain or Northern Ireland prescribed under section 1(6) of the Contributions and Benefits Act.

(4) Condition C is that the payment or transfer is made in connection with the termination of the recipient's employment with the employer.

(5) Condition D is that the payment or transfer is made under an employer-financed retirement benefits scheme.

(6) None of the conditions is met if the payment or transfer is by way of loan.

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(7) In this section—

“the Contributions and Benefits Act” means—

- (a) the Social Security Contributions and Benefits Act 1992 (c. 4), or
- (b) the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c. 7),

“employment income tax charge” means a charge to tax under ITEPA 2003 (whether on the recipient or on someone else), and

“NIC charge” means a liability to pay national insurance contributions under section 6 (Class 1 contributions), section 10 (Class 1A contributions) or section 10A (Class 1B contributions) of the Contributions and Benefits Act.

41 Timing and amount of certain qualifying benefits

(1) If the provision of a qualifying benefit—

- (a) takes the form of a payment of money, and
- (b) is not made under an employer-financed retirement benefits scheme,

the benefit is provided for the purposes of section 38 when the money is treated as received for the purposes of Chapter 4 of Part 2 of ITEPA 2003 (applying the rules in section 18 of that Act (receipt of money earnings)).

(2) If the provision of a qualifying benefit takes the form of a transfer of an asset, the amount provided for the purposes of section 38 is the total of—

- (a) the amount (if any) spent on the asset by the third party, and
- (b) in a case where the asset was transferred to the third party by the employer, the amount of the deduction that would be allowable as mentioned in subsection (1) of that section in respect of the transfer.

(3) But if the amount given by subsection (2) is more than the amount that—

- (a) is charged to tax under ITEPA 2003 in respect of the transfer, or
- (b) would be so charged if condition B in section 40 were met,

the deduction allowable under section 38(2) or (3) is limited to that lower amount.

42 Provision or payment out of employee benefit contributions

(1) For the purposes of section 38(2)(a)—

- (a) any qualifying benefits provided, or
- (b) any qualifying expenses paid,

by the third party after the receipt by the third party of employee benefit contributions are treated as being provided or paid out of the contributions.

(2) This operates up to the total amount of the contributions reduced by the amount of any benefits or expenses previously provided or paid as mentioned in section 38(2)(a).

(3) For the purposes of section 38(3)(a) any qualifying benefits provided by the third party after the receipt by the third party of employee benefit contributions are treated as being provided out of the contributions.

(4) This operates up to the total amount of the contributions reduced by the amount of any benefits or expenses previously provided or paid as mentioned in section 38(2) (a) or (3)(a).

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- (5) For the purposes of this section no account is taken of any other amount received or paid by the third party.

43 Profits calculated before end of 9 month period

- (1) This section applies if the profits of the trade are calculated before the end of the 9 month period mentioned in section 38(2).
- (2) It must be assumed, in making the calculation, that any benefits, expenses or contributions which are not provided, paid or made when the calculation is made will not be provided, paid or made before the end of that period.
- (3) But if the benefits, expenses or contributions are subsequently provided, paid or made before the end of that period, nothing in this section prevents the calculation being revised and any tax return being amended accordingly.

44 Interpretation of sections 38 to 44

- (1) In this section and sections 38 to 43—
- “accident benefit scheme” means an employee benefit scheme under which benefits may be provided only by reason of a person's disablement, or death, caused by an accident occurring during the person's service as an employee of the employer,
- “employee benefit contribution” is to be read in accordance with section 39(1),
- “employee benefit scheme” has the meaning given by section 39(2),
- “the employer” is to be read in accordance with section 38(1),
- “employer-financed retirement benefits scheme” has the same meaning as in Chapter 2 of Part 6 of ITEPA 2003 (see section 393A of that Act),
- “qualifying benefits” is to be read in accordance with section 40,
- “qualifying expenses” includes any expenses of the third party (other than the provision of benefits to employees of the employer)—
- (a) which are incurred in operating the employee benefit scheme, and
- (b) which, if incurred by the employer, would be deductible in calculating for income tax purposes the employer's profits for any period, and
- “the third party” is to be read in accordance with section 39(1).
- (2) A reference in this section and sections 38 to 43 to a person's employee includes the holder of an office under that person, and “employment” is to be read accordingly.

Business entertainment and gifts

45 Business entertainment and gifts: general rule

- (1) The general rule is that no deduction is allowed in calculating the profits of a trade for expenses incurred in providing entertainment or gifts in connection with the trade.
- (2) A deduction for expenses which are incurred—
- (a) in paying sums to or on behalf of an employee of the person carrying on the trade (“the trader”), or

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- (b) in putting sums at the disposal of an employee of the trader, is prohibited by the general rule if (and only if) the sums are paid, or put at the employee's disposal, exclusively for meeting expenses incurred or to be incurred by the employee in providing the entertainment or gift.
- (3) The general rule is subject to exceptions—
for entertainment (see section 46), and
for gifts (see section 47).
- (4) For the purposes of this section and those two sections—
- (a) “employee”, in relation to a company, includes a director of the company and a person engaged in the management of the company,
 - (b) “entertainment” includes hospitality of any kind, and
 - (c) the expenses incurred in providing entertainment or a gift include expenses incurred in providing anything incidental to the provision of entertainment or a gift.

46 Business entertainment: exceptions

- (1) The prohibition in section 45 on deducting expenses incurred in providing entertainment does not apply in either of cases A and B.
- (2) Case A is where—
- (a) the entertainment is of a kind which it is the trader's trade to provide, and
 - (b) the entertainment is provided in the ordinary course of the trade either for payment or free of charge in order to advertise to the public generally.
- (3) Case B is where the entertainment is provided for employees of the trader unless—
- (a) the entertainment is also provided for others, and
 - (b) the provision of the entertainment for the employees is incidental to its provision for the others.

47 Business gifts: exceptions

- (1) The prohibition in section 45 on deducting expenses incurred in providing gifts does not apply in any of cases A, B, C and D.
- (2) Case A is where—
- (a) the gift is of an item which it is the trader's trade to provide, and
 - (b) the item is given away in the ordinary course of the trade in order to advertise to the public generally.
- (3) Case B is where the gift incorporates a conspicuous advertisement for the trader unless—
- (a) the gift is food, drink, tobacco or a token or voucher exchangeable for goods, or
 - (b) the cost of the gift to the trader, together with any other gifts (except food, drink, tobacco or a token or voucher exchangeable for goods) given to the same person in the same basis period, exceeds £50.

The Treasury may by order amend the sum for the time being specified in paragraph (b) so as to increase it.

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- (4) Case C is where gifts are provided for employees of the trader unless—
- (a) gifts are also provided for others, and
 - (b) the provision of the gifts for the employees is incidental to the provision of gifts for the others.
- (5) Case D is where the gift is given to—
- (a) a charity,
 - (b) the Historic Buildings and Monuments Commission for England, or
 - (c) the Trustees of the National Heritage Memorial Fund.

Car or motor cycle hire

48 Car or motor cycle hire

- (1) This section applies if, in calculating the profits of a trade, a deduction is allowed for expenses incurred on the hiring of a car or motor cycle—
- (a) which is not a qualifying hire car or motor cycle (see section 49(2)), and
 - (b) the retail price of which when new exceeds £12,000.
- (2) The amount of the deduction which would otherwise be allowable is reduced by multiplying the amount by the fraction—

$$\frac{\pounds 12,000 + \text{RP}}{2 \times \text{RP}}$$

where RP is the retail price of the car or motor cycle when new.

- (3) Subsection (4) applies if the deduction is reduced as a result of subsection (2) and subsequently—
- (a) there is a rebate (however described) of the hire charges, or
 - (b) a debt in respect of any of the hire charges is released otherwise than as part of a statutory insolvency arrangement.
- (4) The amount that, as a result of the rebate or release—
- (a) is brought into account as a receipt of the trade under section 97 (debts incurred and later released), or
 - (b) is treated as a post-cessation receipt under section 249 (debts released after cessation),
- is reduced by multiplying it by the fraction in subsection (2).
- (5) The power under section 74(4) of CAA 2001 to increase or further increase the sums of money specified in Chapter 8 of Part 2 of CAA 2001 includes the power to increase or further increase the sum of money specified in subsection (1)(b) or (2).

49 Car or motor cycle hire: supplementary

- (1) In section 48 “car or motor cycle” means a mechanically propelled road vehicle other than one—

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- (a) of a construction primarily suited for the conveyance of goods or burden of any description, or
 - (b) of a type not commonly used as a private vehicle and unsuitable for such use.
- (2) In section 48 “a qualifying hire car or motor cycle” means a car or motor cycle which—
- (a) is hired under a hire-purchase agreement (see subsection (3)) under which there is no option to purchase,
 - (b) is hired under a hire-purchase agreement under which there is an option to purchase exercisable on the payment of a sum equal to not more than 1% of the retail price of the car when new, or
 - (c) is a qualifying hire car for the purposes of Part 2 of CAA 2001 (under section 82 of CAA 2001).
- (3) For this purpose “hire-purchase agreement” means an agreement under which—
- (a) goods are bailed or (in Scotland) hired in return for periodical payments by the person to whom they are bailed or hired, and
 - (b) the property in the goods will pass to that person if the terms of the agreement are complied with and one or more of the following events occurs,
- but does not include a conditional sale agreement (see subsection (5)).
- (4) The events are—
- (a) the exercise of an option to purchase by that person,
 - (b) the doing of any other specified act by any party to the agreement, and
 - (c) the happening of any other specified event.
- (5) A “conditional sale agreement” means an agreement for the sale of goods under which—
- (a) the purchase price or part of it is payable by instalments, and
 - (b) the goods are to remain the property of the seller (even though they are to be in the possession of the buyer) until specified conditions as to the payment of instalments or otherwise are met.
- (6) In this section and section 48 “new” means unused and not second-hand.

50 Hiring cars (but not motor cycles) with low carbon dioxide emissions

- (1) Section 48 does not apply to expenses incurred on the hiring of—
- (a) a car with low CO₂ emissions, or
 - (b) an electrically-propelled car.
- (2) For this purpose—
- “car with low CO₂ emissions” has the meaning given by section 45D of CAA 2001, and
 - “electrically-propelled car” has the meaning given by that section.
- (3) This section does not apply to expenses incurred on the hiring of any such car—
- (a) under a contract entered into after 31st March 2008, or
 - (b) for a period of hire which begins after that date.

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Patent royalties

51 Patent royalties

In calculating the profits of a trade, no deduction is allowed for royalties or other sums paid for the use of patents.

Interest payments

52 Exclusion of double relief for interest

- (1) In calculating the profits of a trade, no deduction is allowed—
 - (a) for any tax year for the interest paid on a debt or liability in respect of which relief is given under section 353 of ICTA (see subsection (5) below), or
 - (b) for any relevant tax year for other interest on the same debt or liability.
- (2) A tax year is a relevant one if the interest in respect of which the relief is given could, but for the relief, have been brought into account in calculating the profits of a trade of the tax year.
- (3) For the purposes of subsection (1)(b) all interest which—
 - (a) is capable of being brought into account in calculating the profits of a trade, and
 - (b) is payable by any person on money advanced to the person on current account, is treated as interest on the same debt.
- (4) It does not matter if the money is advanced—
 - (a) on one or more accounts, or
 - (b) by the same or separate banks or other persons.
- (5) For the purposes of this section relief under section 353 of ICTA is to be treated as given only when the claim for the relief can no longer be varied (whether on appeal or otherwise).
- (6) For a rule excluding relief under section 353 of ICTA if interest on a debt or liability is brought into account in calculating the profits of a trade, see section 368(3) of ICTA.

Social security contributions

53 Social security contributions

- (1) In calculating the profits of a trade, no deduction is allowed for any contribution paid by any person under—
 - (a) Part 1 of the Social Security Contributions and Benefits Act 1992 (c. 4), or
 - (b) Part 1 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c. 7).
- (2) But this prohibition does not apply to an employer's contribution.
- (3) For this purpose “an employer's contribution” means—
 - (a) a secondary Class 1 contribution,
 - (b) a Class 1A contribution, or

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(c) a Class 1B contribution,
within the meaning of Part 1 of the Social Security Contributions and Benefits Act 1992 or of the Social Security Contributions and Benefits (Northern Ireland) Act 1992.

Penalties, interest and VAT surcharges

54 Penalties, interest and VAT surcharges

- (1) In calculating the profits of a trade, no deduction is allowed for any penalty or interest mentioned in the first column of the following table.
- (2) This is the table—

<i>Penalty or interest</i>	<i>Description of tax, levy or duty</i>
Interest under any provision of Part 9 of TMA 1970	Income tax, capital gains tax and corporation tax
Interest required to be paid by regulations made under section 71 of FA 2004 (construction industry)	
Penalty under any of sections 60 to 70 of VATA 1994	Value added tax
Interest under section 74 of VATA 1994	
Penalty under any of sections 8 to 11 of FA 1994	Excise duties
Penalty under any of paragraphs 12 to 19 of Schedule 7 to FA 1994	Insurance premium tax
Interest under paragraph 21 of that Schedule	
Penalty under any provision of Part 5 of Schedule 5 to FA 1996	Landfill tax
Interest under paragraph 26 or 27 of that Schedule	
Penalty under any provision of Schedule 6 to FA 2000	Climate change levy
Interest under any of paragraphs 70, 81 to 85 and 109 of that Schedule	
Penalty under any provision of Part 2 of FA 2001	Aggregates levy
Interest under any of paragraphs 5 to 9 of Schedule 5 to, paragraph 6 of Schedule 8 to and paragraph 5 of Schedule 10 to FA 2001	
Penalty under section 25 or 26 of FA 2003	Customs, export and import duties

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Penalty under any provision of Part 4 of Stamp duty land tax
FA 2003

Interest under any provision of that Part

- (3) In calculating the profits of a trade, no deduction is allowed for any surcharge under section 59 of VATA 1994.

Crime-related payments

55 Crime-related payments

- (1) In calculating the profits of a trade, no deduction is allowed for expenses incurred—
- (a) in making a payment if the making of the payment constitutes a criminal offence, or
 - (b) in making a payment outside the United Kingdom if the making of a corresponding payment in any part of the United Kingdom would constitute a criminal offence in that part.
- (2) In calculating the profits of a trade, no deduction is allowed for expenses incurred in making a payment induced by a demand which constitutes—
- (a) the offence of blackmail under section 21 of the Theft Act 1968 (c. 60) (England and Wales),
 - (b) the offence of extortion (Scotland), or
 - (c) the offence of blackmail under section 20 of the Theft Act (Northern Ireland) 1969 (c. 16 (N.I.)) (Northern Ireland).

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